

# The institutional basis of ineffective macroeconomic policy of Ukraine and Russia in the period of crisis. A comparative analysis

*Author\*:*

Dmitry CHISTILIN

**A***bstract.* To sum it up we would note that Russia and Ukraine possess not only common cultural and ethnic territory but also mistakes (not corrected) and institutional problems in forming and implementing effective macroeconomic policy in the period of the crisis.

*Keywords:* Monetary policy, macroeconomic policy, concordance targets of monetary and budgetary politics

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## **Introduction**

The fall of all macroeconomic factors shows that today Ukraine is experiencing a severe social and economic crisis. The extremely negative situation that has been developing in the Ukrainian economy for the last nine months (for 01.04.2009) defines the necessity in analyzing reasons why these processes take place.

There is no need pointing out that crisis of the Ukrainian economy is proceeding in conditions of great recession of the world economy that has a systemic

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\* Dmitry CHISTILIN, Ph.D., Dnipropetrovsk University for Economics and Law. Department of International Economy and Economic Theory, Naberezhnaya Lenina str., 18, Dnipropetrovsk, Ukraine, 49000, E-mail: unid@a-teleport.com.

character. Foreign experts estimate the crisis as powerful as the Great Depression – the 1929 crisis. [1]

At first glance the crisis in Ukraine is of an endogenous nature. The imbalance in the world financial system, the fall in the world production and the deep integration of Ukraine into the world economic relations for the last 10 years explain the current situation and put the inner constituent of expanding destructive process to the second plan.

The crisis occurred to the utmost in the following spheres:

- ✓ **Industry.** The index of industrial output for the first quarter of 2009 was 69.6% comparing to the first quarter of 2008, i.e. in Ukraine the fall in production was 30.4%. It includes: building – 43.3%; transport – 67.1%; extracting and processing industry – 69.4%; chemical and oil-refining industry – 70.2%; light industry – 62.4%; metallurgical production – 56.9%; mechanical engineering - 47%; electric power industry – 89.3%, foodstuff and tobacco production – 90.6%, fuel sector and sectors of producing oil and gas: coal – 96.8%, oil – 94.6%, natural gas – 106.7%, etc. We can see that the best situation is in the agrarian sector (the production volume has grown by 1.7%).
- ✓ **Trade.** The volume of wholesale trade for the first quarter of 2009 wasp – 75.2% from the volume for the similar period in 2008, the volume of retail trade – 88.6%, accordingly.
- ✓ **Foreign trade.** The volume of exports for January-February in 2008 – 61.4% of total exports for January-February 2008. Import – 52.5%. The red ink of the goods made up \$ 708.3 million for January-February in 2009.
- ✓ **Unemployment.** The quantity of the registered unemployed was 879 thousand men for 01.04.2009, if we compare this figure with March 2008 it is 37.4% higher.
- ✓ **Finances.** The financial result of the enterprises ranging from ordinary activity to the taxation for the period of January-February, 2009 makes up 38.6% from volume of this indicator for January-February in 2008:
  - for the period January-March, 2009 the inflation was 5.9% from the figure 9.5% which was predicted by the government for 2009; [2]
  - reduction in exchange reserves of the National Bank of Ukraine (in SDR without taking into account gold) in November 2008 – 25.5 billion, March 2009 – 17.8 billion; [3]

- dollarization of economy reached 23.4%;
- the volume of deposits in national currency decreased by 13.7%, in a foreign currency by 8%; [4]
- by December, 2008 the volume of the credits in a foreign currency given to the population was 90-80% from the total volume; [5]
- a share of foreign banks in the financial system of Ukraine was 38.1% on 01.11.2008. [6]

All data mentioned above occur against the background of coming presidential elections of Ukraine in 2009. The situation becomes more acute owing to the struggle between the acting government headed by J.V. Tymoshenko and the opposition in Parliament. They struggle for opportunity to implement economic and anti-crisis actions which were outlined for 2009. However, there is also quite a difficult situation in the sphere of developing and implementing macroeconomic policy. The purposes of the anti-crisis program of the President of Ukraine, the strategy of the monetary policy (MP) of the NBU and the purposes of the Government that implements the budgetary and the fiscal policy do not coincide and, even, contradict each other.

What reasons underlie tendencies indicated above? Is the current crisis endogenous or does it have deep internal reasons? What is the nature of these reasons? Which reasons are dominating? Since 2005 political structures of a Ukrainian social system have been moving towards normal political process. Why do they not cope with the current crisis? Why do measures not bring desirable results and according to experts' forecasts the situation will be worse? [7]

It should be noted that the problem of the raised issues have not appeared today. Today there is a need for analyzing these problems and taking adequate measures through the macroeconomic policy. Since 2004-2006 scientists of Ukraine and Russia have seen and analyzed the tendencies which had already been outlined at that time and today they have become more acute. Further we will make an analysis of work done by experts. We will also try to estimate events which are taking place now and to explain the current crisis tendencies from the point of view of social self-organization concept. [8] For us a comparative analysis of the situation in Ukraine and in Russia can also be interesting.

