choices, but the actual process of decision making considering political risk has been clouded by secrecy and the difficulty of measuring outcomes months or years forward. The efforts by Chr. Bernanke to provide explanations of the deliberations and forward guidance may aid, but may also allow observers and critics to recognize deviations from the economic theory prescription. Of course the various «audiences» will evaluate the statements from their perspective and what one may see as a bias another may see a within the bounds of a rational application of economic theory. Probably more information is an improvement, but may help the central bankers little in gaining support for monetary policy actions. No matter what political risk aversion will continue as the silent partner.

Cognitive dissonance favoring past positive experiences over negative ones and causing a failure to accurately observe the present.Consider «high» interest rates, dealing with «stagflation,» fear of deflation.Biased self-attribution and dependency on past experiences.

Pavlo LUTSIV
Kyiv School of Economics

FIXED EXCHANGE RATE: VERY EXPENSIVE WHIM

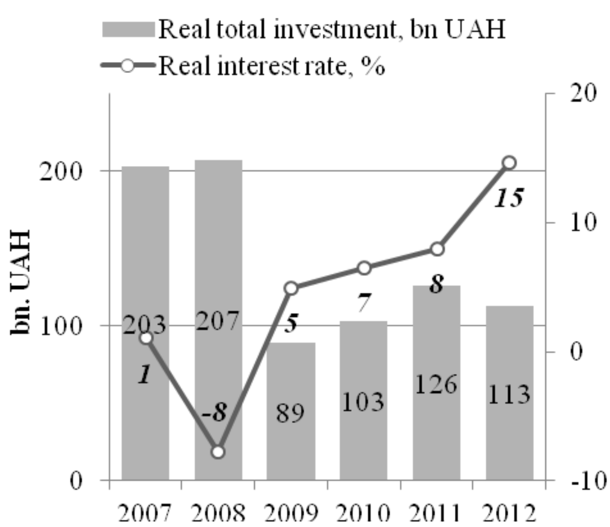
Ukraine follows fixed exchange rate over a long period of time, starting with hryvnia introduction in 1996 to date. National government asserts that such kind of monetary policy makes our economic system more stable. Yet its cost to the society remains ambiguous.

One main disadvantage is alteration of real exchange rate. Different rates of inflation between Ukraine and its major trading partners stimulate the increase in real exchange rate, causing export to decline and import to grow. Another drawback is that current high inflation expectations rocket real interest rate which, in turn, brings about decrease in investment. Investment and net export are two out of four country's GDP components, so their change depresses national income. The government attempts to stabilize the shocks in exchange rate using foreign currency reserves. The consequences are fall in reserves from US$38 bn in August 2011 to US$25 bn to date, though the situation here is not as deplorable as many analysts state.

In order to make an inference whether the current monetary policy justifies itself there was performed an analysis of real exchange rate, net export and NBU's reserves.

Figure 1. The dynamics of real total investment and real exchange rate in Ukraine, 2007-2011

Year	*Nominal interest rate, %*	*Inflation rate, %*	*Real interest rate, %*	*Real total investment, bn UAH*
2007	13.9	12.9	1.1	203
2008	17.5	25.2	-7.7	207
2009	20.9	15.9	5.0	89
2010	15.9	9.4	6.5	102.8
2011	16.0	8.0	8.0	126.1
2012	16.0	1.3	14.7	112.9



Source: State Statistics Service of Ukraine

The data above illustrate the dependence of total investment (fixed investment plus stock building) on real interest rate. The correspondent regression shows that on average, ceteris paribus, for 1 percent point increase in real interest rate total investment falls by 1.4%. Nowadays the total investment is twice lower than its pre-crisis level with the low probability to rebound taking into consideration current government policy. The situation has been aggravated by the population expectations of currency depreciation. And finally we must take into account that since the interest rate is the cost of capital, its higher value forces companies to decrease number of employed capital. In sectors where capital and labor are complements it also reduces the amount of employed labor raising unemployment.

