Local Budgets in Ukraine: Current Trends and Issues

Abstract. The dynamics of revenues and expenditures of the budget system of Ukraine in terms of the State and local budgets, and the system of intergovernmental transfers for the period 2010–2020 is studied in the given scientific paper. The changes in the structure of revenues and expenditures of local budgets during this period as a result of financial decentralization and under the influence of various factors (political, economic, social) have been analyzed too.

Keywords: local budgets, local governments, budget decentralization, intergovernmental transfers, revenues and expenditures of local budgets.

The need for the reform of budget relations in Ukraine arose long ago due to a number of important preconditions. They are excessive centralization of financial resources at the state level, financial weakness and strong dependence of local budgets on intergovernmental transfers from the State budget and as a result, the lack of interest of local authorities in increasing their own revenue basis, inefficient system of intergovernmental transfers, which did not take into account the needs of local governments, significant disparities in the regional development, which affected the financial and budgetary capacity of local governments at different levels.

The general definition of decentralization includes the transfer of power and financial resources for the implementation of delegated tasks from the national to the local level. World experience demonstrates that bringing public services closer to the direct consumers improves the quality of their provision and more completely meets the needs of people. Decentralization may ensure this goal in various forms – political, administrative, fiscal, market [1].
Fiscal (budgetary) decentralization is focused on the delegation of powers to local governments to make decisions in the field of budgetary regulation of regional social and economic development. Budget decentralization involves the reallocation of resources through both fiscal transfers, and by the increased capacity of local authorities empowered to impose and manage their own revenues.

The European Charter of Local Self-Government (approved in Strasbourg on 15 October 1985) sets out the basic principles of its activities, in particular that [2, art. 9.2, 9.3] “... Local authorities’ financial resources shall be commensurate with the responsibilities provided for by the constitution and the law; at least a part of the financial resources of local authorities shall derive from local taxes and charges ... and ... they have the power to determine the rate; ..”

Budget decentralization in practice is implemented in the independence of local governments in making decisions on the formation of their tax base, the rates of taxes and fees assigned to local budgets; introduction of tax incentives for priority economic sectors of particular regions; formation of the appropriate structure of expenditures for the provision of public goods at local level.

Decentralization is a logical step towards strengthening the powers and capacity of local self-government in many countries around the world in present global political, social and economic processes.

The main tasks of the reform of local self-government and territorial organization of power in Ukraine [3] are identified as ensuring the availability and quality of public services, achieving balanced distribution of powers between local governments and executive authorities, determining a reasonable territorial basis for the activities of local authorities to ensure the availability and proper quality of public services provided by them, creating appropriate material, financial and organizational conditions to ensure the implementation of local governments' own and delegated powers.

Reform of inter-budgetary relations in the context of decentralization is an incentive for local communities to form their budgets more efficiently and gradually to move to self-sufficiency.

Long experience in the implementation of decentralization processes in
different countries demonstrates a number of important issues that should be taken into account while developing and implementing such programs to achieve positive results.

In particular, foreign practitioners and scientists [4; 5, p. 12; 6, p. 17] identified a list of potential dangers and challenges of decentralization that are relevant for the present Ukrainian political, economic and social situation. Social and economic pitfalls include shortfalls and inefficiency in service provision (especially in education and health care on local levels), increased spatial disparities across different regions (especially between urban and remote rural, mountainous areas), situations when highly qualified local public officials feel compromised and as a result there is a lack of human resources, opaque decision-making that negatively influences accountability upwards and downwards, loss of the economies of scale gained from central government provision of services. Political challenges of decentralization relevant for the current situation in Ukraine are corruption, sometimes inefficient local politics and bad local governance, inconsistency of regional elites to the needs of the population, incomplete information for qualitative decision making, constituents not able to hold representatives accountable and to recall inefficient deputies.

The purpose of this paper is to assess the basic trends in the development of the budget system in Ukraine and to identify some issues of decentralization.

Scientists [7; 8; 9, p. 334] identified certain indicators of financial decentralization, which make it possible to assess some of its results. These indicators inform about the division of powers between the central government and local authorities, especially in competences of imposing, collecting and shaping revenues (particularly, local taxes and payments), directions and the volume of the expenses of local budgets. Some of these indicators are:

− the share of local budgets’ revenues in total public revenues, the share of tax revenues of local budgets’ in tax revenue of the Consolidated budget, the share of own revenues in the total revenues of local budgets;

− the share of local budgets’ expenditures in the expenditures of the Consolidated budget;
the share of local budgets’ revenues and local budgets’ expenditures in the GDP.