*To understand the situation we should pay attention to conditions in which macroeconomic policy developed and how it was implemented in a political system of Ukraine.* The scientists who analyzed the formation of a dollarized

economy, the increase in an external debt and balance of payments deficit initially gave attention to those reasons where the monetary policy implemented by the National Bank of Ukraine takes the central place. [9]

## **1. The analysis of the monetary policy implemented by the NBU for the period 2004 – 2009**

**Let us consider the period 2004 – September 2008.** In 2004 scientists paid attention to changes in the structure of domestic demand, decrease in bank liquidity and to the fact that deficit in the offer of the NBU credits on domestic market were replaced with the foreign ones (mainly US dollars). [10]

The further events in a financial and banking sector of the Ukrainian economy have been reflected in current works of Ukrainian scientists. A typical case for the countries with transitive economy – dollarization, or currency substitution due to the insufficient internal offer of national money; in 2003 it was replaced by the following stage – substitution of bank liabilities for dollar and increase in volume of the credits given in a foreign currency. In 2006 this figure was 44.9% of the total amount of the given credits. [11] In 2008 this figure was already 80%. [12]

The analysis has shown that volumes of credits in a foreign currency given to residents of Ukraine till the beginning of 2006 have exceeded the deposits involved on domestic market by \$ 16.6 billion. According to estimates made by O. Bereslavskaya and other experts, at the beginning of 2006 the resource potential of the Ukrainian banking system which was not used due to dollarization reached 164.8 billion hrvnas. [13]

At the same time with dollarization there is a process of capitalizing the banking system and economy of Ukraine. By the beginning of 2007 the volume of net assets of the banking system during 1999-2006 increased by 12.2 times. In 2006 the indicator that shows how volume of assets of the banking sector relates to GDP in the country was 63.3%. At the beginning of 2007 all banking capital of a country made up \$ 8.43 billion. [14] For comparison: the capital of one Bank of the USA – Citigroup – made up \$ 66.8 billion in 2004. [15] The presence of the foreign capital in the banking system of Ukraine was 35.5% of the general capitalization of the system in 2006 and 38.1% on 01.11.2008. [16]

**The figures given above show that spheres of the cash and non-cash circulation in Ukrainian economy, bank liabilities and the authorized capital of banks in Ukraine have been dollarized for a long time (since 2005).** In its turn it led to:

- inefficient use of resource potential of a banking system;
- the strongest sag in giving credits to residents of Ukraine in favour of dollar consumer credits;
- increase in the share of a corporate sector (first of all, of a banking sector) in the external debt of Ukraine.

In addition, the Ukrainian banking system attracted the great volume of cheaper foreign credits in order to satisfy the unattended NBU, domestic demand for credit resources increased during 2005-2008. It put all economy of Ukraine on the verge of sovereign default. At the beginning of 2007 the share of a banking sector in the external debt of Ukraine was 25.5%. [17] On 01.01.2008 the share of all corporate borrowers in an external debt of Ukraine made up almost 83% at a rate of \$ 69.4 billion. [18] The external debt of the country in percentage of GDP made up 60.1% from GDP for 01.01.2008, and by the end of 2008 it reached more than 90% of the country's GDP. [19] Since 2006 the balance of the current account of the country's balance of payments acquired a negative character and for September 2008 it made up \$ 11.9 billion. [20] Against the background of this situation monetary reserves were reduced by 19% from 21.54 billion SDR in November, 2008 up to 17.8 billion SDR in March, 2009 (without taking into account gold). [21]

### **Situation on foreign markets**

We should pay attention to the process of Ukraine's economy integration into the world economy in the period after 1991. The geographical structure of the Ukrainian export was essentially reoriented from the post-Soviet countries to the world economy as a whole. On 01.04.09, 33% of foreign trade falls on the CIS countries and 67% on the world economy. [22] The main export industries are the Ukrainian resource potential where there are competitive advantages and surplus resources. The largest commodity groups are as follows: metallurgy (33% of total export), mechanical engineering (including the defense technology – 14.9%), petrochemistry – 10.4%, agrarian sector, mineral raw materials (iron, manganese and other ores as well as semi-finished products from them), etc. [23]

These industries were overtaken by the world economic recession. The financial crisis from autumn 2007 till autumn 2008 came to basic industries including the building sector and mechanical engineering.

At the same time, by 2008 the openness of the economy to the impact made by the world crisis appeared to be maximal due to liberalization of currency sale in 2005 and decrease in barriers to international trade during the process of entering the WTO in the mid-2008.

Conditions of the international balance of payments became worse. It was defined not only by active attracting external borrowed funds, but also by worsening conditions for foreign trade owing to the world crisis. Decrease in demand as well as drop in prices for Ukrainian export on foreign markets and, as a consequence, excess of import over export really influence both national currency stability and the country's balance of payments.

Among the reasons that define negative tendencies stated above the experts called the following: the NBU underestimated the volume of domestic demand for credit resources in economy in the conditions of national economy growth during 2005-2008; interest-bearing policy was defined incorrectly (including high discount rate and high rate of refinancing of the banking system); proposal for credit resources was maintained at a low level; banking system resources were used in an inefficient way. [24]

**What happened to the formation process of the monetary policy in Ukraine these years?** The analysis which was performed by V. Heyets, the Academician of the Ukrainian NAS, showed that the NBU firmly followed purposes stated in the Constitution of Ukraine and in the law of the National Bank of Ukraine. The monetary policy implemented by the NBU was directed at ensuring advanced increase in monetary base and credit proposal in national economy. [25] The targets were focused on maintaining price stability by way of suppressing inflation as well as maintaining confidence in national currency and in stability of exchange rate.

A. Savchenko theoretically substantiated the accurate strategic aims chosen by the NBU. The NBU also chose the right tactics to react to the current changes in economy. It meant maintaining economic stability in the context of a strategic aim by solving two tasks: to sustain both employment at a natural level and price stability on the basis of decline in inflation. He focused his attention on neutrality and superneutrality of money in economy in a long and in a short period of time, absence of their influence on production. In his opinion, the main target function of a monetary policy consists in maintaining price stability, forming a natural employment level and, as a result, economic growth. [26] These tasks are stated for the period 2009 by the decision of the NBU Council No. 14 of 15.09.2008 and the decision No. 1 of 10.02.2009 "The main positions of the monetary policy for

2009". The main objective is to suppress inflation and to maintain national currency stability. The basic instrument lies in reducing the monetary and credit proposal in the national economy, decrease in the growth rate of monetary base concerning the previous periods and the high interest rate (the discount rate and the refinancing rate).

