



The Functioning of Ukraine's Budgetary System in Wartime Conditions

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ABSTRACT

The proper functioning of a budgetary system during wartime is crucial for supporting a country's defense capabilities and fulfilling its essential social functions. This study aims to analyze key indicators of the efficiency and security of Ukraine's budgetary system in wartime conditions. The research employed methods such as economic and statistical analysis, comparative analysis, and normative and marginal analysis. The results of the study analyzed trends in state budget expenditures and revenues. A separate analysis of the budget deficit showed a significant increase (to more than 20% in 2023), indicating a need for additional financing. The structure of state budget revenues and expenditures has also changed significantly. The share of tax revenues has decreased, while defense spending constitutes about 50% of expenditures. However, the main problem remains the growing external state debt, which has nearly reached 100% of GDP. At the same time, the available gold and foreign exchange reserves can cover only 40% of the debt. Based on the research conducted, recommendations were formulated that can guide government officials in shaping future budgetary and tax policy.

Keywords: Budgetary System, Tax Policy, State Budget Revenues and Expenditures, Local Budgets, Budget Security, External State Debt

JEL Classifications: H26; H61; R1; R5.

1. INTRODUCTION

In times of war, a deterioration in the key indicators of the budgetary system, particularly budgetary security, is inevitable (Akimov et al., 2020). War results in an increase in external public debt, a decrease in tax revenues due to a decline in economic activity, and significant expenditures on defense and the restoration of critical and residential infrastructure (Khan et al., 2021; Torregrosa-Hetland and Sabaté, 2022). The characteristics of a budgetary system during wartime include increased military spending, higher taxes, raising additional funds for defense, and reductions in spending in other areas (Tymoshenko, 2023). These aspects lead to imbalances in the budget. Therefore, budgetary policy during wartime must be

particularly well-balanced. Decisions on securing international support and loans must take into account future possibilities for servicing debt and repaying funds (Schmidt, 2024). Domestic policy, in particular tax policy, must find the optimal balance between incentives and restrictions, in order to avoid making the tax burden excessive while simultaneously expanding the tax base (Aisyah et al., 2024; László, 2024).

When analyzing the functioning of Ukraine's budgetary system in wartime conditions, it is important to examine a number of key performance indicators. These include the revenues and expenditures of the state and local budgets, the level of the budget deficit and external public debt, indicators of budgetary

security, and others (Lelyk et al., 2022). Among other things, this is important for forming a strategy for post-war reconstruction, as the observed indicators reflect the state's financial capabilities for economic growth (Kulikov et al., 2022). It is necessary to focus not only on the current state but also on historical and forecast data. The analysis of data from previous years allows for identifying the nature of several current problems, while the study of forecasts contributes to the development of more accurate recommendations. The aim of the research is to analyze the key indicators of the efficiency and security of Ukraine's budgetary system in wartime conditions. To achieve this, it is necessary to:

- Conduct an analysis of the trends and structure of the revenues and expenditures of Ukraine's state and local budgets
- Assess the dynamics of Ukraine's external debt and carry out a comparative analysis of debt volumes with indicators such as GDP, gold and foreign exchange reserves (FER), and others
- Analyze the indicators of budgetary security, including forecast data
- Formulate analytical conclusions and recommendations.

2. LITERATURE REVIEW

The functioning of Ukraine's budgetary system during wartime is a critical topic for national economic research. Numerous scholars have examined trends in key indicators related to the national budget. Tymoshenko (2023) analyzed trends in specific performance indicators of Ukraine's budgetary system under various challenges, including the budget deficit and tax revenues. Bui and Priemerova (2024) conducted an analysis of GDP dynamics, budget expenditures, and the consolidated budget deficit. Both studies emphasize the significant deterioration of economic problems following the start of the war. Sidelnikova and Posadnieva (2023) investigated Ukraine's budgetary security indicators, concluding that budgetary security was already compromised before the war, and the situation became dire after its onset. Bida and Ruda (2022) focused on a general analysis of the deterioration of key economic indicators due to the war, including GDP decline, reduction in gold and foreign exchange reserves, investments, and the increase in public debt.

Some studies focus on a deeper analysis of specific components of the state budget in wartime conditions. Chuhunov et al. (2022) examine state budget revenues, noting the problem of declining tax revenues even during short-term conflicts. Similar conclusions were reached by Voznyak and Dmytryk (2022), who identified the fiscal deficit as one of the main problems since the beginning of the military invasion of Ukraine. Liutii et al. (2023) focus on optimizing state budget expenditures. The need for optimization is driven by such issues as the lobbying of non-priority projects, corruption, misallocation of funds, and insufficient public oversight (Melnik et al., 2022).

