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## **TERRITORIAL AND FISCAL DECENTRALIZATION IN UKRAINE: PRACTICAL RESULTS**

The article reveals the principal issues of practical effects of territorial and fiscal decentralization in Ukraine. On the basis of methodological research the essence of the legal forms of decentralization is defined. It is determined that the practical result of territorial decentralization is ensuring the establishment of new capable territorial communities, which are also called unified territorial communities. The practical outcome of fiscal decentralization is the growth of financial sustainability of unified territorial communities, and the opportunities of bringing in new financial resources. In the process of territorial decentralization, local self-governments receive more powers and right to make their own decisions on the use of financial resources of the unified territorial community. While developing investment projects, the probability of attracting additional funds from the State Fund of Regional Development increases due to fiscal decentralization.

**Key words:** territorial decentralization, fiscal territorial decentralization, budget and tax components, practical results.

**Problem statement.** The decentralization reform in Ukraine has two corresponding legal forms in their practical implementation – territorial and fiscal. During the first stages of territorial and fiscal decentralization, there is an impact on administrative-territorial structure of the state, on the system of public authorities and the distribution of functions, powers, financial resources between them, and also on intergovernmental fiscal relations. The establishment of new territorial entities, which are financially capable to provide new high-quality public services, and the establishment of conditions for personnel growth in local government are all the main aim in the implementation of decentralization reform, and it also updates the study of practical results.

**Analysis of recent research and publications.** The significant number of works in the domestic scientific literature is devoted to the research of decentralization reforms. Thus, the work of O. Boryslavska, I. Zaverukha<sup>1</sup> reveals the dynamics and experience of the reform of the administrative-territorial structure. The effectiveness of budget and tax policies in the reform of fiscal decentralization, the justification of the best methods and tools of controlling budget funds, the analysis of declarations and practical implementation of fiscal decentralization are researched by T. Bogolib<sup>2</sup>, L. Lysiak<sup>3</sup>, I. Lunina<sup>4</sup>, H. Lopushniak<sup>5</sup>, I. Chugunov<sup>6</sup>.

Given the positive experience of decentralization reform in Poland, a large number of works are devoted to the research of this issue by Polish scientists. Thus, Professor E. Rushkovsky<sup>7</sup> (E. Ruśkowski, 2006), analyzing the territorial decentralization, distinguishes its main backbone components. G. Byvalets<sup>8</sup>

<sup>1</sup> Бориславська, О., Заверуха, І., Школик А. (2012). *Децентралізація публічної влади: досвід європейських країн та перспективи України*. Київ: Центр політико-правових реформ.

<sup>2</sup> Bogolib, T. (2016). Budgetary system of Ukraine: a new reality and global challenges. *Економічний часопис – XXI, Vol. 156 (1–2)*, 41–43.

<sup>3</sup> Лисяк, Л. (2015). *Бюджетна складова реалізації домінуючих напрямів суспільного розвитку*. Дніпропетровськ: ДДФА.

<sup>4</sup> Луніна, І. (2014). Бюджетна децентралізація: цілі та напрями реформ. *Економіка України, Vol. 11 (636)*, 61–75.

<sup>5</sup> Лопушняк, Г., Лободіна, З., Ливдар, М. (2016). Фіскальна децентралізація в Україні декларації та практична реалізація. *Економічний Часопис -XXI, Vol. 161(9-10)*, 79–84.

<sup>6</sup> Chugunov, I. (2016). Budget policy under economic transformation. *Економічний часопис – XXI, Vol. 158 (3–4(2))*, 66–69.

<sup>7</sup> Kosikowski, C., Ruśkowski, E. (2006). *Finanse publiczne a prawo finansowe*. Wyd.2. Warszawa: Dom wydawniczy ABC.

<sup>8</sup> Bywalec, G. (2012). Dylematy decentralizacji we współczesnym świecie. *Gospodarka narodowa, Vol. 11–12 (255–256)*, 123–145.

(G. Byvalets, 2012) does not consider the decentralization process as a universal means for socio-economic growth of the state. However, Y. Kuliavik<sup>1</sup> (Kulawik J., 2016) claims that the fiscal decentralization is a tool to ensure the financial sustainability of administrative areas.

Nowadays, the assessment of the practical results of territorial and fiscal decentralization in Ukraine becomes important.

**Formulation of a task.** Based on the above, it is possible to formulate research objective, which is a determination of practical results of territorial and fiscal decentralization in Ukraine.

