

Sergii Slukhaii

Decentralization in Ukraine : What is on the Agenda?

Ante Portas. Studia nad bezpieczeństwem nr 2 (5), 11-24

2015

Artykuł został opracowany do udostępnienia w internecie przez Muzeum Historii Polski w ramach prac podejmowanych na rzecz zapewnienia otwartego, powszechnego i trwałego dostępu do polskiego dorobku naukowego i kulturalnego. Artykuł jest umieszczony w kolekcji cyfrowej bazhum.muzhp.pl, gromadzącej zawartość polskich czasopism humanistycznych i społecznych.

Tekst jest udostępniony do wykorzystania w ramach dozwolonego użytku.

I. ARTYKUŁY NAUKOWE

„*Ante Portas – Studia nad Bezpieczeństwem*”
2015, nr 2(5)

Sergii Slukhaii

Taras Shevchenko National University of Kyiv

DECENTRALIZATION IN UKRAINE: WHAT IS ON THE AGENDA?

Summary:

After the Revolution of Dignity (2013-2014) in Ukraine, the new government declared an extensive decentralization program as a part of far-reaching economic reforms to be implemented. These efforts are supposed to be supported by reassigning of public functions, shifting down some public revenues, and increasing the local autonomy concerning revenue management. The paper shows the main obstacles on the way to decentralization, to what extent these decentralization plans have been realized within the actual governmental policy in 2014-2015, and how these decentralization efforts would contribute to increasing efficiency in public administration.

Key words:

decentralization, local finance, subnational government.

Introduction

The scale and intensity of fiscal decentralization is preconditioned by peculiarities of the country's intergovernmental fiscal relations, assignment of governmental functions and revenues within the sector of public administration. Thus, it also depends on a variety of institutional, political, and economic factors which shape the specific features of the country's public administration sector. Ukraine as a transition nation that gained independence after the disintegration of the Soviet Union in 1991 has inherited some remnants of a socialist past, when there was no place for subnational government (further referred to as SNG) fiscal autonomy and sound fiscal management.

Ukraine, being a unitary state, naturally tended to practise a centralistic model of fiscal federalism; this fact does have an impact on the shape of its intergovernmental fiscal system in general, and the transfer system in particular.

When analyzing the current legal base and actual practice of intergovernmental finance in Ukraine, one will find that actual implementation of many local government functions is mostly vested onto the national government (further referred to as NG) bodies – district and region state administrations that are appointed by and accountable to the President of Ukraine. This means that bodies of self-government in Ukraine enjoy a very limited scale of own competence. The recent Ukrainian revolution (2013-14) triggered the new state’s decentralization efforts, which promise to result in a far-reaching reform of public finance aiming to significantly increase SNGs’ economic and fiscal weight.

Actually, even after the enactment of the Budget Code (2001), SNGs remained deprived of the ability to manage their finances and assets. In many cases they formally bore responsibility for certain public functions (such as general secondary education or primary health care), but had no possibility to manage the basic factors affecting their expenditures, such as salaries and wages; they also had no discretion to hire and fire managers of subordinated public institutions, or to set standards of service delivery etc. They even could not hold accounts in the financial institutions of their choice – only in the State Treasury.

All the above-mentioned gave us reasons to conclude that since Ukrainian independence there was no explicit decentralization policy adopted and no implicit decentralization measures implemented¹. However, new prospects in this field could be opened due to recent changes in governmental policy and practical steps taken concerning retrenching intergovernmental finance; these efforts may really result in a far-reaching decentralization process.

Decentralization nowadays is a way of securing Ukraine as a nation because, if done properly, it could minimize the dangers of country’s disintegration, which would be the goal of Russia’s hybrid war against Ukraine. The Russian government dresses the war to its own population as »protection of the Russian population “against fascism” and American expansion«.

The goal of this paper is to show whether ongoing fiscal decentralization endeavors could open a way to getting a decentralized and efficient public administration sector in Ukraine.