It should be noted that statistical information of budget indicators in Ukraine, especially for local budgets during long period of time, is not always available, due to the reorganization of central government offices during 2015 – 2018, changes in statistical reporting and budget classification.

As noted the researcher [10, p. 8] “the government figures and statistics regarding local government finances are not always readily available …; in most cases, treasury statistics are not adjusted for inflation and thus give a misleading impression of dramatic increases in the government’s real spending commitments at the local level”. It should be taken into account while evaluating the budget information and process of fiscal decentralization since 2014.

The dynamics of some general budget indicators in Ukraine during the period 2010 - 2020 are presented on Figure 1.

Fig. 1. The dynamics of interbudgetary transfers, revenues and expenditures of the State and local budgets of Ukraine, 2010 – 2020, UAH billion
Source: compiled by the author basing on [11, pp.143, 149, 167, 174; 12, pp.149, 156, 175, 182; 13, pp. 146, 153, 169, 176]

The revenues of the State budget of Ukraine in the national currency (UAH) during the study period increased 4.6 times (from UAH 233.9 bn UAH in 2010 to
1065,4 bln UAH in 2020), and the revenue basis of local budgets increased only 3,9 times (from 80,6 bln UAH in 2010 to 313,3 bln UAH in 2020).

The revenues of the State budget are dominating in the structure of the revenues of the Consolidated budget of Ukraine (its share ranges from 74,4% to 81,5% for the study period) and it confirms the high level of concentration of financial resources at the national level. The share of local budgets’ revenues (excluding intergovernmental transfers) in the structure of the revenues of the Consolidated budget of Ukraine even decreased by 3% (as of pandemic 2020) and it shows the relatively low fiscal efficiency and small growth potential of revenues of local budgets during crisis periods.

Despite the declared aims of decentralization to strengthen the financial base of local governments, and increase their power, in reality the revenues of the State budget of Ukraine are constantly growing faster and, therefore, the centralization of financial resources is increasing.

It should be emphasized that in Ukraine there is a significant differentiation in the economic and financial potential across different regions, and in general, local budgets’ revenues do not form the long-term reliable sources of financial resources for local communities. The long-term financial capacity of local budgets basically depends on the scope of the economic development, regional structure of industry and services, profitability of economic activity, the average level of wages, which directly affects the amount of taxes and fees paid to local budgets. Unfortunately, during the economic crisis, only nominal income growth is recorded, and it does not reflects inflation and real purchasing power of the national currency.

Despite the increase in absolute amount of local budgets’ revenues, their share in the Consolidated budget of Ukraine has not increased significantly, and the task of increasing the financial capacity and independence of local budgets still has not been achieved at this stage of the reform.

The growth of the expenditures of the Consolidated, the State and local budgets in Ukraine was quite proportional, appr. 3,6 times during the period 2010 – 2019.

Unfortunately, the Covid-19 pandemic has affected macroeconomic financial indicators. The expenditures of the State budget in Ukraine in 2020 have increased
significantly on health care, vaccination of the population, compensation for businesses during the lockdown periods, etc. That is why there was a huge increase in expenditures of the State budget during last year, which led to an increase of its share in the Consolidated budget up to 70% (from 59,4% in 2019), and the share of local budgets’ expenditures decreased from 40,6% (in 2019) till 30%.

This situation confirms once more the growing trend towards a higher concentration of financial resources at the state level and their predominantly centralized usage without taking into account the specific needs of certain communities.

An important tool of inter-budgetary regulation in Ukraine and at the same time a significant source of revenue for local budgets are intergovernmental transfers. The composition and formation of these transfers have been fundamentally reformed since 2015 according to the amendments to the Budget Code of Ukraine [14].

The structure of earmarked (subsidies and subventions) and grants (donations) intergovernmental transfers fluctuated respectively within 55-50% and 50-45% until 2015. Starting from 2015 the share of donations decreased to 3-4% of intergovernmental transfers with a gradual increase up to 13,5% (2020), respectively, the share of earmarked transfers since 2015 was 96% of the volume of intergovernmental transfers with their gradual reduction to 86,5% (2020).