The problem of inadequate defense funding is reflected in many other studies as well. Cheberyako and Cheberyako (2022) noted that this issue depends on the country's adopted military doctrine, which may include: (1) a complete refusal to allocate funds for defense; (2) the creation of a strong military superpower; or (3) adherence to the principle of minimum sufficiency. The second

approach is applied, for example, in the USA, where national defense expenditures accounted for 12% of the state budget in 2022 (Bartels, 2024). The third approach corresponds to the actions of the Ukrainian government before the armed aggression. The defense budget is closely linked to GDP (Pandia et al., 2022), and according to Ukrainian law, defense expenditures must account for at least 3% of GDP. At the same time, the structure of Ukraine's defense budget before the aggression did not align with global standards – about 80% was directed towards maintaining the core personnel. In NATO countries, this figure reaches only 50%, with the rest spent on operational needs, military research and development, and weapons procurement. Undoubtedly, Ukraine's defense expenditures increased after the large-scale invasion began. In 2022, they accounted for over 36% of total expenditures compared to 6% in 2014, but their structure is changing slowly.

The problems caused by the Russian-Ukrainian war in the economic sphere are reflected in the works of researchers from other countries (Mbah and Wasum, 2022; Liadze et al., 2023; Ozili, 2024). Becker et al. (2023) acknowledges the catastrophic scale of destruction for Ukraine. The scholar notes that, even with the support of foreign partners, post-war public finances will face significant pressure. This is due to the reduction of the workforce and the overall economy, as well as the inability to raise taxes amid the economic downturn.

Many studies also note that it is not only Ukraine's budgetary sphere that suffers from the war (Rubio, 2022; Dorn et al., 2023; Genschel et al., 2023). Christie et al. (2024) and Tian et al. (2023) investigated changes in the defense budgets of countries whose security environment has been disrupted by the war in Ukraine. Blanchard and Pisani-Ferry (2022) highlighted the consequences of the war for Europe, particularly fiscal ones, linked to the influx of refugees and rising defense costs. The most significant impact, according to the scholars, will come from the redistribution of national income, rising prices for food and energy resources. Dorn et al. (2024) noted the growing danger for European countries, prompting researchers to call for an urgent increase in defense spending.

Fabbrini (2023) pointed out that the war has united the European Union countries in their efforts to support Ukraine but has revealed their insufficient fiscal capacity. The use of joint borrowing is an important support tool, but issues in management and structural fiscal problems need to be addressed. In this context, Zgaga (2023) examined the problem that the European Union has not yet achieved fiscal sovereignty. Fiscal sovereignty could become a means of strengthening coordination between countries and improving financial efficiency in supporting Ukraine.

The review indicates that scholars predominantly focus on individual components of the budgetary system. At the same time, a comprehensive analysis is necessary to provide a complete picture of the state and prospects of the budgetary system during wartime. Such an analysis should include an examination of state budget expenditures and revenues, public debt trends, budgetary risks, local budgets, and more. The insufficient coverage of the topic and the constantly changing wartime conditions make further

research essential. The presented study offers an in-depth analysis of key trends in the budgetary sphere and provides a number of recommendations for further actions, taking into account the latest relevant data and events.

3. METHODOLOGY

3.1. Research Procedure

The study includes a sequential analysis of Ukraine's budgetary system in terms of its individual components. At the first stage, attention was focused on the state budget, which is the primary source of funding for government functions. The trends in the expenditure and revenue sides of the state budget were analyzed, with the relationship between them demonstrated through the budget deficit indicator. The aim of this stage was to identify discrepancies between state revenues and expenditures, which allows for determining whether the government requires additional financing. Additionally, state budget revenues were assessed in terms of the main revenue items, while expenditures were classified economically and functionally. The purpose of these actions was to clarify the structure of revenues and expenditures, specifically identifying the sources from which the government generates funds and the purposes for which these funds are allocated. At the second stage of the study, it was important to evaluate the trend of defense expenditures within total expenditures to determine how effectively defense was funded during various periods. The expenditures and revenues of local budgets were examined as an important component of the consolidated state budget. Within the framework of the third stage, trends (including forecasted) of budgetary security indicators were demonstrated. The aim of this was to describe the existing and potential threats to the budgetary system, arising from current issues.

3.2. Sample

The sample indicators for the study consist of the following indicators:

- Revenues and expenditures of the state budget of Ukraine for 2008-2023 (in absolute terms and as a percentage of GDP)
- The volume of the budget deficit of Ukraine for 2008-2023 (in absolute terms and as a percentage of GDP)
- Revenues of the state budget of Ukraine by main revenue items for 2019-2024, million UAH
- Expenditures of the state budget of Ukraine in 2024, million UAH (economic classification)
- Expenditures of the state budget of Ukraine in 2024, million UAH (functional classification)
- Defense expenditures and their share in total expenditures and GDP for 2014-2024
- Expenditures and revenues of the consolidated budget of Ukraine for 2011-2023
- The share of local budgets in the revenues of the consolidated budget in 2017-2023 (excluding transfers)
- Revenues of the general fund of local budgets excluding transfers for 2022-2023, billion UAH
- Expenditures of local budgets and the state budget in 2023 by sectors, billion UAH
- Indicators of budget security starting from 2018 with projections for 2028, % of GDP

- The ratio of international reserves to the volume of external state debt for 2009-2023
- The sources of information were the official websites of the Ministry of Finance of Ukraine, the International Monetary Fund, and the All-Ukrainian Association of Amalgamated Territorial Communities (AATC) of Ukraine (International Monetary Fund, 2023; Ministry of Finance, 2024; AATC, 2024).