Development trends in the Ukrainian public administration sector

In order to understand what kind of developments we have had in the Ukrainian public administration sector, it is worth discussing prevailing trends in subnational government expenditure share, which is conventionally understood as the fiscal decentralization index². The problem is that it does not fully

¹ S. Slukhai, *Ukrainian Public Finance after 20 Years of Independence: Leaping Forward or Going in Circles?*, [in:] *Papers presented at the 20th NISPAcee Conference (May 22-25, 2012, Ohrid, Republic of Macedonia)*, Bratislava 2012 (CD-R).

² D. Bergvall, C. Charbit, D.-J. Kraan, O. Merk, *Intergovernmental Transfers and Decentralized Public Spending*, “OECD Journal on Budgeting”, 2006, Vol. 5(4), pp. 111-158.

reflect the real extent of fiscal decentralization because subnational fiscal autonomy with regard to expenditures is not taken into account. In Ukraine, despite quite a high SNG expenditure share, most public expenditures at the subnational level are administered by the NG bodies, not by SNGs themselves. As Wojciech Misiąg, a well-known Polish economist who is now helping Ukraine implement the decentralization reform, put it, “this is an incomplete self-governance” at the local level³.

When omitting this point, one could depict some contradictory developments where the decentralization trend has been substituted for the opposite one and *vice versa*. Prior to 2000, we could observe: (I) an increase in total government GDP share supported by expenditure decentralization (1991-1993); (II) a decrease in total government share supported by expenditure centralization (1995-1997); (III) a decrease in total government share supported by expenditure decentralization (1998-1999); (IV) in 2000-2011, an upward trend in the relative size of the public administration sector generally dominated, supported by a very slight growth of the relative role of the subnational sector within it; (V) since 2012, a diminishing governmental share has been complemented by a clear centralization bias⁴. It looks like Ukrainian experience is fully consistent with Oates’ conclusion drawn about 20 years ago: “there does not exist a strong, systematic relationship between the size of government and the degree of centralization of the public sector”⁵.

Observations of SNG share in public expenditure dynamics could be very misleading, because local fiscal autonomy with regard to revenues is something that really matters here. As concerns Ukrainian public revenues, the trends here are not ambiguous, but quite straightforward. The data in Table 1 demonstrates that SNGs’ role in mobilization of revenues has been permanently diminishing through the years. Starting with about 46 per cent at the moment of gaining independence (1991), the total subnational share in public revenues (transfers excluded) has actually halved – it had dropped to about 22 per cent by 2014. Simultaneously, the NG gained a much bigger role in subsidizing SNGs and making them more dependent on its decisions concerning the fiscal support granted.

³ В. Мисенг, *Провести децентрализацию так, чтобы были довольны все, невозможно. Главное – начать*, „Зеркало недели”, Украина, 11 сентября 2015.

⁴ S. Slukhai, *Fiscal Decentralization efforts in Ukraine: Tax Competition on Agenda?*, [in:] *Insourcing and/or Outsourcing: How Do They Contribute to the Public Administration Reform. Presented Papers from the 23th NISPAcee Annual Conference (May 21-23, 2015, Tbilisi, Georgia)*, Bratislava 2015 (CD-R).

⁵ W.E. Oates, *Searching for Leviathan: An Empirical Study*, “American Economic Review”, 1985, Vol. 75, p. 756.

Table 1. Distribution of revenues among Ukrainian governmental levels (inter-governmental transfers excluded), per cent

Governmental levels	1991	1995	2000	2005	2010	2011	2012	2013	2014
National	54.1	47.6	70.9	77.3	74.4	78.3	77.4	76.2	77.8
Total subnational	45.9	52.4	29.1	22.7	25.6	21.7	22.6	23.8	22.2
Regional	9.8	24.8	12.2	7.3	8.9	7.7	8.6	8.9	8.5
Cities of regional significance	25.6	17.6	10.2	11.3	11.8	9.4	9.2	9.7	8.8
Districts	6.3	7.5	4.8	1.8	2.4	2.1	2.1	2.2	2.2
Total SNGs of subdistrict level	4.2	2.5	1.9	2.3	2.5	2.5	2.7	2.8	2.8

Source: Own calculations based on MoF data.