V. Geets, V. Kozjuk, A. Gritsenko, T. Krichevskaja, T. Vahnenko, S. Rybak, Lazebnyk and others investigated the monetary policy implemented by the NBU. [27]

In 2006 T. Vahnenko pointed out the necessity of banning credits in foreign currency for residents of Ukraine. She recommended introducing a barrier for deposits in a foreign currency in a form of interest rates. It was to be done to reduce unit weight in bank liabilities. [28]

A. Gritsenko and T. Krichevskaja have made a qualitative analysis of the current monetary policy of the NBU. They also substantiated and indicated that the monetary policy really influences economic activity of agents of a system through conditions of crediting and the number of credits given by the NBU to a national economy. [29] T. Vahnenko understands that the main objective of the monetary policy of the NBU is price stability by way of suppressing inflation. She has shown that currency credits which were given on domestic market do not influence inflation provided that expanding economy has a great demand for a credit resource. [30] Analyzing the monetary policy implemented by the Central Bank of the RF, the Russian scientists O. Suharev and the Academician of the Russian Academy of Sciences V. Maevskiy have come to the same conclusions. [31]

### **What does the monetary theory say on this occasion?**

M. Friedman and D. Meiselman's researches and later L. Andersen and J.L. Jourdan's (1968) have shown that the monetary policy influences economy more strongly than budgetary and fiscal components of a macroeconomic policy. Later A. Ando and F. Modigliani pointed out consistent conclusions based on their own model of economy.

Investigating a neoclassical economic growth model J.L. Stein [1970], M. Sidrauski [1967] and J. Tobin [1965] have shown that money is not neutral in expanding economy by any means. Growth in money supply impacts on inflation and through it on the level of capital endowment. [32] M. Friedman spoke on this subject differently: "Potential options of the monetary policy are limited by area of strong indignations" [33]. It is worth citing one more Friedman's thought which is

included in textbooks on the monetary policy and on a banking system of the USA: "... Money is too important to allow the central banks to manipulate them at their own discretion ..." [34]

What conclusions can be drawn from the performed analysis in the monetary policy implemented by the NBU for the period 2004 – September 2008?

**First of all, we should address to facts, then to the theory.** The actual material stated above shows that there were two severest destructive shifts in Ukrainian economy in the specified period. These shifts had enormous negative social and economic consequences for citizens of Ukraine.

They are:

- *strong and unreasonable dollarization of economy* expressed in great volumes of dollar deposits in liabilities of the banking system of Ukraine and huge volumes of currency credits given to economic agents where consumer orientation of population dominates.
- *dollarization of assets of the Ukrainian banking system in a part of unprecedented percent of the foreign capital presence.*

In its turn indicated tendencies had predetermined two negative macroeconomic results by the end of 2008:

- *growth in the external debt of the country that exceeded marginal rates (35-45% of the country's GDP)*
- *balance of payments deficit.*

As a result there arises instability in the exchange rate. What is more terrible, there arose a great social stress in the conditions of underestimating the world economic crisis which provoked the devaluation of the hryvna.

**There is an obvious fact – all data stated above are the results of the monetary policy implemented by the NBU within 2003-2009.** Many facts did not allow the NBU to meet internal requirements of the expanding national economy as for liquidity of the banking system. Among these factors we can mention the following: a conservative theoretical basis which forms the monetary policy, the absence of targets with a legislative confirmation in order to analyze the current economic situation and the absence of thorough and effective monitoring of internal and external economic situation with a qualitative scientific analysis. One more fact has not been taken into consideration: the influence of the world interest rate on a small open economic system – the economy of Ukraine.



**The analysis of interest rates policy.** In the 1990's in conditions of structural reorganization of the national economy the NBU maintained a high interest rate (discount rate and refinancing rate), which proved to be correct and effective. The conservative monetary policy implemented at that time allowed overcoming hyperinflation and stagflation in the 1990's. However, subsequent factors obliged the NBU to think about the influence of global financial and trade markets over the monetary policy implemented within the country. To these factors we can refer: gradual and deep integration of the Ukrainian national economy into the world economic relations; later in 2005 conditions of the obligatory currency sale were canceled and in 2008 Ukrainian markets became open when the country entered the WTO.

**It is obvious that having such a degree of open economy, which Ukraine reached in 2005-2008, there was a necessity of adequate understanding of the effectiveness of the interest rates policy and adequate reaction to influence of the processes occurring in the world economy.**

By 2004 interest rates (including discount rate and refinancing rate) had to be approximated to global norms in order to avoid inflow of the speculative capital to the banking sector of Ukraine. Unfortunately, it has not been done. Transnational financial corporations (TFC) took advantage of this situation. The global market and the capital market which Ukraine joined function in accordance with the market laws. Therefore it is natural that the world economic resources flow into that part where they have the big profit. Tables (1 and 2) show that the economy of Ukraine as well as of the Russian Federation attracts the international capital.