3.3. Methods

The main method of the research was economic-statistical analysis, which allowed for the identification, comparison, and evaluation of trends in the studied indicators and their structure. This provided important information for forming conclusions and proposals for the research. A significant role was played by the method of comparative analysis, which helped identify existing imbalances. The combination of normative and marginal analysis methods allowed for the characterization of the current state and prospects of budget security. By comparing actual and forecasted budget security indicators with their normative values, it became possible to identify key risks and propose measures for stabilizing the situation.

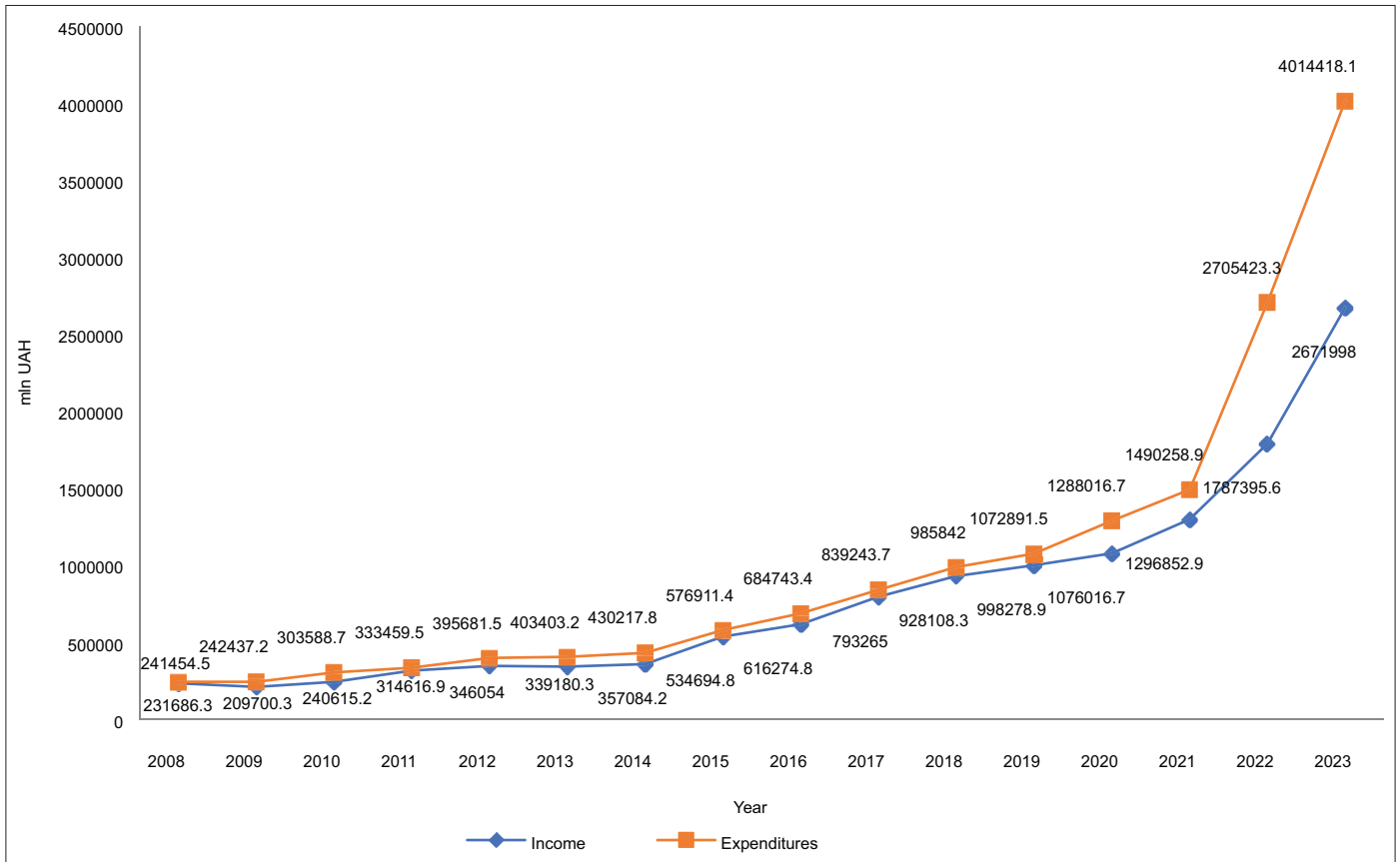
4. RESULTS

The state budget is the primary instrument for resource redistribution, financing state programs, social needs, and national defense. In the context of war, proper revenue collection for the state budget and balanced expenditure distribution are critically important for ensuring defense capabilities. The trends in revenues and expenditures of the state budget are presented in Figure 1.