An important issue of concern related to fiscal decentralization is direct fiscal transfers. Ukrainian SNGs are heavily subsidized by the NG. As the data in Table 2 demonstrates, intergovernmental finance in Ukraine displays the following trends: (I) a growing dependence of SNGs on fiscal transfers, (II) a substitution of NG's discretionary transfers (mutual settlements and budgetary loans) for formula transfers ("grants"), and (III) a substitution of general transfers ("grants") for earmarked ones ("subventions").

Table 2. Evolution in composition of the fiscal transfer fund in Ukraine, per cent

Year	Transfer share in the SNG total revenues	Out of total transfer mass:			
		Mutual settlements	Grants	Intergovernmental loans	Subventions
1991	14.4	34.8	55.9	9.2	-
1995	4.9	51.7	40.3	8.0	-
2000	22.9	0.2	96.5	1.9	2.4
2005	43.5	-	61.8	-	38.2
2010	48.8	-	56.8	-	43.1
2011	52.3	-	50.7	-	49.3
2012	55.2	-	48.7	-	51.3
2013	52.4	-	52.9	-	47.1
2014	56.4	-	50.7	-	49.3

2015 pro- jections	50	-	7.2	-	92.8
--------------------------	----	---	-----	---	------

Source: Own calculations based on MoF data.

The growing transfer dependence of SNGs signals a soaring vertical imbalance and diminishing local fiscal autonomy. The increasing relative importance of earmarked transfers could hardly be judged positively, because earmarking puts additional restrictions on SNGs’ fiscal policy and may distort their spending priorities.

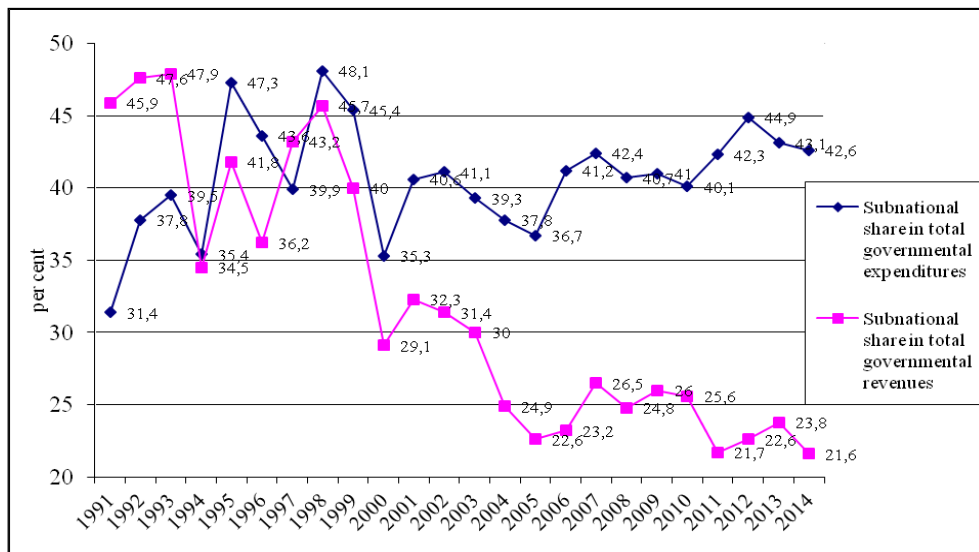
Among the different reasons for implementing some kind of intergovernmental transfer policy, bridging the vertical fiscal gap is the less controversial one. A gap between revenue capacity and expenditure liability of governmental levels, “vertical fiscal imbalance” (further referred to here as VFI), is quite big in Ukraine, like in many other transition nations. Conventionally, VFI for different governmental tiers could be measured as a relation of revenue and expenditure shares.