**Presentation of the research material.** The beginning of the decentralization reform in Ukraine was announced as the reform of local government. In particular, on April 1, 2017 the Government of Ukraine adopted "Concept of local government reform and territorial organization of power". According to this Concept, it was expected to create capable territorial communities, provided the transfer of authority and resources to local self-governments (rural and urban councils).

Namely, the territorial decentralization as a modern reform of administrative-territorial structure is based on two fundamental conditions of its realization: the reform of territorial entities should take place through voluntary unification of territorial communities (UTC); new territorial communities must be able to provide new quality of public services.

Nowadays, the conditions of territorial decentralization are provided by a number of legal documents: the Law of Ukraine "On cooperation of local communities" 17 June 2014, No. 1508-VII, the Law of Ukraine "On Voluntary Unification of Territorial Communities" 5 February 2015, No. №157-19, "Methods of forming of capable territorial communities" CMU approved on April 8, 2015 No. 214, the Law of Ukraine "On Amendments to the Budget Code of Ukraine on the reform of intergovernmental fiscal relations" 26 April 2015, ground 288-19, etc.

Turning to the study of the essence of decentralization, it is hard to fully agree with the opinion of the Polish scientists, that the process of decentralization should be considered by the subjects and spheres of influence distinguishing territorial, substantive and functional decentralization. However, it is fully rational to share their approach to the interpretation of territorial decentralization as a the process of creating public administration, which will carry out self-government in administrative-territorial units and regardless of the state authorities, being out of their system and hierarchical subordination, i.e. local and regional authorities<sup>2</sup>. Polish Professor Ye. Rushkovskiy has distinguished three system-components of the territorial decentralization while analyzing it: political decentralization (corresponding structure), administrative decentralization and financial decentralization<sup>3</sup>.

Similarly, the vast majority of domestic scientists distinguish administrative (territorial) decentralization, financial (fiscal) decentralization, budget decentralization and others. Therefore, it is essential to make a more detailed analysis of the content and the practical results of two areas of decentralization, such as territorial and fiscal.

Assessing the practical results of the decentralization process, firstly it is vital to focus on its territorial (administrative) component. The Law of Ukraine "On Voluntary Unification of Territorial Communities" that was approved on 5 February 2015 allowed local governments to unite into local communities, but de facto to form new administrative-territorial units (ATU) – unified territorial communities (UTC). In fact, in two years' time there were created 366 unified territorial communities (UTC), 159 in 2015 and 209 in 2016 (as of January 1, 2017).

In 2016 the pace of establishing territorial communities accelerated: their number has increased from 159 to 366, and the population has more than doubled, exceeding 3.1 million people. Today, they have unified 1740 (about 15%) former city, town and village councils. The geography of the most active regions in establishment of unified territorial communities has also changed. As a result, Zhytomyr, Dnipropetrovsk, Vinnytsia, and Zaporizhzhia regions are ahead. Instead, the pace of establishment of territorial communities in Ternopil and Khmelnytsky regions, which were initially ahead, has significantly stagnated. However, it is currently Khmelnytsky region, which has the largest share of unified territorial communities, covering more than 43% of the area and concentrating about a third of the population (434 thousand people).

<sup>1</sup> Kulawik, J. (2016). Federalizm fiskalny a rozwój wiejski. *Zagadnienia Ekonomiki Rolnej*, Vol. 3 (348), 41–66.

<sup>2</sup> Woś, T., Stelmach, J., Bankowicz, M., Grzybowak, M. (2003). *Wlydyka Wiedza o społeczeństwie*. Warszawa: Wydawnictwo Prawnicze LexisNexis.

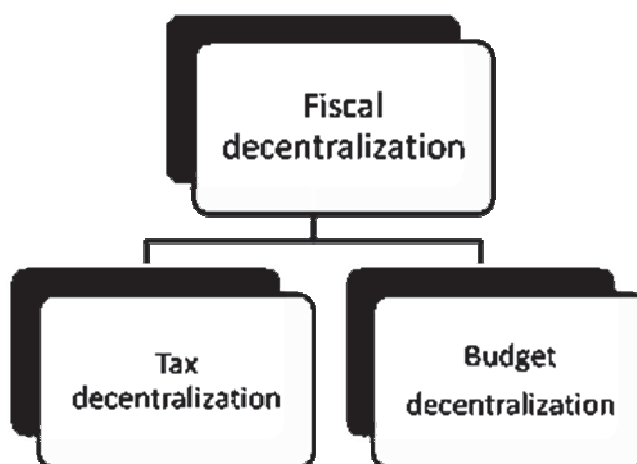
<sup>3</sup> Kosikowski, C., Ruśkowski E. (2006). *Finanse publiczne a prawo finansowe*. Wyd.2. Warszawa: Dom wydawniczy ABC.

Overall, as of April 2017, there were established 366 unified communities, where the elections to local authorities have already taken place, and 47, where the elections were held on April 30 this year. In addition, according to the Ministry of Regional Development, at the final stage of establishment there are still 102 potential communities. So, there are more than 500 unified territorial communities that have been already established or might be established soon. On March 14, 2017 there was signed the law on the peculiarities of voluntary unification of territorial communities, located in the territories of adjacent areas, which will allow holding the elections in a number of unified territorial communities. It will probably accelerate the process of establishing new communities, since many town and village councils on the borders of different areas are attracted by neighboring centers. In some cases, a similar situation is observed on the borders of regions, but then it is needed to amend the Constitution<sup>1</sup>.

Therefore, the main practical results of territorial decentralization are the establishment of new territorial entities, i.e. unified territorial communities, along with their new powers and independent right to make management decisions regarding the use of financial resources. That last part of practical value of territorial reform takes us to fiscal decentralization.

The essence of fiscal decentralization is the ability of local authorities to ensure independent and effective territorial community social services by balancing expenditures and revenues with local needs and capacities. Thus, there are two main causes of fiscal decentralization in Ukraine. Firstly, there is an actual need to ensure the financial autonomy of local governments. Secondly, decentralization is necessary to ensure effective service delivery, which is closest to the people, improve management and increase efficiency in undertaking the tasks, which were transferred to the local level, the level of territorial communities.

Based on its essence, fiscal decentralization has two components: tax and budget decentralization (Fig. 1).



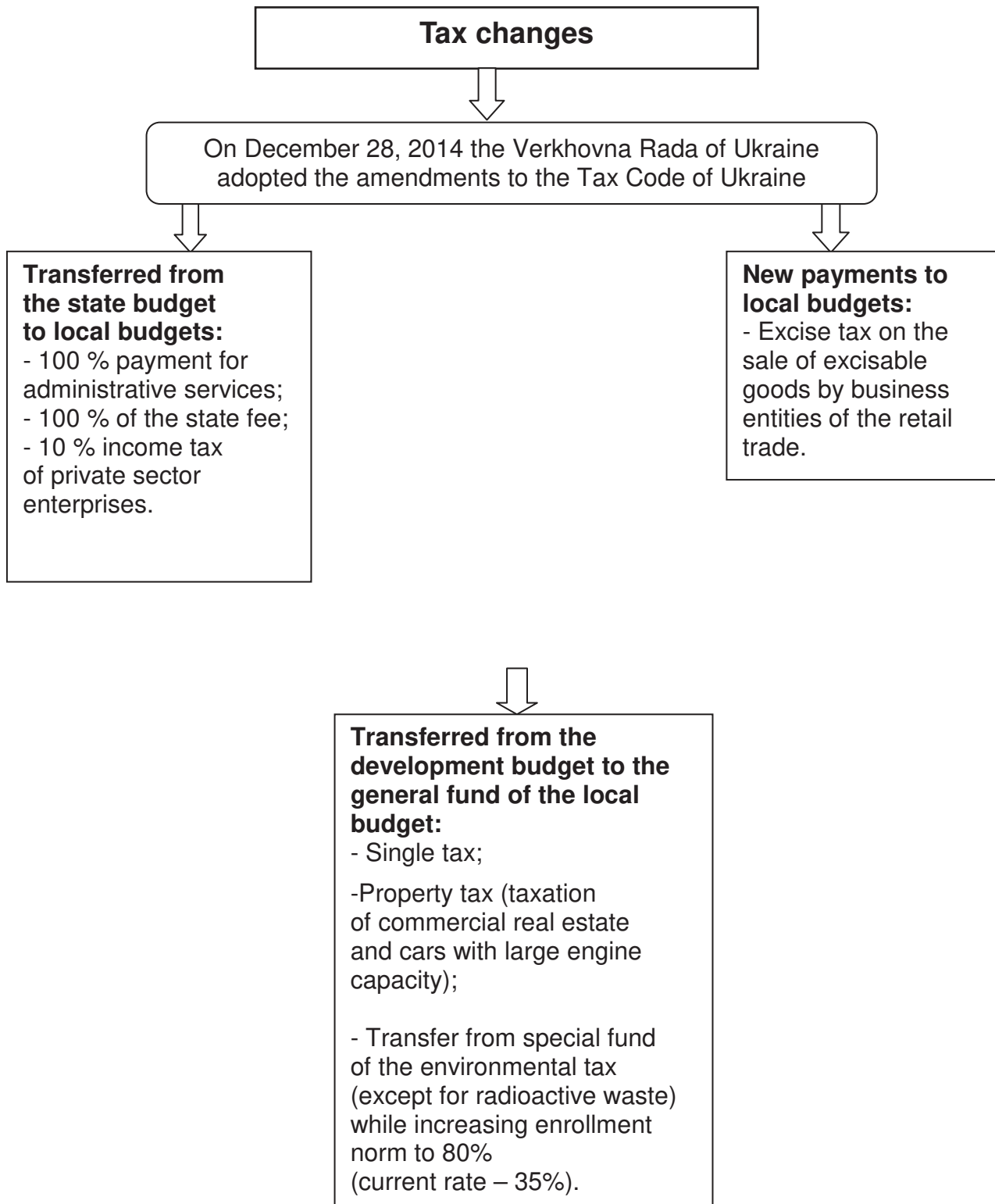
**Fig. 1. The components of fiscal decentralization**