Throughout the studied period, the revenues and expenditures of the state budget of Ukraine have shown a tendency for continuous growth. Up until 2020, there was no significant predominance of expenditures over revenues. However, during the spread of the COVID-19 pandemic, the growth rate of expenditures began to noticeably outpace the growth rate of revenues. The most significant leap occurred in 2022, following the full-scale invasion of Ukraine. The ratio of expenditures to revenues reached 52.12-34.43% of GDP, and in 2023, the gap exceeded 20%. These trends are particularly evident in the analysis of the budget deficit (Figure 2). As seen in Figure 2, the budget deficit was present throughout the entire studied period. The years 2013-2014 were marked by an increase in the budget deficit, which was associated with the beginning of Russian aggression against Ukraine. After a noticeable rise in the budget deficit in the year the pandemic started, Ukraine's economy began to return to its pre-quarantine state in 2021. However, this was followed by a full-scale invasion. The deficit reached a record low of -17.62%, increasing to -20.39% of GDP in the following year.

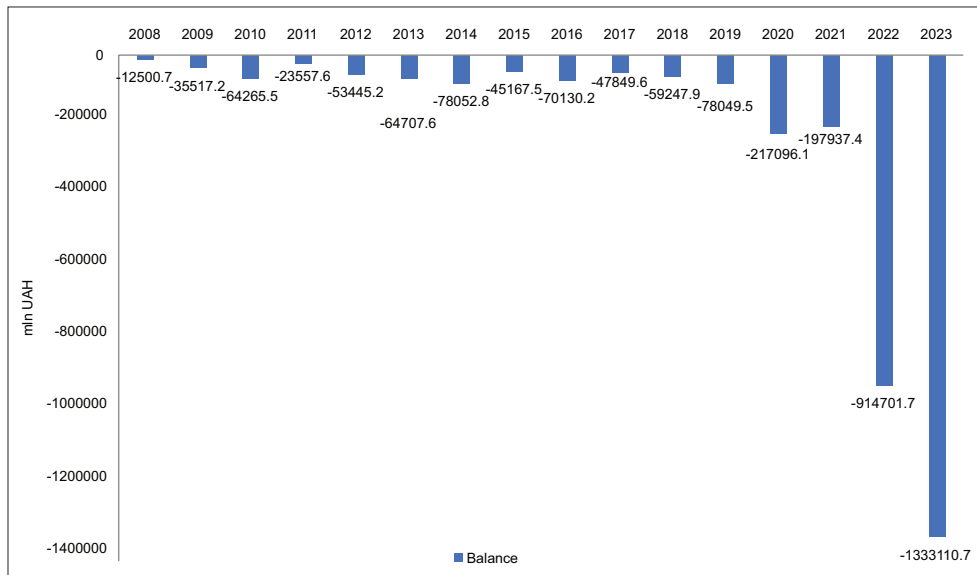
When analyzing the revenues of the state budget by revenue items in terms of their structure, it is worth noting the predominance of the share of tax revenues. Tax revenues are the main source of state budget income for many countries. In Ukraine, until 2022, their share ranged from 79.9% to 86.2% (Figure 3).

Figure 1: Trends in revenues and expenditures of the state budget of Ukraine (in absolute terms and as a percentage of GDP)



Source: Constructed by the author based on data from the Ministry of Finance (2024)

Figure 2: Trend in the change of the budget deficit of Ukraine (in absolute terms and as a percentage of GDP)

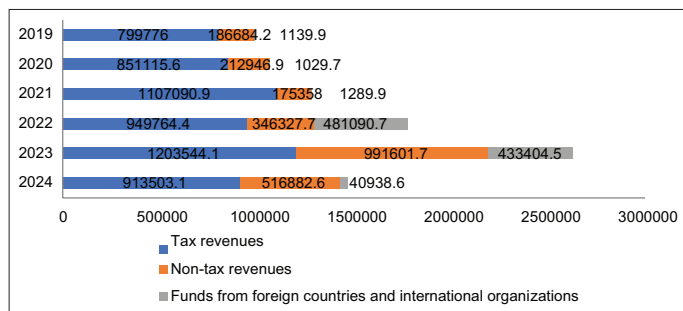


Source: Constructed by the author based on data from the Ministry of Finance (2024)

In 2022, there was a noticeable reduction in tax revenues. In contrast, non-tax revenues increased primarily due to the own revenues of budget institutions and income from property and entrepreneurial activities. Additionally, with the support of international partners, the volume of funds from other countries and

organizations significantly increased, which previously constituted a minor share of the budget's revenue part. In 2023, these two revenue items together accounted for more than half of all budget revenues. However, in 2024, the share of funds from other countries and organizations (as of August 1) remains insignificant.

Figure 3: Revenues of the state budget of Ukraine by main revenue items, million UAH



Source: Constructed by the author based on data from the Ministry of Finance (2024)

The expenditures of the state budget can be viewed through two classifications: functional and economic. The economic classification distinguishes state budget expenditures based on their economic essence, dividing them into current and capital expenditures. The expenditures of the state budget of Ukraine for 2024 according to the economic classification are presented in Figure 4.