It should be noted that in the crisis year 2020, the volume of intergovernmental transfers in Ukraine decreased compared to the previous 2019 by 38%. The amount of subsidies and subventions (mainly economic) was significantly reduced (by 40,9% comparing to the previous 2019) and the reduction of grants (donations) was not so significant (by 16,3%).

The distribution of budget resources aimed to support local social and economic development is sufficiently centralized, because the resources of the State Fund for Regional Development (SFRD), which are provided on a competitive basis, are constantly decreasing in favor of the budget subvention for such purposes, which is distributed manually.

The above mentioned situation somewhat contradicts to the Article 9.7 of the European Charter “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” [2]. Therefore, the current system of intergovernmental transfers in Ukraine has limited the possibilities of local authorities in determining the use of such funds and at this stage only strengthens the centralized administration of budgetary resources in the country.

According to the Budget Code of Ukraine [15, Art. 9] budget revenues consist of 4 main groups (tax revenues, non-tax revenues, revenues from capital transactions, intergovernmental transfers).

It is important to study the dynamics of the structure of local budgets’ revenues in Ukraine for understanding the effectiveness of decentralization and the level of achievement of the defined tasks (Table 1).

Table 1

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</thead>
<tbody>
<tr>
<td>Tax revenues, including</td>
<td>37.7</td>
<td>33.4</td>
<td>40.1</td>
<td>40</td>
<td>41.3</td>
<td>48.3</td>
<td>60.6</td>
</tr>
<tr>
<td>Personal income tax</td>
<td>27</td>
<td>18.7</td>
<td>21.6</td>
<td>22</td>
<td>24.6</td>
<td>29.5</td>
<td>37.7</td>
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<tr>
<td>Corporate profit tax</td>
<td>0.1</td>
<td>1.5</td>
<td>1.6</td>
<td>1.3</td>
<td>1.7</td>
<td>1.8</td>
<td>2.1</td>
</tr>
<tr>
<td>Excise taxes</td>
<td>0.1</td>
<td>2.6</td>
<td>3.2</td>
<td>2.6</td>
<td>2.5</td>
<td>2.4</td>
<td>3.3</td>
</tr>
<tr>
<td>*Land tax and land rent</td>
<td>5.2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Local taxes and payments, including</td>
<td>3.5</td>
<td>9.2</td>
<td>11.5</td>
<td>10.5</td>
<td>10.9</td>
<td>13.1</td>
<td>16.1</td>
</tr>
<tr>
<td>Land rent and land payment</td>
<td>0</td>
<td>5</td>
<td>6.4</td>
<td>5.3</td>
<td>4.9</td>
<td>5.9</td>
<td>6.7</td>
</tr>
<tr>
<td>Flat tax</td>
<td>3.2</td>
<td>3.7</td>
<td>4.7</td>
<td>4.7</td>
<td>5.3</td>
<td>6.3</td>
<td>8.1</td>
</tr>
<tr>
<td>Non-tax revenues</td>
<td>5.3</td>
<td>6.8</td>
<td>6</td>
<td>5.2</td>
<td>5</td>
<td>4.7</td>
<td>4.6</td>
</tr>
<tr>
<td>Other revenues</td>
<td>0.6</td>
<td>0.7</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>0.6</td>
<td>0.8</td>
</tr>
<tr>
<td>Intergovernmental transfers, including</td>
<td>56.4</td>
<td>59.1</td>
<td>53.4</td>
<td>54.3</td>
<td>53.2</td>
<td>46.4</td>
<td>34</td>
</tr>
<tr>
<td>*grants (donations)</td>
<td>27.8</td>
<td>2.5</td>
<td>1.9</td>
<td>4.4</td>
<td>4.5</td>
<td>4.6</td>
<td>4.6</td>
</tr>
<tr>
<td>*subsidies, subventions</td>
<td>28.6</td>
<td>56.6</td>
<td>51.5</td>
<td>49.9</td>
<td>48.7</td>
<td>41.8</td>
<td>29.4</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>


The pandemic 2020 year significantly changed the structure of local budget revenues in Ukraine and the share of tax revenues increased up to 60.6%, and consequently the share of intergovernmental transfers decreased to 34% of local budget revenues. The largest sources of local budget revenues until 2018 (more than 50%) were intergovernmental transfers. The share of tax revenues gradually
increased from 37.7% (in 2014) up to 48.3% (2019) and this reflected the decentralization goal to strengthen the financial base of local self-governments by the long-term sources of own resources (the main of which are tax revenues).