**Table 1. The national interest rate (selectively)**

	2005	2006	2007	2008	2009	
					January	February
<i>EU</i>	3.25	4.50	5.00	3.00	3.00	3.00
<i>Canada</i>	3.50	4.50	4.50	1.75	1.25	1.25
<i>Hong Kong</i>	5.75	6.75	5.75	0.50	0.50	0.50
<i>Island</i>	12.00	15.25	15.25	22.00	22.00	22.00
<i>Japan</i>	0.10	0.40	0.75	0.30	0.30	0.30
<i>USA</i>	5.16	6.25	4.83	0.86	0.50	0.50
<i>China</i>	3.33	3.33	3.33	2.79	2.79	2.79
<i>Pakistan</i>	9.00	9.50	10.00	15.00	15.00	15.00
<i>Hungary</i>	6.00	8.00	7.50	10.00	9.50	9.50
<i>Serbia</i>	19.16	15.35	9.57	17.75	17.50	17.50
<i>Russia</i>	12.00	11.00	10.00	13.00	13.00	13.00
<i>Ukraine</i>	9.50	8.50	8.00	12.00	12.00	12.00

**Source:** April 2009, International Monetary Fund: International Financial Statistics.

**Table 2. Dynamics of the discount rates of the Central Banks in the world financial centers, Ukraine and Russia**

Session date	The US FRS, in%	Bank of England	The European Central Bank	Bank of Japan	The Central Bank of the RF	The National Bank of Ukraine
04.2009	0.25	0.5	1.25	0.25	12.5	12
03.2009	0.25	0.5	1.5	0.25	13	12
01.2009	0.25	1.5	2	0.5	13	12
12.2008	0.25	2	2.5	0.5	13	12
11.2008	1.0	3	3.25	1	12	12
10.2008	1.5	4.5	3.75	2	11	12
09.2008	2	5	4.25	2.75	11	12
03.2008	2.25	5.25	4	2.75	10.25	10
01.2008	3.50	5.5	4	2.75	11	10

Sources: [www.mvf.klerk.ru](http://www.mvf.klerk.ru), [www.uabanker.net](http://www.uabanker.net), [www.infobanks.com.ua](http://www.infobanks.com.ua).

Whereas in the world economy the discount rates of the world leading centers were supported at the level of 3.5-5%, in Ukraine this indicator did not fall below 8%. The refinancing rate did not fall below 10%. Foreign banks and financial groups purchased a large number of shares of the Ukrainian banks. It is the way how transnational financial corporations (TFC) implement their strategy as for the safe exit to the financial market of Ukraine. Accordingly, low capitalization of the banking system in the conditions of expanding economy testifies that the difference in interest rates was not capitalized, but was taken out from the Ukrainian economy into the capital of parent banks or companies which are giving credits.

*According to articles No. 1; 7 and 15 of The Law of Ukraine on the National Bank of Ukraine, one of the main tasks of the NBU consists in maintaining the balance of payments of Ukraine and controlling sales of the banking assets to the foreign capital (to non-residents of Ukraine).*

However, the monetary policy implemented by the NBU did not satisfy the domestic demand for credit resources, but allowed dollarizing the banking sector and the national economy. As a result, the balance of payments received an economic knockout.

**Let us consider the period September 2008-2009.** The restrictive monetary policy firmly orients towards restraining rates of economic growth during the first 9 months in 2008 and towards suppressing inflation since the 10<sup>th</sup> month. This

policy ignores the increasing need to provide liquidity of the banking system, to support both growth of employment and regressive production by stimulating domestic demand and offering reasonable credits. The national economy becomes acutely aware that in conditions of the severest global crisis the monetary base as well as credits offered by a banking system is reduced. **Sudden fall in the economy's productivity as well as growth in unemployment (during the 4<sup>th</sup> quarter of 2008 and the 1<sup>st</sup> quarter of 2009 as it was shown earlier) was caused by the monetary policy implemented by the NBU rather than by the world financial crisis. In 2008-2009 the NBU oriented its policy towards reducing the monetary base in economy and decreasing the bank's liquidity, which led to evident deflation.**

The experience which the USA had during the Great Depression showed that, without being controlled, the Federal Reserve System implemented a policy of reducing the monetary supply and it caused the next coil of crisis. [35] However, the world community drew conclusions from the events connected with the Great Depression. Besides huge financial inflows and other methods of maintaining bank's liquidity, interest rates during 2008-2009 fell to the lowest rates (see Table 2). Bank's liquidity is ensured by very low discount rates in conditions when the world production falls. The process of providing liquidity is directed to fighting deflation, which is more important than struggle with inflation. It is also aimed at maintaining a domestic demand, on the one hand, whereas on the other hand, the process is aimed at a maximum damping of production fall at the expense of giving economy credits and reducing social strain on the whole. *In what way is this circumstance connected with the monetary policy implemented by the NBU?*

**Firstly**, it is necessary to be aware that targets of the monetary policy should be changed in conditions of an endogenous economic shock received from drop in prices and reduction in demand for exports from Ukraine. Bank's liquidity has to be maintained at the level that will maintain national economy productivity at the highest possible level in conditions of economic recession.

**Secondly**, it is connected with the necessity of supporting the country's export potential at the highest possible level, and consequently an external demand for national currency in conditions of unprecedented dollarization of the economy. External demand for national production is the main element in estimating conditions for maintaining stability of the national currency.

**The restrictive policy of the NBU gives results opposite to those which are necessary for the national economy and the Ukrainian society.** Decrease in

the monetary base and low liquidity of the banking system reduce production, which in its turn leads to reduction both in export and in demand for national currency. Either new devaluation of the hryvna or sovereign default becomes more and more appreciable.

We can see in Table 1 that even though the world crisis influenced China's economy insignificantly the country has the discount rate at the level of the world standard.

By its policy during 2005-2009 the NBU forced the Ukrainian government not only to dollarize economy but also to hold strained negotiations with the IMF over obtaining credits in order to maintain the country's balance of payment.

## **2. The analysis of the budgetary and fiscal policy during 2008-2009**

Not taking into account the budgetary and fiscal policy which was implemented up to September 2008 we will pay attention to opportunities which J.V. Tymoshenko's acting government has in order to carry out macroeconomic policy in 2009.