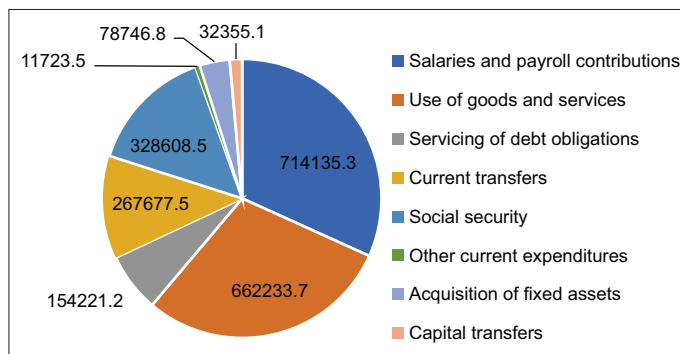
Most of the expenditures according to the classification presented in Figure 4 are directed toward wage payments, the use of goods and services, and social protection. The functional classification shows the directions of expenditures according to the functions performed by the state. Figure 5 presents the state expenditures specifically in terms of this classification.

The wartime conditions highlight the necessity of maintaining the state's defense capabilities. Thus, approximately half of the state budget expenditures in 2024 were directed toward defense. Significant amounts of expenditures are allocated for maintaining public order, security, and the judiciary, as well as social protection and provision. For example, in peacetime (from 2019 to 2021), the largest portion of expenditures was directed toward social protection and social provision, accounting for 20-25% of total expenditures. Table 1 presents the dynamics of defense expenditures from 2014 to 2024.

As seen in Table 1, defense expenditures were not given adequate attention even after the events of 2014 – at that time, they accounted for <3% of GDP. A significant increase in expenditures occurred only after the full-scale invasion. During this period, they reached over 22% of GDP and over 42% of total budget expenditures.

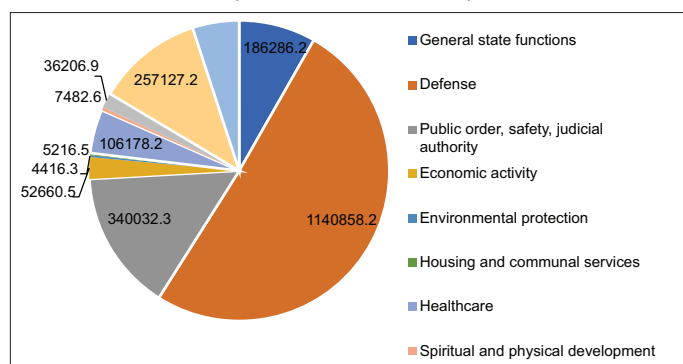
The state budget is part of the consolidated budget, which encompasses all budgets of the country, including local ones. According to the budget declaration for 2022-2024, the share of local budgets in the consolidated budget should be no <20%. As of 2023, this indicator has significantly decreased, amounting to only 17.8% of the revenues of the consolidated budget (Figure 6). This is due, firstly, to the increase in the share of revenues to the state budget, and secondly, to the withdrawal from local budgets of the full volume of revenues from one of the taxes.

Figure 4: Expenditures of the state budget of Ukraine, million UAH (economic classification)



Source: Constructed by the author based on data from the Ministry of Finance (2024)

Figure 5: Expenditures of the state budget of Ukraine, million UAH (functional classification)



Source: Constructed by the author based on data from the Ministry of Finance (2024)

Table 1: Expenditures of the state budget on defense and their share of total expenditures and GDP

Year	Defense, million UAH	% of Total Budget Expenditures	GDP, million UAH	% of GDP
2014	27363.4	6.36	1566728	1.75
2015	52005.2	9.01	1979458	2.63
2016	59348.9	8.67	2383182	2.49
2017	74346.2	8.86	2982920	2.49
2018	97024	9.84	3558706	2.73
2019	106627.7	9.94	3974564	2.68
2020	120374.1	9.35	4194102	2.87
2021	127527.3	8.56	5459574	2.34
2022	1142872	42.24	5191028	22.02
2023	2097621	52.25	6537825	32.08
2024	1140858	50.71	n/d	n/d

Source: constructed by the author based on data from the Ministry of Finance (2024)

In general, regarding the revenues of local budgets, there was an increase for all regions during the period from 2022 to 2023. Exceptions include the Donetsk, Luhansk, and Kherson regions (Figure 7). Most of these territories are temporarily occupied.

At the same time, expenditures from local budgets are crucial for supporting the functioning of specific sectors of the economy. These sectors include education, economic activity, housing

and communal services (HCS), as well as spiritual and physical development. Local budgets also play a significant role in carrying out nationwide functions (Figure 8).

Thus, both the state and local budgets play an important role in supporting defense capabilities, public order, and the fulfillment of social functions by the state. However, considering the ongoing war and the problems characteristic of Ukraine's budget system prior to the invasion, its current state can be described as critical. This is confirmed by the indicators of budget security (Figure 9).