Our next step will be to investigate the net exports part:

Table 1. National trade balance performance, 2007-2012, bn UAH

Year	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Real export	323.2	341.7	266.4	276.8	282.9	277.4
Real import	364.3	426.4	260.6	290.0	338.7	357.9
Real net export	-41.1	-84.7	5.7	-13.2	-55.8	-80.5

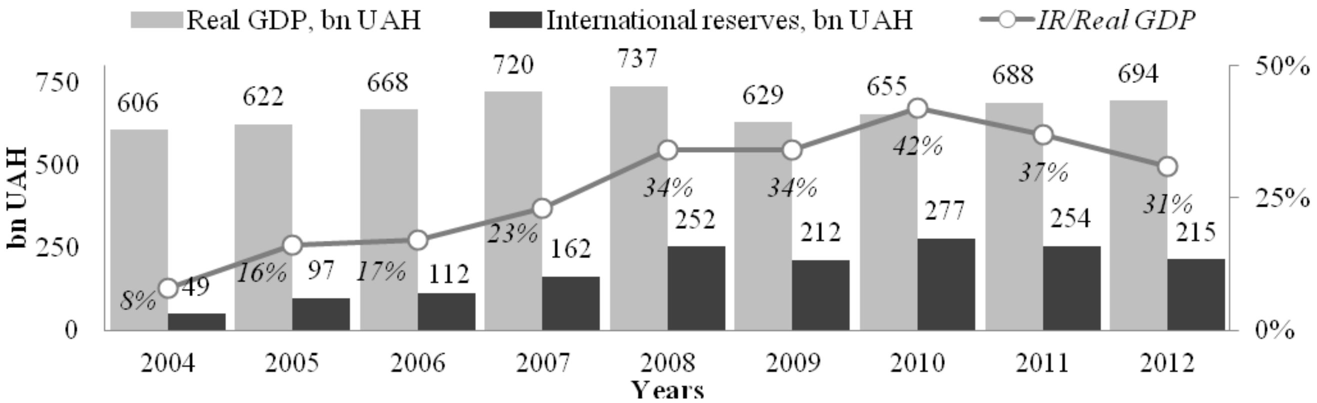
Source: State Statistics Service of Ukraine

We can observe improvement in trade balance in 2009 which has been the aftermath of currency devaluation at the end of 2008. Within the last 4 years rate of inflation in Ukraine was higher than in major trading partner countries, causing real exchange rate to appreciate. This, in turn, induced real net export to decline. The regression results of real net export on real exchange rate show that for one point increase in exchange rate, on average, ceteris paribus, real net export decreases on 4.4 bn UAH. Since 2009 real exchange rate has appreciated significantly, making high pressure on net export. Since 2008 the inflation in Ukraine has been at about 8% level higher every year than inflation by trade partners. This means that our export goods now are on average 40% more expensive, than 4 years ago. For the last 3 years average YoY import growth was 1.4% while import growth rate was 11.2%. This led to the negative net export and to lower GDP. Ukraine is more dependent from export than developed countries, that's why we are very sensitive to trade changes. Appreciation of real exchange rate also hurts domestic producers. Import in real terms costs less and less, so people start to buy more foreign goods instead of domestic. It reduces firm's revenues and forces them to shrink their production, which results in workers firing and real wage reduction.

Net export and investment fluctuates over years, but it composes from 15 to 28 percent of GDP in different years. So the negligence of these factors leads to strong negative impact on real GDP.

In the last part of our analysis we will look at the national reserves part:

Figure 2. GDP vs. International reserves 2004-2012, bn UAH



Source: "The economist" journal

For last 2 years reserves have been decreasing with 12% YoY rate, which has been caused by fixed exchange rate. But let's look at the reserves relative to real GDP. The lowest level was in 2004. Then reserves had been moving up till 2010, where reaching maximum level of 42% and being now 31% relative to GDP. According to the current trend and economic circumstances they are predicted to decline steadily over next years, so the problem is that if the government doesn't stop maintaining fixed exchange rate than in few years it will run out of reserves.

