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THE INFLUENCE OF THE WAR ON THE FORMATION OF THE BUDGETARY SYSTEM IN UKRAINE

Introduction

Russia's full-scale invasion of Ukraine has acted as a catalyst for profound transformations in all spheres of life, including public finance. The destruction of infrastructure, disruptions in energy supply, rising unemployment, and mass migration have led to a significant decrease in tax revenues and, simultaneously, an increase in government spending on defense, social protection, reconstruction of damaged infrastructure, and humanitarian aid. The new realities necessitate a radical overhaul of the budget system and the search for innovative ways to finance the state.

The war has become a severe test for Ukraine's budget system. To adapt to the new conditions, there is a need for large-scale reforms aimed at increasing the efficiency of budget spending, attracting investments, and expanding the tax base.

Purpose, subject and research methods

The purpose of this study is to analyze the impact of the full-scale war on the formation of Ukraine's budget system, identify key challenges, and develop recommendations for optimizing budgetary policy both during wartime and in the perspective of post-war recovery.

The relevance of the study is due to the unprecedented shocks that the Ukrainian budget system has experienced as a result of Russian aggression. The decrease in tax revenues, the growth of the budget deficit, the increased dependence on external financial assistance, and the significant increase in military expenditures have become the main consequences of the war. Under conditions of constant changes in the external environment and economic instability, traditional mechanisms of budget regulation have proven ineffective.

The main problems of Ukraine's budget system are: a significant increase in expenditures on defense and security at the expense of reducing funding for other important areas such as education, healthcare, and infrastructure; the growth of public debt and increased dependence on external financial assistance; instability of tax revenues due to the destruction of production capacities, migration of the population, and a decrease in economic activity; the complexity of budget planning due to a high level of uncertainty and constant changes in external conditions; insufficient efficiency of the use of budget funds and the presence of corruption risks

The methods of research

Methods of system analysis and synthesis, methods of abstraction, grouping and generalization.

Research results

The full-scale invasion of Ukraine by Russia has catalyzed an acute budgetary crisis. The sharp increase in defense and social spending, coupled with the decline in tax revenues due to mass migration, economic destruction, and the occupation of parts of the territory, has led to an unprecedented State Budget deficit. To cover the deficit, the government has been forced to attract significant volumes of external financing and issue war bonds.

Due to the significant increase in spending on defense, security, and the social sphere, the gap between budget expenditures and revenues has increased significantly, which means a further increase in the deficit. In the first year of the full-scale war, the Ukrainian economy faced the largest budget deficit in the last 15 years - 914,701.7 million UAH, which is more than 17% of GDP. The budget deficit for 2024 is at the level of 20.7% of GDP, or 1.57 trillion UAH. For comparison: in 2020 and 2021, the budget deficit was 5.18% and 3.63%, respectively (Minfin.com.ua/, October, 2024).

The war has led to a rapid increase in financing needs, and since the beginning of the Russian invasion of Ukraine, the amount of Ukraine's public debt has doubled. In July 2024, the public debt increased by 2.1%, which is equivalent to \$3.20 billion. At the end of the month, the amount of public debt reached \$155.4 billion (Ukrinform.ua, October, 2024).

For many years, the Ukrainian budget system has been characterized by instability and constant reform, caused by the inefficiency of public expenditures, a chronic budget deficit, a significant amount of public debt, and imperfections in intergovernmental relations. The period of 2014-2015, marked by a significant budget crisis caused by military actions in eastern Ukraine, became a catalyst for reforms of the budget system and fiscal relations. In response to the challenges, a set of measures was implemented aimed at increasing the efficiency and transparency of public finances. Among the key reforms, it is worth noting:

1. Fiscal consolidation: A gradual reduction in the share of government expenditures in gross domestic product (GDP) contributed to budget stabilization and reduced the risk of inflation.

2. Introduction of medium-term budgeting: The transition from annual to medium-term budgeting allowed for greater predictability of fiscal policy and more effective planning of government expenditures.

3. Improvement of the program-target method: Strengthening the effectiveness of budget programs contributed to a more rational use of budget funds and improved the quality of public services.

4. Adherence to fiscal rules: The introduction of fiscal rules helped to keep the budget deficit at a controlled level and reduce public debt.

5. Decentralization reform: The delegation of powers and resources to the local level stimulated the economic development of regions and increased the responsibility of local authorities.

Thanks to these reforms, Ukraine has managed to build trusting relationships with international creditors and become a more predictable borrower on the global financial markets. Despite numerous challenges, including armed conflict and the COVID-19 pandemic, the state has managed to maintain macroeconomic stability and avoid significant financial shocks. Stabilization of the economy and the implementation of structural reforms have contributed to a decrease in the share of public debt in GDP, indicating an increase in the sustainability of public finances.

Russia's full-scale invasion of Ukraine in 2022 significantly impacted the country's budget system, causing significant changes in its functioning and financing.

The main consequences of the invasion on the budget system include:

- Decreased revenues and a deepening deficit: Due to the destruction of infrastructure, reduced economic activity, and population migration, there has been a significant decrease in tax revenues to the budget, leading to a deepening budget deficit.
- Increased dependence on external assistance: To cover the budget deficit and finance urgent needs related to the war, Ukraine required significant financial support from international partners. This has led to an increased dependence of the budget system on external financing.
- Structural restructuring of expenditures: There has been a significant reorientation of budget expenditures towards the security and defense sector, humanitarian aid, and the restoration of damaged infrastructure. This has led to a reduction in expenditures in other areas, such as education, healthcare, and social protection.
- Introduction of new financial instruments: To raise additional funds to finance military expenditures, war bonds were issued.

- Increased burden on local budgets: Local budgets have also been significantly burdened by the war, as they have had to take on part of the costs of ensuring the functioning of communities and providing assistance to displaced persons.