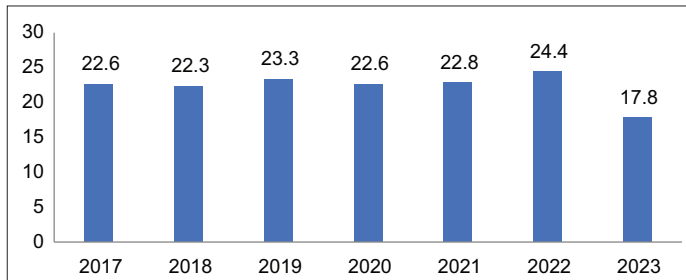
General government net lending/borrowing demonstrates negative values throughout the entire period, indicating the presence of a budget deficit, as mentioned earlier. The level of the General government revenue indicator, as defined by the Methodological Recommendations for Calculating the Level of Economic Security of Ukraine, is considered critical if it exceeds 37% of GDP. Therefore, the level of this indicator has been critical in all years except for 2021. In wartime conditions, this is related to the need

to attract additional resources and ensure effective responses to current challenges. The General government structural balance shows what the budget balance could have been under normal economic conditions, fully supported by current policy. This indicator demonstrates the possible state of the economy if it were not affected by certain temporary factors and emergencies. A zero value of the indicator, projected from 2023 onwards, can be considered optimal.

Particular attention should be given to the General government gross debt indicator. This indicator reached nearly 80% of GDP in the year of the invasion, and it is projected to exceed 100% of GDP by 2025. According to the Maastricht criterion, this indicator should not exceed the benchmark value of 60%. However, reaching a value of 100%, meaning the debt reaches the volume of all goods and services produced in the economy, indicates a significant risk to financial stability. Figure 10 shows the trends of another important indicator in the context of debt security – the ratio of the country's international reserves to the volume of state debt.

As seen in Figure 10, after the invasion, the value of the indicator significantly decreased. In 2022 and 2023, international reserves could cover only about 40% of external state debt. This poses a high risk of financial instability and even the risk of default. If Ukraine needs to quickly repay its debts, it may face significant difficulties in finding ways to mobilize the necessary resources.

Figure 6: Share of local budgets in the revenues of the consolidated budget (excluding transfers)

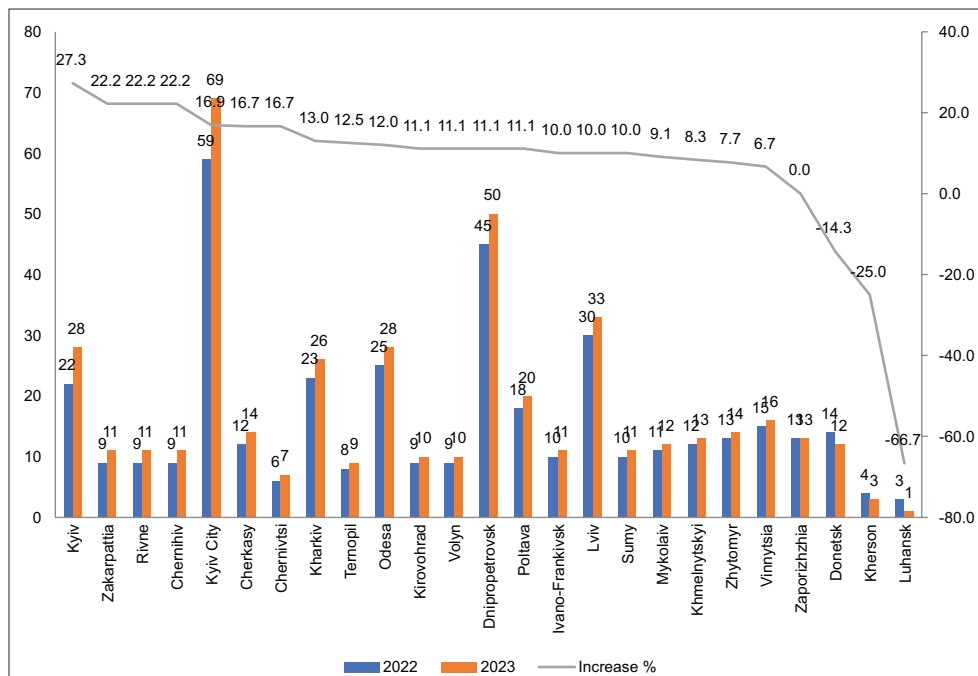


Source: Constructed by the author based on data from the All-Ukrainian Association of Amalgamated Territorial Communities (AATC, 2024)

5. DISCUSSION

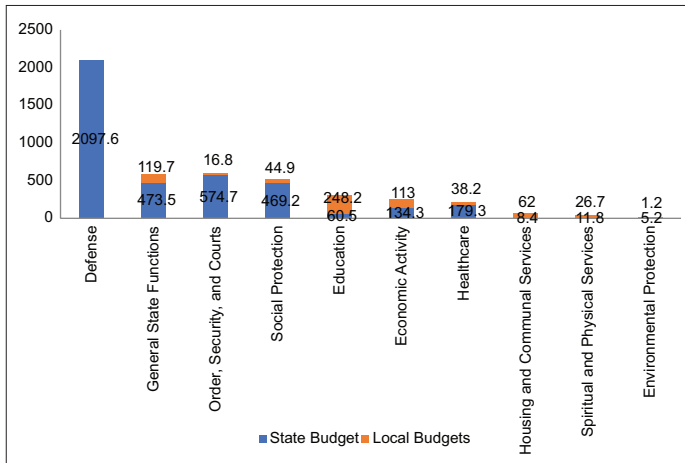
The conducted analysis has allowed for the assessment of current and projected trends in the budget system of Ukraine. Among the most threatening trends is the increase in the volume of state debt. Negative trends also include the reduction in tax revenues