Amendments to the Budget and Tax Codes of Ukraine have been introduced since 2015. These changes streamlined the list of local taxes and payments, expanded the list of excise taxes as revenues of local budgets, and as a result the own revenues of local budgets in Ukraine significantly increased.

Significant changes happened in the structure of expenditures of local budgets of Ukraine during the study period (Table 2).

**Table 2**

**Dynamics of the structure of expenditures of local budgets in Ukraine, 2014 – 2020, %**

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<tr>
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<tbody>
<tr>
<td>General public services</td>
<td>4,9</td>
<td>5,2</td>
<td>4,6</td>
<td>4,8</td>
<td>5</td>
<td>6,2</td>
<td>8,6</td>
</tr>
<tr>
<td>Economic activity</td>
<td>4,1</td>
<td>6,8</td>
<td>9,9</td>
<td>11,3</td>
<td>13,5</td>
<td>14,5</td>
<td>19,7</td>
</tr>
<tr>
<td>Housing and utilities</td>
<td>7,8</td>
<td>5,6</td>
<td>5</td>
<td>5,5</td>
<td>5,3</td>
<td>6,1</td>
<td>6,7</td>
</tr>
<tr>
<td>Health care</td>
<td>20,6</td>
<td>21,3</td>
<td>18</td>
<td>17,3</td>
<td>16,3</td>
<td>15,9</td>
<td>10,6</td>
</tr>
<tr>
<td>Cultural and physical development</td>
<td>4</td>
<td>3,4</td>
<td>3,4</td>
<td>3,3</td>
<td>3,3</td>
<td>3,8</td>
<td>4,6</td>
</tr>
<tr>
<td>Education</td>
<td>31,7</td>
<td>30</td>
<td>27</td>
<td>27,5</td>
<td>29</td>
<td>33</td>
<td>41,7</td>
</tr>
<tr>
<td>Social protection and social security</td>
<td>25,5</td>
<td>25,9</td>
<td>30,3</td>
<td>28,5</td>
<td>25,5</td>
<td>18,2</td>
<td>5</td>
</tr>
<tr>
<td>Other expenditures</td>
<td>0,5</td>
<td>0,7</td>
<td>0,6</td>
<td>0,6</td>
<td>0,8</td>
<td>0,8</td>
<td>0,9</td>
</tr>
<tr>
<td><strong>Total expenditures</strong></td>
<td><strong>99,1</strong></td>
<td><strong>98,9</strong></td>
<td><strong>98,8</strong></td>
<td><strong>98,8</strong></td>
<td><strong>98,7</strong></td>
<td><strong>98,5</strong></td>
<td><strong>97,8</strong></td>
</tr>
<tr>
<td>Interbudgetary transfers</td>
<td>0,9</td>
<td>1,1</td>
<td>1,2</td>
<td>1,2</td>
<td>1,3</td>
<td>1,5</td>
<td>2,2</td>
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</tbody>
</table>

*Source: compiled by the author basing on [11, p. 177 – 178; 12, p. 185 – 186; 13, p.179 – 180]*

The majority of local budget expenditures (81.8%) in 2014 were focused on financing social needs, but in 2020 the share of social expenditures decreased to 61.9%, mainly due to the reduction of expenditures on health care and social protection and social security.

The budget decentralization is based on certain social and economic indicators and reflects identified priorities of public policy. The state policy of reducing social guarantees for people without adequate compensation of their income increases tensions in society, degrades the access to basic social services for the population, especially in remote rural or mountainous communities. We can state about a
tendency to the degradation of social infrastructure in small settlements as the majority of the closed social institutions were located in rural areas. This situation leads to intensification of negative social and demographic processes, namely the migration of the working people (especially families with children) abroad or to larger cities with developed social institutions, decline of the birth rate, aging of population, etc.

The reform of the system of intergovernmental transfers is focused mainly on the financing of delegated state powers (education, health care, social protection and social security programs), rather than stimulating the social and economic development of communities. Basing on the objective indicators this process has not yet achieved the declared goals.

References:


