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LOCAL BUDGETS IN THE CONTEXT OF DECENTRALIZATION PROCESSES IN UKRAINE

***Abstract.** Some important results of financial and administrative aspects of decentralization in Ukraine as of the beginning of 2022 were discussed. Certain stages of financial decentralization aimed to strengthen the financial base of sub-national governments and to form self-sufficient united territorial communities have been studied. The dynamics of revenues and expenditures of the Consolidated budget of Ukraine in terms of the indicators of the State and local budgets and inter-budget transfers were analyzed. The criteria of self-sufficient united territorial communities have been studied.*

***Keywords:** decentralization, revenues, expenditures, self-sufficient united territorial communities, sub-national governments*

The decentralization processes in Ukraine that started after 2014, were caused by a number of factors related to the discrepancy between the revenues and

expenditures of local budgets, the imbalance of the budget system in a whole, and certain legal problems related to insufficient powers of local authorities in solving important community tasks (like property rights, including land issues).

European Charter of Local Self Government identifies that “Local authorities’ financial resources shall be commensurate with the responsibilities provided for by the constitution and the law; Part ... of the financial resources of local authorities shall derive from local taxes and charges of which,, they have the power to determine the rate” [1, art. 9.2, 9,3].

The classical definition of the term “decentralization” is “decentralization is the delegation of power from a central authority to regional and local authorities” [2].

There are different approaches to the concept of decentralization, in particular, authors [3, p.5] emphasize an expanded definition like “decentralization ... involves shifting a combination of political, fiscal and administrative responsibilities from central to sub-national governments, ... , civil society and the private sector”.

Some international institutions [4] support the mentioned approach that decentralization includes the delegation of power to a wide range of stakeholders as “decentralization transfers authority and responsibility of government functions from central to sub-national governments – including local governments, civil society, and the private sector”.

The number of successful cases proves that the provision of services closer to their direct consumers ensures the improvement of the quality and more complete satisfaction of customers’ needs. Therefore, the general definition of decentralization involves the transfer from the national to the local level of powers and financial resources for the implementation of such transferred responsibilities.

It is assumed that the successful implementation of various aspects of decentralization can create possibilities for sustainable communities’ development, but foreign researchers accent that decentralisation without strengthening and expanding responsibility at both local and national levels would not bring successful results that are beneficial to all parts of the society [5, p. 77].

The purpose of this scientific paper is to evaluate some preliminary administrative and financial results of decentralization in Ukraine.

Administrative decentralization means the transfers of administrative decision-making, resources and responsibilities for the provision of the defined public services to the sub-national levels. Fiscal decentralization aimed to reallocate the budget resources and to delegate the responsibilities to local authorities in budget decision-making with the simultaneous increasing capacity to raise and manage their own revenues.

The long preparatory work and discussions between various stakeholders like national and sub-national governments, national and foreign professionals, scientists, NGOs representatives preceded the implementation of decentralization processes in Ukraine.

One of the main tasks of decentralization was identified as strengthening of financial capacity of sub-national governments by providing them with long-term reliable revenues' sources and reforming the relations between the State and local budgets in Ukraine [6]. The related amendments were made to the Budget and the Tax Codes of Ukraine at the end of 2014.

The reform of budgetary relations supposed the rearrangement of revenues and expenditures of the State and local budgets [7, art. 29, 43, 64, 66, 67, 69, 77 – 90], determination of a new way of horizontal equalization of tax capacity of local budgets, introduction of special types of earmarked transfers (like educational and health care subventions).

In parallel, amendments to the Tax Code of Ukraine [8] were put into effect since January, 2015. They streamlined the list of national and local taxes and fees, expanded the list of excise taxes that were included in local budgets, which also increased the own revenues of local budgets in Ukraine.

The most important tax revenues of local budgets were studied [9, p. 62] for understanding the possible ways for further strengthening of local budgets' capacity. In Ukraine the most significant tax revenue of sub-national budgets is the personal income tax, the amount of which is subdivided between various budgets (table 1).

Table 1

**Enrollment of the personal income tax amount between
budgets of Ukraine, %**

Tax	State budget of Ukraine	Level of local budgets in Ukraine			
		Regional / oblast	Cities of regional subordination, united territorial communities	District / rayon	Villages, towns of district subordination
Till December, 2014					
Personal income tax	-	25	75	50	25
Since January, 2015					
Personal income tax	25	15	60	60	-

Source: compiled by the authors basing on [10, art. 64 – 66, 69; 11, art. 64, 69]

One of the controversial results of the budget reform is the fact that beginning from 2015, the certain proportion of the personal income tax (25%) started to be enrolled as revenues to the State budget of Ukraine, while before the reform the whole amount of this tax was subdivided only between different level of local budgets.