Figure 7: Revenues of the General Fund of local budgets excluding transfers, billion UAH



Source: Constructed by the author based on data from the All-Ukrainian Association of Amalgamated Territorial Communities (AATC, 2024)

Figure 8: Expenditures of local budgets and the state budget in 2023 by sector, billion UAH



Source: Constructed by the author based on data from the All-Ukrainian Association of Amalgamated Territorial Communities (AATC, 2024)

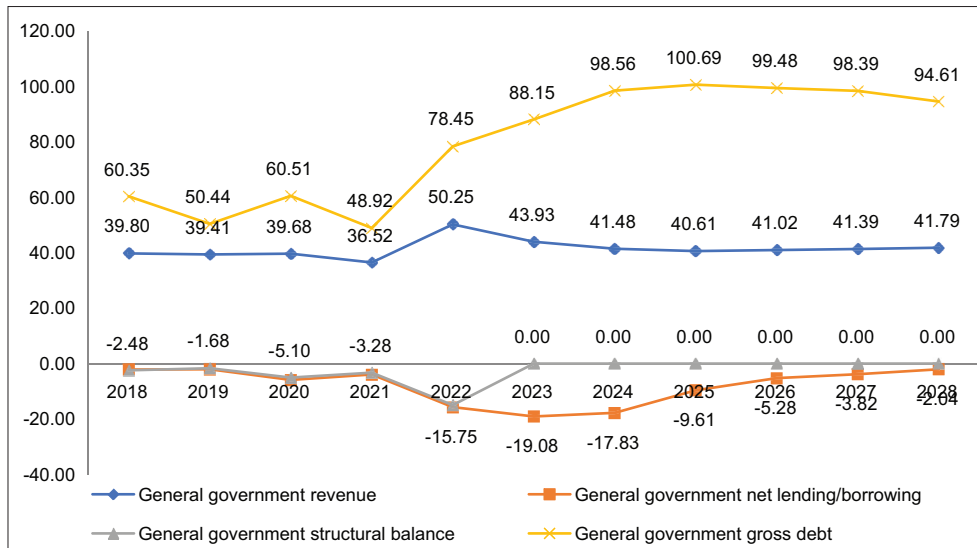
and the insufficient share of local budgets in the revenues of the consolidated budget.

Several studies have also analyzed the problems of Ukraine's budget system caused by the war. Like the author's work, significant attention is given to the evaluation of tax revenues and ways to optimize tax policy. Tymoshenko (2023) emphasizes that the desire to increase the budget through tax increases may not be the most effective solution in the context of an economic crisis. Agreeing with these conclusions of the researcher, the author's work proposes a number of alternative paths for optimizing tax policy.

At the same time, alongside the analysis of problems, it is important to propose specific solutions considering the current conditions. Sidelnykova and Posadnieva (2023) pointed out the impossibility of refraining from borrowing funds in wartime and during post-war

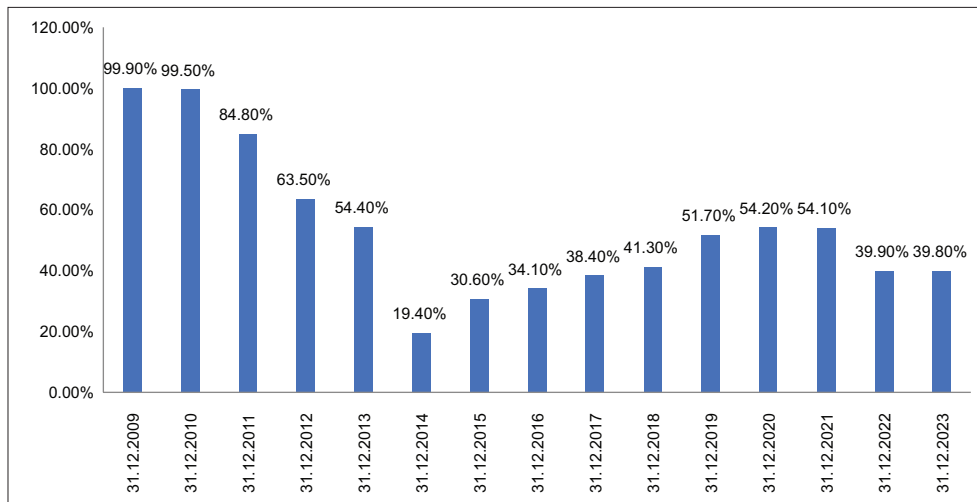
1. After 2022, the International Monetary Fund provides projected values for the specified indicators.