Due to a crisis situation that has been developing since 2008, the administration of the President of Ukraine passed the first anti-crisis law No. 639-VI on 31 October, 2008.

The adoption of the law became a signal for the government to react to destructive changes in economy. And it was expressed in a number of decisions taken by the government. [36] J.M. Keynes and his followers define the main objectives of a government's actions: to reduce tax pressure, to make budget investments in the problem branches of the country's economy and to implement the government's investment programs directed to employment growth (for example, anti-crisis plan of B. Obama's government has determined \$ 250 billion as tax subsidies – the amount of taxes not levied).

Implementing objectives of the budgetary and the fiscal policy requires necessary means in the budget of 2009. However, during the first quarter of 2009 the government faced both immense cutback in production and financial results in economic activity of economy's subjects. [37] It is a result of implementing objectives of the monetary policy implemented by the NBU during 2008 – the 1<sup>st</sup> quarter of 2009.

**Thus, for the government to implement objectives of the budgetary and fiscal policy in 2009 is impossible due to the fact that they are antithetic to those objectives which the NBU is pursuing in its monetary and credit policy.**

Deficit in sources which could fill the budget for implementing an anti-crisis program, the extremely negative situation concerning the external debt and balance of payment deficit, the devaluation of the hryvna during the 4<sup>th</sup> quarter of 2008 and dollarization of economy make the government direct its efforts towards obtaining credits from the IMF instead of taking effective budgetary and fiscal measures in order to stimulate economy. **Maintaining the balance of payment as well as eliminating the next devaluation of the hryvna, which can lead to a social catastrophe on the eve of the presidential elections, has become for the government a target which is more important than classical aims of macroeconomic policy in conditions of crisis.** The struggle with “gas” inflation, imported from the RF, has become one more important target of the government. One of the main instruments in the struggle with inflation and social strain in the society became the opportunity of the Ukrainian government to pay Russia for gas and to pay the National Incorporated Company “Ukraine’s Naftogas” compensation for variation in gas price for use by population. Targets were also replaced because the objectives of the monetary policy of the NBU did not correspond to current economic situation.

It should be noted that not only the Ukrainian government appeared in such situation. Iceland, Romania, Hungary, Serbia, Pakistan and others are the clients of the IMF for improving the balance of payments. Moreover, Iceland is a member of the country group – OECD (the Organization for Economic Cooperation and Development). Romania and Hungary joined the EU i.e. they belong to highly developed countries. As we can see in Table 1, high interest rates are what they all have in common with Ukraine.

If we sum up what was stated above we can conclude that the objectives of the budgetary and the fiscal policy implemented by the government in accordance with the “Law of Ukraine on the state budget of Ukraine for 2009” No. 835-VI of 26.12.2008 and objectives of the monetary policy implemented by the NBU in accordance with Resolution №1 adopted by the NBU Council on 10.02.2009 “The main orientation of the monetary policy for 2009” exclude each other.

**About the economic policy theory.** From all variety of works about the economic policy theory we will choose the most interesting and important works in our case. Walter Eucken, one of the classics of the economic policy theory,

pointed out that the main task of the macroeconomic policy is to take into account negative tendencies in forming objectives. It implies responsibility for consequences of wrong estimation of negative tendencies in economy. [38] Walter Eucken's main thought can be quoted as: "The policy can be effective if all its laws are directed towards the common decision". [39]

Jan Tinbergen investigated problems of the economic policy. The essence of an analysis consists in explaining the simple rules. Firstly, macroeconomic policy should have ultimate aims that implement the ultimate function – an increase in public welfare. Targets are defined in order to solve the task. The solution to the task on the model showed that the optimal macroeconomic policy is the one where the objectives of different policies (the monetary policy, the budgetary and the fiscal policies) are taken into account and connected. In other words, to achieve economic effect different types of economic policies should be coherent and coordinated in its targets and mechanisms of implementation. The instrument that would provide reconciliation of the targets of these policies should be present. [40]

R. Mandell considered a situation when reconciliation of the targets of political instruments cannot be reached in a centralized way. He showed that when different political instruments are attributed to different branches of power, reconciliation of the targets of the monetary policy, the budgetary and the fiscal policies are possible if every target is attributed to the concrete target indicator and to the instrument that can influence it in a maximum way. Further the rule of reconciliation of targets comes into force. R. Mandell's conception about "effective market classification" became the basis for confirming the fact that optimization of the macroeconomic policy's targets is possible in conditions of decentralization. [41]

### **3. Policy measures answers. Between necessity and opportunity**

All factors stated above clarify that rules of reconciliation are absent from a Ukrainian political system in conditions of decentralization of instruments which implement policy and its targets.

**It remains only to answer a question: "why did it happen so?"**

**One of the main reasons is** that there are no targets fixed by the legislation which could oblige the NBU to take into consideration not only well-known macroeconomic norms and indices but also the influence of global trends over

Ukraine's economy. It also includes the current changes in conditions of international economy, demand for goods of national production at foreign markets, world interest rates, provision of industries oriented at export with liquidity of the national banking system, dollarization of the national economy. The Ukrainian society acutely needs a law similar to the "Law about full employment and balanced growth" [42], which was adopted in the USA in 1978 and is the constitution of economic policy for FRS of the USA.

**The next reason** is the absence of qualitative prompt monitoring of the current internal and external situation and further scientific analysis. Having a large number of highly qualified scientists (including those mentioned in this work), the power that forms macroeconomic policy does not have an analytical center. For example, the Council of Economic Advisors under the President of the USA monitors and analyzes an economic situation in the world and in the country every day. Even though a skilled analyst and opponent can point out that the USA allowed financial and then industrial crisis first in its economy and later in the world economy, we can answer that this situation arose in the 21<sup>st</sup> century whereas the USA has been developing and increasing people's welfare for more than 200 years.

**It is obvious that there are reasons according to which the results of Ukrainian scientists' analysis did not become a signal to overvalue targets for the NBU.**

The conception of a social development and self-organization that uncovers the role of the structure of a political system in the process of forming and implementing effective macroeconomic policy gives a clear and unambiguous answer to this question. [43]

However, to come to the final conclusion it requires estimating an institutional basis of forming Ukraine's macroeconomic policy.

In accordance with the Constitution of Ukraine and the Ukraine's Law on the National Bank of Ukraine, the NBU independently forms targets, strategic tasks and the mechanism of implementing the monetary policy. The work is done by the NBU Council on the basis of the article No. 9 of the Law of Ukraine on the NBU No. 679-XIV of 20.05.1999.

Though the NBU gives an account to the Sepreme Rada twice a year it is absolutely out of control and does not fall under influence of the acting government and parliament.

Only consultations are held between the Cabinet and the NBU at the option of the latter.

The Cabinet of Ukraine carries out the budgetary and the fiscal policy on the basis of Constitution of Ukraine and a number of laws. [44]

**The Cabinet of Ukraine is fully responsible for an economic situation in the country to Parliament and the society and does not impact on implementation of the monetary policy with regard to reconciling targets of three constituents of the macroeconomic policy.** Furthermore, the Cabinet of Ukraine as well as the NBU does not have a center of prompt monitoring and qualitative economic analysis of the current situation. Owing to incompetence of those who form the monetary policy J.V. Tymoshenko's government was compelled to state that the main content of anti-crisis program consists in obtaining credits from the IMF. Reviewing targets of the monetary policy as well as coordinating them with the similar ones of the budgetary and the fiscal policies in the context of the public discussion and their confirmation in Parliament is out of question. Therefore, those professionals who have already indicated mistakes in implementing the macroeconomic policy, unfortunately, remained unheard. If N. Sheludko, T. Vahnenko, A. Gritsenko, A. Rybak and others had been heard we would not have to conduct an analysis in this work. There would not be any cause.

The reason is very simple. First of all, the change from the Presidential republic to the Parliamentary republic and alterations to the Constitution did not eliminate conflict ambiguity in implementing power between the Prime-minister and the President. The President of Ukraine submits the candidate for the position of the head of the Ukraine's NBU and Parliament confirms it. The President independently confirms 50% of the NBU Council and two ministers of the Cabinet (the Minister of Defense and the Minister of Foreign Affairs). The Prime-minister submits candidates for the posts as ministers of the Cabinet, and then Parliament confirms them. As a result, the monetary policy is being formed under President's supervision whereas the budgetary and the fiscal policies are being formed under the supervision of government's opposition in the parliament. **At the same time the government carries the burden of mistakes made by the NBU in the monetary policy since the government is responsible for serious current economic consequences to Parliament and the society.**

In addition, the opposition should be fixed by the legislation as the "Law about the opposition and the shadow cabinet" and should play the key role in this matter. The Ukrainian society urgently needs the law which would oblige



politicians responsible for forming and changing the monetary policy, the budgetary and the fiscal policies to take into account the opposition's opinion. In his interview for TV channel "TVi" on 20.04.2009 V. Janukovich pointed out two features in The Party of Regions work. [45] The party has put forward more than 100 suggestions for changes in the current macroeconomic policy; nevertheless none of them was considered. Undoubtedly, suggestions were prepared by professionals and that is proved by "The analysis regarding causes of crisis and ways of its overcoming. Demands for anti-crisis program". [46] One can have any attitude towards the Party of Regions and its leader V.F. Janukovich; however, one cannot overlook a substantial, professional and careful analysis of the current situation and ignore actual suggestions concerning changes in the current macroeconomic policy. For example, Party of Regions is the only party that offered to dedollarize Ukraine's economy in conditions of crisis: they offer to protect the population from reduction in the national wealth through further devaluation of the national currency and collapse of the banking system. They have offered to transfer population's currency credits to the hryvna (the national unit) at the hryvna/dollar exchange rate before devaluation and to remain interest rates (dollar) unchangeable. They propose to share reimbursement for devaluation between the government (at the expense of the budget) and banks (at the expense of their profits). [47] This suggestion is quite logical and socially substantiated. It seems as if it were not considered from an economic point of view. However, it is necessary to estimate the value and significance of combining critical parameters: dollarization of economy and the quantity of consumer credits given to the residents of Ukraine (up to 80% from the total volume) in conditions of unemployment growth, the fall in production and personal income, the hryvna devaluation during September-December 2008 by approximately 70%. For most citizens this combination is like the heaviest catastrophe which has already happened but not the one to be coming. **In such conditions the government should take measures adequate to the social and economic situation in the country.** Unfortunately, neither the anti-crisis program of the President's administration nor the anti-crisis program of the acting government (though it does not have time to estimate and to consider opponents' suggestions) has such professional suggestions as The Party of Regions does in its economic analysis (not taking into consideration accusation and emotion). The government is striving to implement one task – the Law of Ukraine on the State Budget of Ukraine for 2009. Conflicts between the Cabinet and the President, on the one hand, and the Cabinet and the opposition in Parliament, on the other hand, are created in institutional conditions. In these conditions the government is striving to maintain social stability and not to let

sovereign default happen. In order to implement these tasks the government needs to reorient the monetary policy from the restrictive policy towards damping the fall in production as well as towards stimulating the capacity of export sectors through increase in liquidity of the banking system. The government is unable to do it because the institutional instruments are absent.

Besides, we can add that the parliamentary republic did not bring expected political stability. Instability was caused by clan struggle in Parliament before 2004 when the law 2222-IV was passed on 07.12.2004, after that – by faction struggle. From 2004 till now four prime ministers were changed, including J.V. Tymoshenko twice. Therefore the Ukrainian society urgently requires the law which would provide the executive power for 5 years of normal work.

Moreover, the economic efficiency of a political system is indicated by time of an executive power's reaction to crisis events. This time is spent for taking necessary measures: from estimating the situation to enforcing laws. The anti-crisis plan of Bush's government provides \$ 700 billion of inflow for the financial system of the USA. This plan was approved by the Congress in autumn of 2008 and it was adopted within a week. B. Obama's plan increased the amount of inflow in economy by \$ 787 billion. This plan was approved within 2 weeks in February 2009. In the RF this situation had a simple solution: the process of decision-making has a high speed which is defined by the legislative unity between the President D. Medvedev and the Prime-minister V. Putin [48] coupled with the domination of the the United Russia party in the State Duma of the RF. But these circumstances do not protect the government of the Russian Federation from mistakes and we will return to this analysis later. In Ukraine an anti-crisis set of measures offered by the government was introduced for consideration in autumn of 2008 and by 01.05.2009 it has not been accepted yet. Only two laws out of five were adopted. These two laws are directed to increase in excise tax on tobacco goods and alcoholic beverages. Laws aimed at changing the budget, balancing the budget of the National Incorporated Company "Ukraine's Naftogas" and reviewing the pension legislation were not adopted. It should be noted that they adopted some laws with anti-crisis orientation, including the law about forming the equalization fund as a solution to the crisis tasks. [49]

## **Conclusions**

Thus, we can summarize abovementioned information and point out those institutional elements of the Ukrainian political structure that the society lacks

and urgently needs. These elements create economic efficiency and serve as the base of the self-organization mechanism, which is expressed by processes of forming and implementing an effective macroeconomic policy. The main condition of an effective macroeconomic policy consists in ability to optimize resources and goods. To the main condition we can also refer a flexible change in an orientation of a policy without conflicts in case this policy is incorrect and inappropriate to requirements of the current economic conditions (for example, the current monetary policy in conditions of crisis). Such factors are:

- the legitimate opposition that acts on the basis of the Law on the opposition and the shadow cabinet and obliges the acting government to react to political opponents' critical comments and suggestions within the due date and in an established order;
- two-party parliament (the party in power and the opposition). There is a need in the law about the two-party system which would stipulate not only two-party membership but also obligatory 5 years of power obtained as a result of the political struggle.
- interaction between the President of Ukraine and the Prime Minister of Ukraine without conflicts. There is a need in the law – alteration to the constitution of Ukraine – which would neutralize the institutional conflict between the President and the Prime Minister and prevent parties that are not responsible for an economic policy to Parliament and to the society from participating in forming the executive structure: the Cabinet of Ukraine and the National Bank of Ukraine. Highly developed countries' experience shows that the executive power controlled by the opposition should bear responsibility for implementing a macroeconomic policy to the society. The executive power should also form the group of executives and set targets and instruments of a macroeconomic policy on the basis of corresponding laws the way it is performed in the USA and in the RF. At the same time having targets and the process of obligatory reconciling the monetary policy with the fiscal and the budgetary policies in Parliament, the NBU can be independent.

The political system of Ukraine also needs the following laws:

- the law about elections on party basis by open lists;
- the law about targets and the content of the macroeconomic policy of Ukraine (including the monetary, the budgetary and the fiscal policies) and about the procedure of their reconciliation with the opposition in Parliament. It would maximize the function of social efficiency of the macroeconomic policy. The

law should stipulate the creation of the governmental centre to perform the monitoring and the economic analysis.

The social self-organization of the system shows that economic the effect of a political system is formed on two institutional bases:

- consolidation of a society in a form of majority in socium and in parliament to form the executive power;
- the legitimate opposition that acts in accordance with the Constitution and the legislation, and which controls and restricts actions of the executive power. Elaborate rules of interaction between the party in power and the opposition should be aimed at competitive interaction but not at conflict. This condition is very important.

In contrast to Ukraine the RF has the single condition of forming and implementing a macroeconomic policy. According to the Constitution of the Russian Federation (ch. № 83), the head of the Central Bank of the RF and the Prime Minister are appointed by the State Duma. The candidates are submitted by the President. According to the Federal Constitutional Law about the Government of the Russian Federation – the government is completely accountable to the State Duma of the Russian Federation. It coordinates and implements all kinds of macroeconomic policy including the monetary policy. [50]

The Central Bank of the Russian Federation in accordance with the article 45 of the Federal Law about the Central Bank of the Russian Federation No. 86-F3 of 10.07.2002 has a set of targets and means of achievement. The Central Bank develops targets and the strategy of the monetary policy and proposes them to the government, the State Duma and the President of the RF for consideration.

Moreover, the CB of the RF is obliged to develop purposes for the current period: for example, “Main orientations of the state monetary policy for the period 2009, 2010 and 2011”. [51] The Central Bank is obliged to coordinate the adopted program with the government, after that the program is to be adopted by the State Duma, to be ratified by the Senate of the RF and this document becomes valid. The program becomes the basis for both the Central Bank and for the government of the RF to act.

Such full institutional base that forms a macroeconomic policy does not prevent the government of the RF from making system mistakes. Unity in mutual relations between branches of power becomes the obstacle to optimize a macroeconomic policy.

Russian scientists analyzed the current macroeconomic policy of the Russian Federation. The analysis shows that a macroeconomic policy has definite disproportions in forming targets of the monetary policy, the budgetary and the fiscal policies during 2005-2009.