Important result of budget reform in Ukraine was the rearrangement of the list and fixing of determined expenditures at defined levels of the budget system [11, art. 86, 87, 89 – 91]. As a result, since 2015, the financing of some educational (like vocational education) and other social institutions had been gradually passed from the State budget to local budgets.

The establishment of self-sufficient communities basing on the union of small settlements was an important stage in the successful implementation of decentralization process. The Law of Ukraine “On Voluntary Association of Territorial Communities” [12] was adopted for this purpose, and it regulated the relations arising during the process of voluntary union of territorial communities of villages, towns, and cities.

The Law of Ukraine “On Cooperation of Territorial Communities” [13] defines the organizational and legal basics of cooperation between territorial communities, principles and forms of such cooperation, its stimulation, financing and control.

It is important that a new concept of self-sufficient territorial community (STC) was elaborated. STC is a territorial community of villages, towns or cities, which as

a result of voluntary union is able to ensure the appropriate level of public services (education, culture, health care, social protection, housing and utilities); and it has sufficient human, financial and other relevant resources.

The document that defines the criteria of STC is the Methodology of the Formation of Self-Sufficient Territorial Communities [14]. According to the Methodology the capacity of the community is assessed basing on social and economic indicators that affect the development of the respective community, namely they are:

- the number of permanent residence population of the territorial community (TC);
- the number of schoolchildren studying at general secondary educational institutions located on the territory of the TC;
- the territory of the TC;
- index of fiscal capacity of the budget of the TC;
- the share of local taxes and fees in the revenues of the community's budget.

Some quantitative results of the process of voluntary (and at the end of the decentralization process even mandatory) union of communities, which had been going on since 2015, were formalized in a Resolution of the Verkhovna Rada [15].

It should be mentioned that at the beginning of 2014 the budget system of Ukraine consisted of approximately 12 000 budgets, and only 694 of them (or appr. 6%) had direct budget relations with the State budget. The remaining budgets were budgets of small settlements, towns and villages, that had lack of finance and others resource and were unable to provide the required services at a sufficient level; those local budgets were subsidized from the respective regional or district budgets. Therefore, one of the main problems of the previous budgetary system was its high subsidization.

The implementation of mentioned legislative and regulatory documents regarding the streamlining and consolidation of territorial communities significantly changed the number of local budgets in Ukraine and their relationship with each other and with the State Budget of Ukraine (Table 2).

Table 2

The number of local budgets in Ukraine with direct interbudgetary relations with the State budget of Ukraine, beginning of the year, 2014 –2022, units

Type of the budget / Year	2014	2018	2020	2022
Total local budgets, that have direct interbudgetary relations with the State budget of Ukraine, including	694	1288	1453	1582
Crimea	1	-	-	-
Sevastopol	1	-	-	-
Regional / oblast budgets	24	24	24	24
District / rayon budgets	488	450	448	119
Budgets of cities of regional subordination, united territorial communities (UTC)	179	813	980	1438
Kyiv	1	1	1	1

Source: compiled by the authors basing on [16; 17; 18; 19, annexes 5, 6]

The budget system of Ukraine underwent radical transformations both quantitatively and qualitatively during the period of 2014-2021. The number of budgets decreased dramatically, at the beginning of 2014 it counted for appr. 12000, and at the beginning of 2022 the number of budgets was cut up to 1582, most of them (90,9%) were the budgets of UTCs.

It should be emphasized that the decrease in the number of budgets in 2014-2018 was also influenced by the military actions in the Eastern regions of Ukraine and by withdrawal from the budget process of temporarily occupied territories of Crimea, Donetsk and Luhansk regions.

Since the administrative reform was conducted simultaneousle with the budget reform, the number of districts in Ukraine decreased by 75% (from 488 to 119 units), but the number of cities of regional subordination and UTC increased by 8 times (from 179 to 1438 units) during the analyzed period. This process directly effected the budget system of Ukraine.

It is worth to mention about the discussions among professionals and experts regarding the correctness and certain lobbying by local authorities while determining the administrative centers of self-sufficient UTCs, when 2-3 self-sufficient communities claimed this title basing on the objective criteria. At the end of the period (2020), when the process of even mandatory union of communities was finishing, communities had been joined to the UTC automatically without

observing all the proper requirements.

Similarly, many questions and contradictions are related to the consolidation of districts, especially in large regions (like Kyiv, Odesa, Kharkiv, Poltava, Vinnytsia regions), which before the reform counted up to 25-27 districts, and after the reform the number of districts in that regions decreased to 4-7 units.

The dynamics of the Consolidated budget's revenues in terms of the State and local budgets is shown in fig. 1.