As shown in Figure 1, during 1991-1993 and in 1997, the subnational revenue share exceeded its expenditure share; since 1998, the situation has reversed: a trend towards further VFI increase has dominated. In 1998, VFI was only 2.4 per cent points, but it soared by 2014 by almost 10 times (!), reaching the highest historical level of 21.6 per cent points. The soaring VFI contributes to the growing need for direct fiscal transfers and to SNGs’ direct and hidden indebtedness.

Observing a trend in subnational revenue share, we should take into account a specific composition of subnational tax proceeds, most of which belong to ceded national levies. As concerns own revenues, here SNGs in Ukraine don’t have rights to set rates, define base, freely spend proceeds, and grant credits. That is why own revenues cannot secure a satisfactory level of local fiscal autonomy.

Firstly, their revenue potential is very limited (in 2010 the local tax share in total SNG revenues was only one percent, in 2014 – 3.2 per cent). Secondly, local governments have no big incentive to collect them because they depend highly on ceded taxes and direct transfers. Thirdly, local governments have no power to administer them (local taxes and duties are collected by the state tax authorities).

Figure 1. Subnational shares in total government revenues and expenditures in Ukraine (direct fiscal transfers excluded), per cent



Source: Own calculations based on MoF data.

That is why there exists a high need to expand the list of truly local revenues by shifting some national levies down and converting the existing ones from quasi-own to true own. In this way, the local share in total public sector tax proceeds could be significantly expanded, up to 20-30 per cent. Of course, increasing local fiscal autonomy will trigger a problem of fiscal inequality of territories, and fiscal competition could also become an issue of special concern.

Decentralization: approaches and obstacles

After the revolutionary events of 2013-2014, a change in top state political powers created a new political environment in Ukraine that could make decentralization a success. As the informal institutions of civil society culminated in helping the nation to hold out against Russian aggression, it became obvious that society in general has ripened to bear more important public responsibilities and to limit NG functions. This created a good soil for real decentralization efforts which were proclaimed by the newly elected President and Parliament.

In April 2014, the official Decentralization Concept was approved by the Cabinet of Ministers of Ukraine⁶. According to this document, the government planned to take the following major steps towards decentralization: (I) reallocation and strict delineation of public functions among governmental levels; (II) rearranging the administrative and territorial structure of administration (all local communities should be in position to supply basic public services to its inhabitants); (III) instituting full-range self-governance in regional and district levels and limiting territorial state administration bodies' functions by coordination and supervision over the legal adherence of SNG activities and quality of public service delivery; (IV) increasing SNGs' competence concerning revenue generation up to setting rates for local levies. The heart of this future reform is community empowerment – making the territorial community a key factor of societal life and a decision-maker with regard to public good delivery.

It is worth mentioning that up to now several decentralization concepts have been adopted, but none of them implemented. This time it looks much more serious because of the approval of respective amendments to the Tax Code and the Budget Code in December 2014 – so decentralization started with fiscal decentralization through giving to SNGs additional sources of revenue.

It is expected that amendments to the Tax Code will increase subnational revenues by UAH 25 billion (plus around 25 per cent to the level of year 2013) in 2015 due to introduction of the property tax for commercial property, local excises, luxury car tax, increasing shares in some national levies like EPF (10 per cent), mineral resources extraction rent (25 per cent), environmental tax (80 per cent instead of 35 before), and assigning 100 per cent of fees for public administrative services.

The new non-transfer proceeds will be supplemented by additional UAH 20 billion in the form of intergovernmental transfers due to amendments to the Budget Code (changes in fiscal equalization procedure and introduction of new types of targeted subventions – medical and educational subventions – which will be allocated according to some formulae). Borrowings have been allowed to any city of regional significance and newly established amalgamated communities (only cities of regional significance with a population of above 300,000 had such a right before).

However, new proportions of PIT proceed sharing (NG 25 per cent; regions 15 per cent; districts, cities of regional significance and new amalgamated communities 60 per cent, Kyiv City 40 per cent) would diminish SNG tax revenues by UAH 25 billion. As a result, we would have a situation when local revenues would experience an increase only due to a bigger transfer dependency – the state merely substituted indirect transfers for the direct ones.