Figure 9: Indicators of budget security projected for 2028, % of GDP¹



Source: Constructed by the author based on data from the International Monetary Fund (2023)

Figure 10: The ratio of international reserves to the volume of external state debt



Source: Constructed by the author based on data from the Ministry of Finance (2024)

reconstruction. The priority areas for the use of funds should be the rebuilding of infrastructure, housing, and production facilities, as well as providing the population with social and medical services. After the war, it is necessary to focus on developing sustainable infrastructure, enhancing the competitiveness of the economy, and improving the quality of the workforce (Prykaziuk et al., 2023; Kulikov et al., 2022). Becker et al. (2023) also consider the participation of international partners in post-war reconstruction to be essential. Among the measures proposed by the researcher, the necessity of negotiations for debt relief, expanding the tax base, and privatizing state enterprises are highlighted. These views have been taken into account and expanded upon by the author during the formation of their own recommendations.

A key topic in many works is ensuring adequate financing for the defense sector. Pandia et al. (2022) noted that to increase the volume of defense budgets, states may resort to implementing a number of measures. However, scholars focus on increasing the defense budget in peacetime, which may not meet the demands of wartime. Instead, Liutii et al. (2023) examined priority directions of budget policy in the defense sector specifically during wartime, using Ukraine as an example. The scholars believe that the priority areas for state budget expenditures should be financing innovative developments in the military sphere and creating enterprises for the repair of weapons. Assistance to citizens who have become victims of the war and the restoration of critical infrastructure are also important.

Many researchers analyze the impact of the Russian-Ukrainian war on the defense budgets of other countries as well. Dorn et al. (2024) are convinced that all European countries must immediately increase defense spending in light of the rising level of danger. To achieve this, governments should allocate at least 1% of non-defense expenditures to defense purposes. Regarding the current situation, Tian et al. (2023) established that higher defense spending is characteristic of countries geographically close to the aggressor. This conclusion was also reached by Christie et al. (2024), who highlighted different types of behavior of countries in this context. For example, for Poland, increased attention to the defense sector is mandatory, while the behavior model of Hungary is defined by researchers as “antagonistic free management.” In other words, this is an approach that may contradict the goals of other alliance members, while the country continues to benefit from its membership. Despite Hungary's contradictory actions, many studies note the solidarity of European countries in supporting Ukraine and the rapid mobilization of resources (Fabbrini, 2023). However, some important issues remain unresolved, such as the lack of fiscal sovereignty in the European Union (Zgaga, 2023). Achieving fiscal sovereignty could significantly enhance the effectiveness of support for Ukraine. Moreover, resource mobilization for support could occur without the need to coordinate these matters with each member state. The author's research focuses on Ukraine's budgetary system but also emphasizes the need for international support and the development of relationships with partners. Considering the authors' conclusions, an important direction for further research may be to explore ways to improve coordination among Ukraine's international partners to unite and enhance the effectiveness of efforts to counter the aggressor.

Thus, the main goal of the work was achieved – analyzing key indicators of the effectiveness and security of Ukraine's budget system in wartime. The results align with and complement the conclusions of other authors. The recommendations presented in the conclusions can be practically applied by the government to optimize budget and tax policy.

6. CONCLUSIONS

The budget system of Ukraine faced various problems before the war; however, with the onset of the invasion, these issues have significantly deepened. This necessitates careful monitoring and timely adjustment of budgetary policies, as well as the effectiveness and security indicators of the budget system. The main problems that have intensified since the start of the war include the increase in external state debt to nearly the level of GDP, as well as the lack of adequate reserves to cover it. The structure of revenues and expenditures in the state budget has also changed. The share of tax revenues has decreased due to the slowdown in economic activity, while the majority of expenditures are on defense. Defense spending is necessary to maintain the state's defense capability in wartime; however, at the same time, the state is forced to economize on other expenditure items.

The conducted analysis allows for a number of recommendations and key directions for further action to address the problems of the budget system:

- Fiscal policy requires special attention; however, the author does not see an increase in the tax burden as an effective solution. On the contrary, reducing it and simplifying taxation procedures could attract the shadow economy into the official sector, potentially expanding the tax base. Furthermore, support for small and medium-sized enterprises (including fiscal aspects) should increasingly be provided, as they can become an important engine for economic growth
- The issue of the large volume of state debt should be addressed through negotiations with partners regarding restructuring and improving the terms of its servicing. In addition, in the future, when obtaining new loans, conditions should be established that minimize the state's debt burden
- Ensuring transparency in the budget system and the targeted use of funds is a necessary requirement for the normal functioning of the country's economy as a whole. Corruption, the lobbying of non-priority programs, and insufficient public oversight are pervasive and pressing issues in Ukraine, making their resolution a priority task
- Monitoring and saving budget expenditures are also important tasks that should prioritize expenditures on key areas such as defense and social needs, the restoration of critical infrastructure, and so on;
- The digitalization of the budget process can be a very useful tool at all its levels, as it will enhance transparency, reliability, accountability, and the speed of fund distribution;
- The continuation of the decentralization reform can contribute to increasing the efficiency of local budgets. Especially in wartime conditions, local authorities will be able to respond more quickly and effectively to unforeseen events and crises.

Additionally, by understanding the specifics of their territories, they will be able to allocate resources to priority tasks and enhance their investment attractiveness through support for the development of specific business sectors.

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