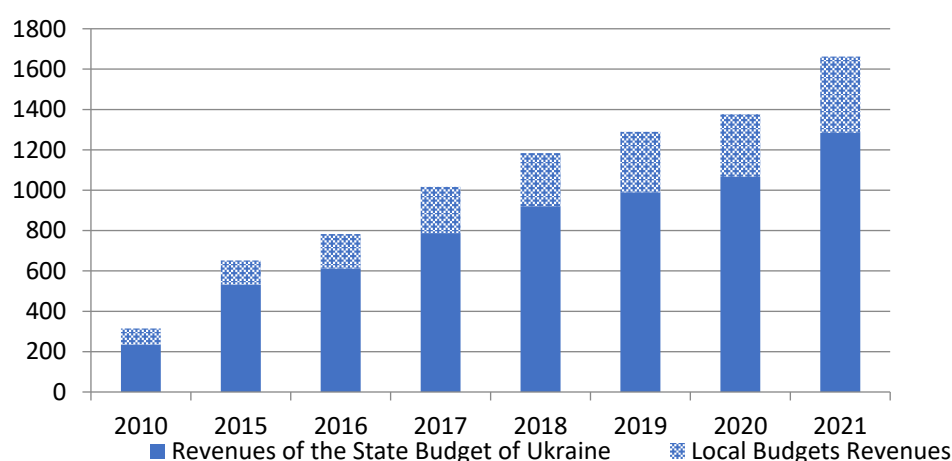


Fig. 1. The dynamics of revenues of the Consolidated budget of Ukraine in terms of the State budget and local budgets, 2010 – 2021, bln UAH [20; 21; 22; 23]

The amount of the Consolidated budget's revenues during 2010-2021 increased by 5,3 times (from 314,5 billion UAH to 1662,2 billion UAH), at the same time there was an anticipatory growth in revenues of the State budget of Ukraine (by 5,5 times), while the volume of local budgets' revenues (excluding interbudgetary transfers) increased by 4,7 times.

Revenues of the State budget of Ukraine dominate in the structure of the Consolidated budget's revenues and its share fluctuated within 74.4% - 81.5% (77.3% at the end of 2021) during the study period, and this fact additionally confirms the high level of concentration of financial resources at the national level.

Despite the declared goals of decentralization to increase the importance of local budgets and to strengthen the financial base of sub-national governments, in

present the revenues of the State budget of Ukraine are constantly growing at a faster pace. This is confirmed by the high level of centralization of financial resources at the national government.

There is a significant differentiation in economic and financial potential of different territories in Ukraine and therefore the current revenues of local budgets still do not always ensure the creation of long-term reliable sources of financial resources of the respective local communities.

The share of local budgets' revenues (without interbudgetary transfers) in the structure of the Consolidated budget of Ukraine even decreased to 21,9% (2021), which confirms the relatively low fiscal efficiency and the potential for growth of selected revenues of local budgets within the framework of analysis of the whole budget system of Ukraine.

Thus, despite the increase in absolute amount of local budgets' revenues, their share in the Consolidated budget of Ukraine did not increase significantly, and the task of enlarging the importance of local budgets in the financial system was not successfully achieved at this stage of decentralization.

The dynamics of the State budget and local budgets expenditures in Ukraine for the period 2010-2021 is presented in Fig. 2.

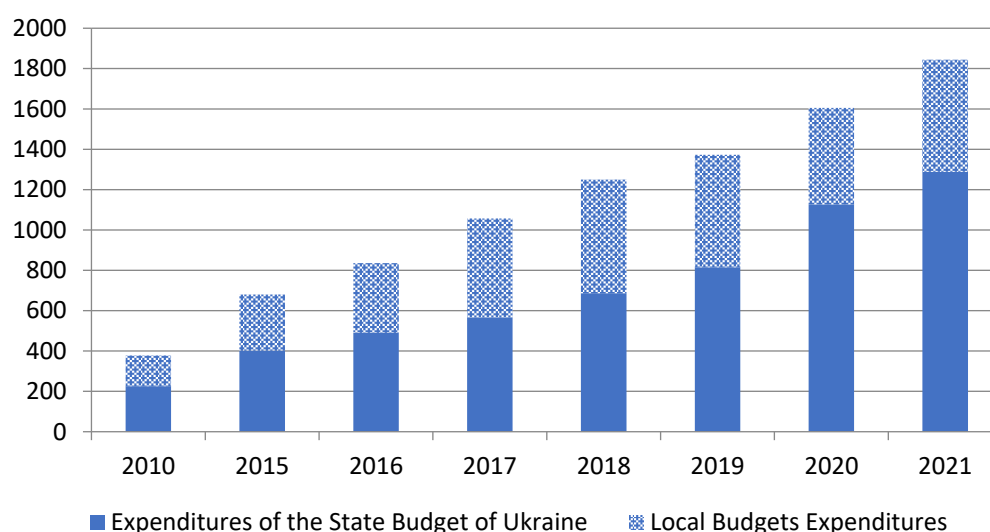


Fig. 2. The dynamics of the expenditures of Consolidated budget of Ukraine in terms of the State budget and local budgets, 2010 – 2021, bln UAH

[20; 21; 22; 23]

It should be emphasized the accelerated growth of the State budget expenditures (by 5,7 times) comparing to the increasing of expenditures of the Consolidated budget (by 4,9 times) and local budgets (by 3,7 times).