Summary

The fixed exchange rate undoubtedly makes some guaranties for investment in Ukraine and for people confidence, but the cost is too high. It makes a contribution into Ukraine GDP reduction and the further we go, the harder it hurts our economy. Inflation expectations push up real interest rate, diminishing investment. Appreciation of real exchange rate beats net export, depressing domestic producers. Despite the reserves are now at acceptable level, we won't be able to maintain fixed exchange rate in long run. Based on stated above the author has come to the conclusion that fixed exchange rate decreases level of living in Ukraine.

Asie TSINTSADZE, Lilit MELOYAN
Batumi Shota Rustaveli State University, Georgia

FINANCIAL MECHANISM OF SOCIAL INSURANCE IN GEORGIA

During the transition to market economic relations before each Soviet Union country between the facing problems - one of the most acute problems was currently existing social situation. The main task was creation of socio-economic conditions relevant social protection mechanisms. From 1990, in Georgia has catastrophically reduced production, real income, consumption, and capital - investments and all economic indicators. During 1990-1995 political developments in the country - as a result of the economic events GDP amount per capita was 250 dollar, accordingly reduced to 0.81 U.S. dollars per capita health care costs. During this period, the social security system was carried out only for medical applications. In 1996 was made the first step towards social insurance financing mechanisms, namely, has been introduced compulsory medical insurance 3% employer and a 1% employee contribution. Later has been introduced a system of social insurance and mandatory health insurance and social contributions in the share of public spending on health was up 10% - to 34%. However, this mechanism proved to be weak because the fixed contributions (3+1) was used for employed population and manufacturing-organizations and fast-growing unemployment made powerless social insurance financial base and the state budget.

For the implementation of existing objectives, by the assessment of the Doctor of Medical Sciences, Mr. Verulava «medical insurance mandatory contributions were accumulated through the State Health Insurance companies, which was public or main-governmental structure, and the contribution, in fact, was an intermediate category between «mandatory contribution and targeted budgetary costs» in particular the collection technique (exclusively for the State Health Insurance Company) resembled «3 +1» contribution, the payer and the payment procedure accounting technique - targeted budget tax. (T.Verulava Health Economic and Insurance 2010 July).

During the years 2003-2004 of its social insurance taxes were sat in the framework and deliberately failed to fulfill the targeting function, so 2005 was withdrawn or revoked social insurance taxes and established social charges that was accumulated in budget. In Georgia during 20 years has not been established such a mechanism of the protection from the risks, which could reduce the number of social insurance or the number of state social beneficiaries and social assistance and simultaneously would create preconditions for the creation of condition gradual inclusion of population in private health system. Existing current Social Fund minimally did not comply with the demands. That was not the main reason for the inappropriate use of it, but the social background - which was created in the country after the collapse of the Soviet Union. During the transition period by disruption of economic relations, in fact, destroyed factories were not able to put into operation, and creation of new enterprises proceeded with difficulty. If we take into account, it's easy to explain, the social fund inability. Contrary to the small number of taxpayers appeared huge army of socially vulnerable people. Based on the abovementioned thus the existence of a unified social tax lost all sense and taking into account this and other reasons, in 2007 in accordance with the amendments made in tax code has been abolished social tax from January 1, 2008. The social fund function was imposed to the state. By January 2012 situation 1,639,264 people are registered in miserable conditions database in Georgia, 36,7% of the population of Georgia. Based on these data, the use of the social security system, social insurance mechanism is associated with very difficult conditions, but however its ignoring even more separates the population from payment equivalent insurance protection receiving possibility and social insurance institute, as the most reliable protection mechanism couldn't develop. We have developed social insurance financial model, which