⁶ Cabinet of Ministers of Ukraine, *On Approval of the Concept of Reforming Local Self-Governance and Territorial Power Organization in Ukraine*, Ordinance No. 333 as of April 1, 2014.

Summing up, due to all these policy measures, some increase in subnational fiscal autonomy in Ukraine is to be expected, but it will not affect the share of really independent revenues. Releasing today's strict limits on subnational borrowing policy and administration of accounts (an SNG may independently choose a bank for holding accounts, not only the State Treasury, as until now) is on the agenda, too. It is also worth mentioning that up-to-date decentralization efforts did not affect the functional competence of SNGs, and this could also be a challenge.

All these problematic issues give reason for some domestic experts to claim that nowadays we have something like “decentralization without decentralization”⁷.

The reform has been performed against a very harsh background both politically and economically. It means there are some issues that, despite possible benefits from decentralization as predicted by the so-called “decentralization theorem”⁸, make implementation of the respective policy in Ukraine very problematic. In our opinion, the hurdles to decentralization include several main factors, each of which could be eliminated with varying efforts. To these belong, in the first row, the Russian aggression.

In February 2014, using a moment of temporary weakness of Ukrainian public institutes, Russia annexed the Crimean Peninsula; in April 2014, it triggered unrest in Donbas and then occupied parts of Luhansk and Donetsk regions. The undeclared Russian-Ukrainian war started, and it has demanded huge efforts of the national government and society to secure Ukrainian sovereignty and national statehood in view of the overwhelming economic and military power of the attacker.

Firstly, we should point out the indirect losses of the Ukrainian economy due to retrenchment of public expenditures and reallocation of the scarce economic resources because of the war. One should bear in mind that direct defense expenses of Ukraine soared from 2.9 per cent of the total governmental expenditures in 2013 up to 5.2 per cent in 2014. In 2015 only direct war expenses will reach 5 per cent to GDP. The nation also has to allocate resources to support more than one and a half million internally displaced people who moved to Ukrainian regions not affected by the war in the hope of securing their livelihoods.

Secondly, there is a shrinking in total revenue base that has caused direct fiscal losses for the state. In the course of Russia's aggressive policy Ukraine has lost about 20 per cent of its economy. The war caused a direct loss of UAH 23 billion in budget revenues in 2014. It is hard to assess the total material loss so far, but in case of Crimea it is assets of estimated value UAH 1.2 trillion; in Donetsk region – a deterioration of infrastructure of more than UAH one tril-

⁷ И. Лунина, Д. Серебрянская, *Декларации и реалии бюджетной децентрализации*, „Зеркало недели”, Украина, 13 ноября 2015.

⁸ W.E. Oates, *Fiscal Federalism*, New York 1972.

lion worth. Most enterprises in the occupied Donbas have been destroyed, robbed out, or taken out with their personnel to the Russian territory.

Thirdly, there are macroeconomic issues that could be related to the war, too. In 2014, the real GDP of Ukraine decreased by 7 per cent, inflation reached 25 per cent, industrial production experienced a cut by 11 per cent (especially in the war-affected regions: Donetsk by 32 per cent, Luhansk by 41 per cent), loss of foreign investments exceeded USD 6.5 billion. The budget deficit comprised five per cent to GDP in 2014, and is expected to be the same in 2015. External public debt reached USD 33 billion, that is around 2/3 to GDP in 2014.

As is well-known from fiscal federalism literature, decentralization efforts could generate additional macroeconomic risks for the economy. Since the country experiences huge macroeconomic problems, the decentralization policy could weaken the state's ability to stabilize the economy. With a quite significant subnational economy share it would be very important, while giving SNGs more space in performing own fiscal policy, to prevent them from counteracting the NG macroeconomic policy efforts in achieving financial recovery.