As an economic category, tax decentralization involves improving and strengthening the rights and powers of local and regional self-government concerning the independent decision-making and the formation of local budgets by self-establishing tax rates, fees and benefits.

Budget decentralization is a process of transferring revenues and / or expenditures of funds to lower levels of government, while maintaining fiscal accountability.

In practice, tax decentralization in Ukraine implies strengthening and consolidating of state taxes assigned to local budgets and improving the system of the local taxation (Fig. 2).

<sup>1</sup> Крамар, О. (2017). Децентралізація: перетягування ковдри. <<http://tyzhden.ua/Politics/191040>>. (2017, May, 01).



**Fig. 2. Tax changes in the tax decentralization in Ukraine<sup>1</sup>**

\* Compiled by the author on the basis of the current Tax Code of Ukraine

<sup>1</sup> Податковий кодекс 2010 (Верховна Рада України). Офіційний сайт Верховної Ради України. <<http://zakon2.rada.gov.ua/laws/show/2755-17> (2017, May, 26).

The basis of tax decentralization in Ukraine was founded on the eve of 2015, as a result of the adoption of the Tax Code. At the same time, the first stage of the budget decentralization was held along with the adoption of the amendments to the Budget Code. In addition to the changes in the budget and tax legislation, there was adopted a number of important documents, which have contributed to the implementation of the decentralization process in Ukraine. On August 6, 2014 the Cabinet of Ministers of Ukraine approved a new National Strategy of Regional Development for the period till 2020. At the end of 2014, the Verkhovna Rada of Ukraine amended the Budget Code, in particular the article 241 about State Regional Development Fund, which provided an opportunity to attract additional financial resources of local self-governments for development projects. At the beginning of 2015, the Verkhovna Rada of Ukraine adopted the Law "On State Regional Policy", which determined objectives, basic principles and priorities of state regional policy; the foundation for coordinating the authorities regarding the regional development policy, etc. As required by the Law, the Cabinet of Ministers of Ukraine approved the Decrees №195 and №196, which defined the procedure for the preparation, evaluation and selection of projects for regional development in 2015-2016. On October 7, 2015 the Cabinet of Ministers of Ukraine approved a plan for 2015-2017 for the implementation of the State Strategy for Regional Development. On February 5, 2015 the Verkhovna Rada of Ukraine adopted the Law "On Voluntary Unification of Territorial Communities", which provided an increase of their financial security and the revival of infrastructure in these localities.

In general, in 2015-2016 fiscal decentralization in Ukraine passed the first stage, which provided an increase of budget and financial independence of local budgets, stimulated territorial communities to voluntary unification, expanded opportunities to attract additional financial resources for the implementation of regional development projects, and provided regional policy reform. The key changes in the process of fiscal decentralization were provided by relevant regulations and implementations (table 1).