There was a significant growth in expenditures of the State budget of Ukraine during 2020-2021 (for overcoming the pandemic, financing significant infrastructure projects, reforming the system of some services, especially health care), and this led to an increase of its share in the Consolidated budget’s expenditures up to 70%, and respectively, the share of local budget’s expenditures had decreased in recent years from 46% (in 2017) to 30% (in 2021).

Local budgets in Ukraine are traditionally focused mostly on financing social expenditures – education, health care, social security. Majority of these expenses are delegated to the local level with appropriate compensation in the form of earmarked transfers from the State budget of Ukraine.

That is why the system of interbudgetary transfers is an important tool of budget regulation in Ukraine and significant source of local budgets’ revenues. This system has been fundamentally reformed since 2015 according to the adopted amendments to the Budget Code of Ukraine [7]. (Fig. 3).

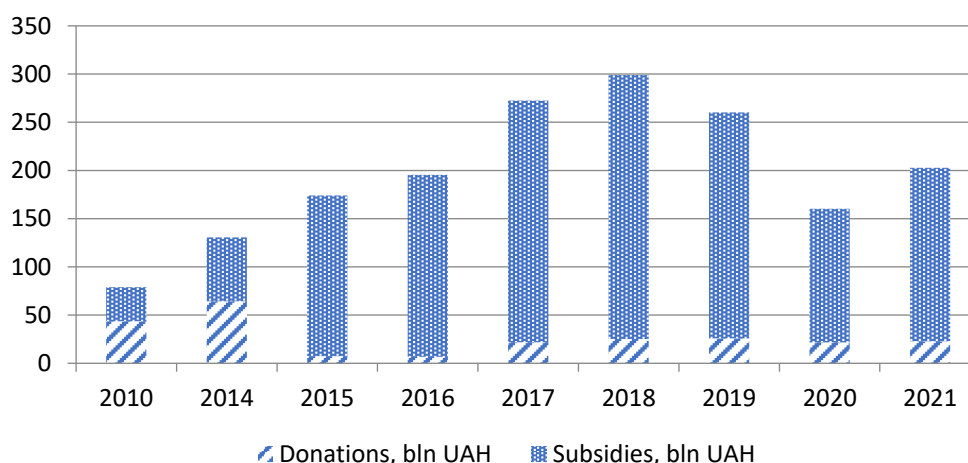


Fig. 3. The dynamics of interbudgetary transfers from the State budget to local budgets in Ukraine, bln UAH, 2010 – 2021 [20; 21; 22; 23]

The total amount of interbudgetary transfers in Ukraine increased by 2,6 times during the period 2010-2021 (from 78,9 billion UAH in 2010 to 202,7 billion UAH

in 2021), at the same time the volume of donations (grants) decreased by 47,7%, and the volume of subsidies and subventions (earmarked transfers) increased by 5,1 times, which confirms the reorientation of the national budget system to the provision of earmarked transfers from the state level to sub-national governments. The share of subsidies counted up to 96% of the total amount of budget transfers in 2015, but during next years its share was gradually reduced to 88,8% in 2021.

This situation somewhat contradicts with the art. 9.7 of the European Charter of Local Self-Government that states that “as far as possible, grants to local authorities shall not be earmarked for the financing of specific projects. The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction” [1].

Therefore, the present system of interbudgetary transfers in Ukraine has practically deprived sub-national governments in independence for determining the way of use of these transfers and strengthens the centralized regulation of budgetary resources in the country.

Some previous positive results of financial decentralization can be highlighted, like:

- the concept of self-sufficient territorial communities was created, and it became the basis for a fundamentally new organization of the budget system, when every sub-national budget has direct budget relations with the State budget of Ukraine;

- the criteria and conditions for the formation of self-sufficient UTCs which are capable to provide required services are determined;

- a number of functional and fiscal powers have been transferred from the districts’ level to the level of UTC in administrative aspect, which in the future reduces the importance of the district level of governance;

- the distribution of revenues has been streamlined between the State budget and local budgets; certain types of significant tax and non-tax revenues are assigned for local budgets;

- the distribution of expenditures between different levels of the budget system of Ukraine was further streamlined.

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