In his substantial works the Academician of the Russian Academy of Sciences S.Y. Glaziev indicates that the targets of the monetary policy do not correspond to the current demands of Russian economy. The main problems are the same as in Ukraine. [52]

The policy of overstated interest rate (discount rate and refinancing rate of the CB of the RF are overstated) is being implemented. In its turn it leads to deficit in banking system liquidity and unnecessary dollarization of the economy including increase in number of deposits and credits in foreign currency. This circumstance forms the disproportion in balance of payments including the high rate of the corporative part in the external debt of the RF at the expense of attracting foreign credits. It occurs against the background of decreasing prices for the main export from Russia (oil) and reducing currency supply.

The order of events is the same as in Ukraine but it is expressed in a softer form: overstating the interest rate, undue reaction to disproportions in a banking system, disproportion of liquidity, dollarization of bank liabilities and credits given by banks, forming a big share of corporative debts in external debt of the RF, the current devaluation of the ruble and inadequate policy of distributing currency resources.

Academicians of the Russian Academy of Sciences S. Glaziev and A. Nekipelov indicated the necessity for changing targets of the monetary policy implemented by the Central Bank of the RF since 2008. The main task of this policy is stability in prices by way of suppressing inflation. They offer to increase liquidity of the banking system at the expense of decrease in interest rates (including discount rate and refinancing rate). It will support production that falls. [53] The Academicians also point out that the CB of the RF ignores growing internal demand for credit resources as well as requirement of the national economy from the banking system concerning support of the falling production on a maximum level. [53]

The Corresponding Member of the Russian Academy of Sciences G. Fetisov earnestly proves that reduction in the rate of refinancing up to 4.5-6% will go smoothly. [55] In our opinion, one needs to be orientated towards the interest rate of the world economy which is 0.25-1.5% today. The Central Bank of the Russian Federation needs to orientate towards P.R. of China mainland rate which is 2.79%.

The Academicians of the RAS V. Maevsky and O. Suharev based their suggestion on the instruments of the institutional theory and substantiated the necessity of increase in the credit offer since the expanded credit offer was required for innovative development according to J. Schumpeter's method. O. Suharev indicated that the increase in the credit offer does not influence inflation since a possible inflationary reaction of the economy is being damped by the growing productivity. [56] The Academician of the RAS V. Nekipelov points out the problems concerning high rates of refinancing and the necessity of repeated introduction of the currency regulation. [57]

It should be noted that S. Glaziev, the Academician of the RAS, suggested a well-founded target program, which stipulates forming the monetary policy, the budgetary and the fiscal policies in conditions of crisis including the following steps:

- obligatory sale of currency to the state by the residents of the RF in times of crisis;
- blocking off the foreign currency from participation in forming liabilities of a banking system by way of increasing the deposit rates in the national currency;
- the ban on giving foreign credit to residents of the RF;
- forming the currency zone of the ruble on the territory of the CIS and the EU countries by way of selling gas and oil for rubles and other measures. [58]

Ukraine and Russia have conflict relations in the energy sphere so it would be useful for both Ukraine and Russia to use rubles for gas and oil contracts. Long-term and more favourable conditions and terms of crediting in rubles on long term would certainly stabilize the situation regarding payments for gas with the RF. It would also protect the economy and the population of Ukraine from devaluation of the hrivna against all main currencies in the world.

Such situation would become a good testing area to develop relations between Ukraine and Russia and to cooperate on the post-Soviet territory.

The analysis of inflation in the RF shows that its basis is considered to be not the monetary policy of the Central Bank of the RF, but increase in price for the main energetic resources and rates for their transportation by the energy and raw monopolies. [59] This policy has inflationary expansion in Ukraine and other countries that use Russian gas and oil. The fact that this question is raised leads to external political relations with the countries that consume energy resources.

One more object for criticism is actions of the CB of the RF as for distributing foreign currency resources in securities of the USA government. The authorities of the Russian Federation give credits to the US government instead of crediting the deficit of own economy's liquidity. [60]

Last two circumstances show that the macroeconomic policy of the RF government, first of all, serves the interests of monopolists who deal with energy and raw material and targets of the foreign policy of the RF, but not the interests of society and its citizens.

It should be noted that the anti-crisis strategy implemented within the targets of the budgetary and the fiscal policies contradict targets of the monetary policy implemented by the CB of the RF. Thus, in accordance with anti-crisis objectives the government intends to compensate for interest rates concerning credits to population who buy housing and cars produced domestically, whereas the CB maintains the low liquidity of the banking system through a high interest rate. [61]

Unfortunately, officials did not take into account a highly professional analysis and critical comments offered by Russian scientists.

Russia, like Ukraine, lacks a civilized instrument of social self-organization in order to hear reasonable economic recommendations especially in conditions of the current crisis.

The law about the legitimate opposition and the shadow cabinet should become such an instrument. They will estimate the current macroeconomic policy implemented by the acting government in an official and critical way. The opposition and the shadow cabinet will also define the mechanism of changes and reconciliation of a new group of targets that correspond to the current conditions.

Academician S. Glaziev pointed out the necessity of qualitative preparation of information on the basis of governmental monitoring. He also suggested that the scientists of RAS analyze this economic information and provide solutions to difficult economic tasks. [62]

This aspect undoubtedly concerns system changes and formation of a civil society. Y. Kornai, the Academician of the RAS O. Bogomolov, the corresponding member of the RAS R. Grinberg spoke about these changes. [63]

To sum it up we would note that Russia and Ukraine possess not only common cultural and ethnic territory but also mistakes (not corrected) and institutional problems in forming and implementing effective macroeconomic policy.

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