Table 1

#### The key changes in the process of fiscal decentralization

Key change	Legislation	Implementation
Implementation of fiscal decentralization and financial stability of local budgets	Changes to tax and budget legislation	New rules for communities that were voluntary unified
Implementation of regional policy reform and effective mechanisms for supporting regional development	Changes to the Budget Code regarding the State Regional Development Fund, the Law "On Fundamentals of State Regional Policy"	Financing of the Regional Development Fund projects is available for the communities that were voluntary unified

In 2015, analyzing the change in the volume of revenues to local budgets without taking into account the transfers, at first sight, it seemed that fiscal decentralization had an opposite effect, i.e. there was a decrease of those revenues compared to 2014 by 1.3 billion UAH (table 2). However, according to the Ministry of Finance of Ukraine, in 2016, there was growth in local revenues without transfers by 46.8 billion UAH, which was much higher than revenues in 2014 before the decentralization reform. That means, the changes that occurred in the budget and tax areas in the context of fiscal decentralization provided their financial effect. The growth of financial resources in local budgets occurred not only due to the growth of tax revenues, but also due to changes in intergovernmental fiscal relations. As part of local budget revenues, the amount of subventions, which have a targeted direction and ensure effective use of budget funds in the field, have significantly increased.

Due to the implementation of fiscal decentralization in Ukraine, the first practical results were obtained. A new leveling system, which allows leaving most of the funds in the field, provided a change in the share of subsidized local budgets, simultaneously tripling the share of donor budgets and ensuring the availability of balanced budgets (pic. 3). Local self-governments have become less dependent on the decisions taken at the center.

According to the reports of the Ministry of Regional Development, Construction, and Housing and Communal Services of Ukraine, due to the first stage of fiscal decentralization, in 2016, own revenues of local budgets of Ukraine increased 1.5 times (+ 49,3%) or 48.5 billion UAH compared to 2015, and amounted to 146.6 billion UAH.

**The dynamics of revenues and transfers of local budgets  
of Ukraine during 2013-2016**

Index	Years				Absolute increase		
	2013	2014	2015	2016	2014-2013	2015-2014	2016-2015
Revenues of local budgets (excluding intergovernmental transfers), billion UAH.	105,20	101,10	99,80	146,60	-4,10	-1,30	46,80
The share of income, %	47,59	43,63	36,42	42,80	-3,96	-7,21	6,38
Official transfers from government, billion UAH., including:	115,84	130,60	174,19	196,00	14,76	43,59	21,81
Grants, billion UAH.	61,22	64,43	5,26	4,70	3,21	-59,17	-0,56
Subventions, billion UAH.	54,62	66,16	168,93	191,30	11,54	102,77	22,37
The share of income, %	52,41	56,37	63,58	57,20	3,96	7,21	-6,38
Total revenues, billion UAH.	221,01	231,70	273,99	342,60	10,69	42,49	68,61

\* *Compiled by the author based on data from the Ministry of Finance of Ukraine*<sup>1,2</sup>

The establishment of unified territorial communities (UTC), which during the first stage of decentralization were formed 159 units, provided them with access to direct intergovernmental fiscal relations with the state budget and obtaining basic (reverse) grants, educational and medical subventions. In 2016, own revenues of these unified communities' budgets increased more than 3 times compared to 2015 (from 1 billion UAH up to 3.3 billion UAH). Per capita, on average, own budget revenues of unified territorial communities (UTC) increased by 1645 UAH (from 700 UAH to 2345 UAH).

In total, the resources of local budgets of 159 unified territorial communities (with transfers) increased almost 7 times (compared to the revenues to the budgets of local councils that joined unified territorial communities in 2015) and amounted to 7.1 billion UAH. At the same time, state financial support in 2016 for development and infrastructural facilities totaled 7.3 billion UAH, including unified territorial communities that received nearly 1.2 billion UAH, and allowed them to implement 1500 development projects<sup>3</sup>. Due to the growth of own budgets of unified territorial communities (UTC) and their capabilities to raise funds from the State Fund of Regional Development, numerous infrastructure projects (kindergartens, water systems, rural and urban roads, road lighting, etc.) have been restored or built in many localities.

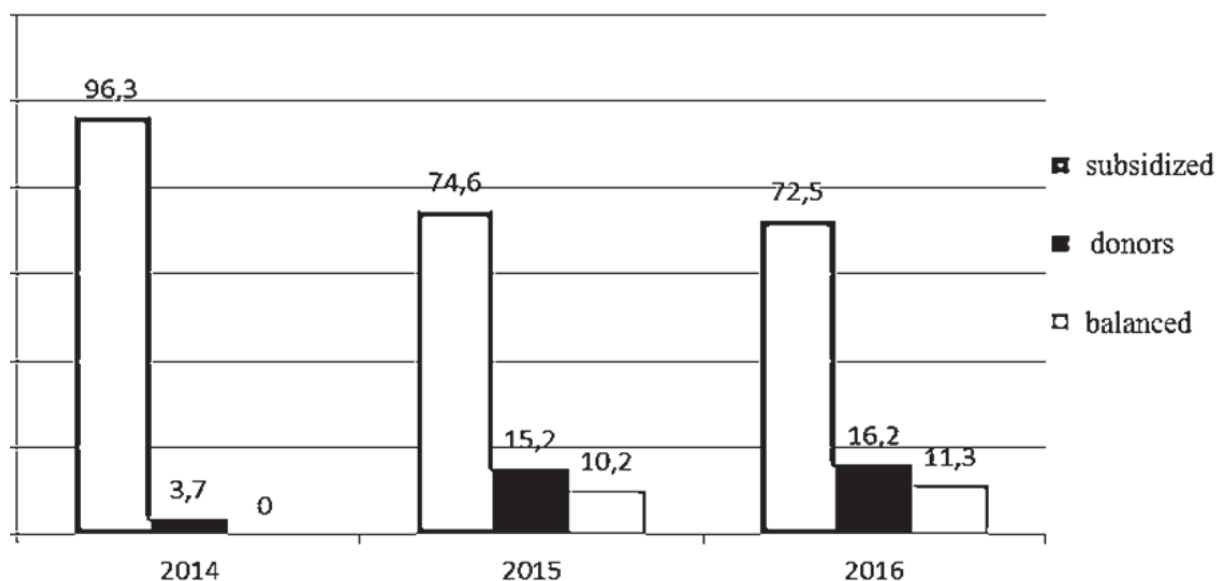
Thus, summing up the analysis of the practical results of territorial and fiscal decentralization, it is important to emphasize the major successes and financial benefits of this reform. Territorial decentralization ensured the establishment of unified territorial communities that have received the empowerment and autonomy in decision making regarding the use of the development budget. Fiscal decentralization has provided a significant increase of own revenues to local budgets and budgets of unified territorial communities (UTC). Its budget component became the basis for improving intergovernmental fiscal relations, and strengthened the financial independence of local budgets along with increased accountability of the participants of the budget process. Fiscal and territorial decentralization within the

<sup>1</sup> Довідка щодо стану виконання місцевих бюджетів за 2015 (Міністерство фінансів України). Офіційний сайт Міністерства фінансів України. <<http://www.minfin.gov.ua/news/view/vikonannja-dohodiv-miscevih-bjudzhetiv-za-n-2015-rik?category=bjudzhet&subcategory=local-budg> (2017, February, 12).

<sup>2</sup> Довідка щодо стану виконання місцевих бюджетів за 2016 (Міністерство фінансів України). Офіційний сайт Міністерства фінансів України. <<http://www.minfin.gov.ua/news/view/vykonannia-dokhodiv-mistsevvykh-bjudzhetiv-za-rik?category=bjudzhet&subcategory=local-budg> (2017, April, 14).

<sup>3</sup> Фінансово-аналітичні матеріали. Децентралізація. Виконання доходів місцевих бюджетів 2016 (Міністерство регіонального розвитку України). Офіційний сайт Міністерства регіонального розвитку України. <<http://www.minregion.gov.ua/decentralization/presentation/finansovo-analitichni-materiali-detsentralizatsiya-vikonannya-dohodiv-mistsevvykh-byudzhetiv-2016-rik/> (2017, May, 04).

framework of establishing the budgets of unified territorial communities (UTC) provided a significant increase in their incomes, the possibility of attracting other centralized budget funds, which in turn will lead to improved socio-economic development of localities, which are parts of unified territorial communities (UTC).



**Fig. 3. Grant level of local budgets in 2014-2016 роках, %<sup>1</sup>**

\* Compiled by the author on the basis of data of the Cabinet of Ministers of Ukraine

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<sup>1</sup> Завдяки фінансовій децентралізації хронічно дотаційних бюджетів в Україні зменшується (Кабінет міністрів України). *Офіційний сайт Кабінету міністрів України*. <<http://www.kmu.gov.ua>> (2017, May, 18).

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