Under such extreme conditions, it became impossible to adhere to previously established budgetary rules, as they were developed for peacetime. Instead, the state was forced to quickly adapt to new realities and seek alternative sources of financing.

Given the foregoing, the key challenges for the state are: the restoration of the economy and the budget system after the end of the active phase of hostilities, which will be one of the main tasks, namely, the restoration of the economy and stabilization of the budget system. The war has revealed the weaknesses of the budget system, so after the end of the war, it will be necessary to reform it in order to increase its efficiency and resilience to external shocks.

Russia's full-scale invasion of Ukraine has been a serious test for the country's budget system. The war has led to significant changes in the structure of budget expenditures, increased dependence on external assistance, and a departure from previously established budgetary rules. Ongoing hostilities, the destruction of infrastructure, and mass migration of the population have led to a significant increase in government spending and a decrease in government revenues.

Key terms and phrases explained:

- Full-scale invasion: A large-scale military attack
- Budget system: The system of managing public finances
- Budget deficit: The amount by which government spending exceeds government revenue
- External financing: Financial assistance from foreign countries or international organizations
- Structural restructuring: Significant changes in the way something is organized
- War bonds: Bonds issued by a government to finance a war
- Fiscal rules: Regulations that govern a government's budgetary policy
- External shocks: Sudden and unexpected events that have a significant negative impact on an economy

This translation aims to accurately convey the meaning of the original Ukrainian text while using appropriate economic terminology. If you have any further questions or require additional explanations, please feel free to ask.

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Table 1. Expenditures on security and defense for 2024-2025 (state budget), UAH billion

Expenditure Metrics	2024 (01.01.2024)	2024 (taking into account salary changes)	2025 (project on 12.09.2024)
Total Expenditures	1692,6	2176,7	2223,0
Compensation and Benefits	1071,1	1149,0	1158,4
Armaments and Military (Special) Hardware, of which:	447,7	704,9	737,2
Ministry of Strategic Industries (defense industry complex development)	51,0	39,8	54,6
State Special Communications Service (UAV procurement)	43,3	43,3	46,9
Government Guarantees	30,0	30,0	30,0
Other Expenditures	173,8	322,8	327,4

Source: Based on: *Economic Truth*, 2024

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The allocation for the security and defense sector in 2025 is set to rise to 2,223 billion UAH, constituting 26.3% of the projected GDP. This allocation encompasses monetary, material, and food provisions for the military, procurement of armaments and military hardware, and support for the defense industrial base (Ligazakon.net, October 2024).

Key factors substantially influencing the budget deficit during wartime can be identified as follows:

1. Intensity of hostilities: The severity of armed conflict directly correlates with the scale of defense expenditures and reconstruction costs.
2. International aid: The magnitude of international financial assistance significantly impacts the government's capacity to finance the budget deficit.
3. Public financial management efficiency: The effectiveness of public finance management determines the optimal utilization of funds and minimization of losses.
4. Economic conditions: The state of the economy influences the level of tax revenues and the demand for government expenditure.

Summary

The socio-economic life of the country during active hostilities is quite complicated by a number of unforeseen external and internal circumstances, often changing the intended course. However, in wartime, effective public finance management is critical to ensuring the country's defense capability and supporting the economy. Several key areas can be identified to help improve efficiency:

1. Transparency and openness of the budget process: publication of detailed budgets (regular publication of budgets at all levels, including information on sources of income and expenditure; electronic procurement system - implementation of transparent electronic procurement systems that will prevent corruption and ensure competition; audit and control - systematic audits and financial control to identify and prevent abuses);

2. Optimization of budget expenditures: prioritization of expenditures (concentration of resources on the most important areas, such as defense, humanitarian aid, and infrastructure restoration); review of programs and projects (regular review of existing programs and projects with a view to their optimization or liquidation of ineffective ones); reduction of administrative expenses (reduction of costs for maintaining the state apparatus and optimization of its structure);

3. Strengthening financial discipline: establishment of clear rules and procedures for budget execution; strengthening accountability for inefficient use of funds (introduction of accountability mechanisms for officials involved in abuses); incentives for efficiency (creation of a motivation system for public servants that will stimulate them to work effectively);

4. Attracting international aid: ensuring transparent distribution of international aid and its effective use; cooperation with international organizations; active cooperation with international financial organizations to obtain consultations and technical assistance; development of digital technologies;

5. Implementation of e-government: transition to e-government to increase the efficiency of providing administrative services and reduce corruption; use of data analytics (application of data analytics for making informed budget decisions);

6. Public involvement: transparency and openness (ensuring wide public access to budget information; public consultations (involving the public in the discussion of budget decisions); public control (creating effective mechanisms of public control over the use of budget funds); improving the qualifications of public servants (training programs: development and implementation of training programs for public servants in the field of finance; exchange of experience: providing opportunities for exchange of experience with specialists from other countries).

Therefore, despite the complexity of all aspects of the state's functioning, public financial management plays a key role. The effectiveness of this process affects not only the volume of financing for mandatory expenditures but also the potential and necessary implementation of international aid programs, which are extremely necessary to ensure the current functioning of the country.

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Abstract

The full-scale war in Ukraine has led to fundamental changes in the functioning of the budget system. This article analyzes the consequences of the military actions and their impact on the formation of the budget system in Ukraine, in particular: the growth of defense and security expenditures, the increase in the deficit, and the attraction of significant external financial assistance. The author analyzes the problems that Ukraine faces during the war in filling the revenue side of the budget and proposes solutions, including tax system reform, expenditure optimization, and strengthening financial discipline.

Keywords: budget system, deficit, military actions, government debt, external financial assistance, tax revenues, government expenditures

JEL Classification: G00, G01