Fourthly, there is the external political pressure from Russia and Europe. Russian demands concerning the political order of Ukraine are as follows: Ukraine should be a federal state with regions (especially Donbas) having extensive rights extending to vetoing NG actions in any policy sphere. With regard to this Russia wants Ukraine to change its Constitution granting a "special status" to occupied Donbas. The idea behind is to make Ukraine a weak state on an anchor that would hold it in the Russian sphere of dominance. Russia also demands that Ukraine restore economic relations with the occupied territories, having in mind that our country should bear all the costs related to support of these territories in terms of paying salaries to public servants, pensions and social benefits to population, transfers to local governments, making investments into restoration of the physical infrastructure eroded by Russian troops and separatists, etc. This sounds surreal, because according to international legislation an occupant bears full responsibility for the well-being of the population in the occupied territory. However, Russia tries to shift the fiscal burden of occupation onto Ukraine – a good example could be repeated efforts to make Ukraine pay for gas consumption in the occupied territories (in November 2015, Gasprom issued a next invoice for USD 256.6 million which, of course, Ukraine will not accept).

This fact also creates a specific attitude in society towards decentralization because this "Russian style decentralization" would undermine the national ability to make the right decisions on its political modernization and choosing a path of future development.

Finally, there is the lacking readiness of the Ukrainian administrative elite to loosen control over society. An important issue is its disposition to control society like before – no power should be given away, because this would mean less possibilities. The administrative elite in Ukraine, like in many other transi-

tion (especially post-socialist) nations, has no will to outsource public functions and to give more power to communities. They understand: if power is being shifted to the regions and locations – then regional and local decision-makers will play a more important role. However, real decentralization will occur only when local communities enjoy significant authority in fiscal and administrative sphere, and when communities decide what kind of public services and on what scale they need. Some explicit signs of this fight could be seen in recent endeavors to reassign revenue sources recently granted to SNGs in favor of the upper-level governments (like making local excise a shared tax or even full centralization of its proceeds). However, under the pressure of society this kind of opposition could be gradually fought back with the practical implementation of anti-corruption measures and especially after the local elections (October 2015), which could lead to significant shifts in the cross-national political landscape, since many informal civil society leaders were elected to the representative bodies at the local, district and regional levels.

All these factors should be neutralized or dealt with appropriately in order to pave the nation's path to decentralization.

Fiscal decentralization on the march

In 2015, important acts of legislation have been approved, which represents the subsequent steps toward decentralization. To these belongs draft legislation on extending competence of SNGs (in business registration, construction oversight, forming municipal guard, etc.) which passed the first reading, and draft changes in the Constitution. The latter introduce new shaping of territorial administration (three types of basic territorial units – community, district and region, instead of existing six – Kyiv-City, AR Crimea, Sevastopol and oblasts, districts, cities, urban districts, townships and villages), endowing territorial units with instruments of self-governance like forming the executive, substituting state territorial administrations in districts and regions for prefects.

Now SNG budgets could be approved independently from the state budget, and strict limits of borrowing policy and administration of accounts (an SNG could choose its bank, not only the Treasury) have been released. There are also changes in the revenue side of subnational budgets. To these belong extension of local property taxation to commercial property and cars; assigning proceeds from some excises and other national levies to local budgets.

Since 2015, SNGs have received a part of the profit tax from newly-established private companies in the territory of their jurisdiction for five years; they could set rates for local levies and decide upon tax credits for them. However, it should be mentioned that SNGs' ability to administer local levies still looks quite limited, as the legislation does not grant them full discretion to set rates. So, most local rates have been capped due to the national legislation, e.g.: 1-3 per cent to the normative valuation rate depending on land use type for the land tax; 0.5-1 per cent to tax base (cost of accommodation) for the tourist fee;

no more than 2 per cent of the minimum wage per sq. m (now about UAH 24, or one USD according to current exchange rate) per annum for the property tax; 10 or 20 per cent of the minimum wage depending on turnover for the unified small business tax; excise rates for alcohol and tobacco assigned to the local budgets are fixed. This means that SNGs have no big possibility to expand proceeds concerning local taxation, as they cannot exceed the rates prescribed by the legislation. The only possibility remaining is to set rates below the caps, which could be considered a manifestation of fiscal competition in case these proceeds fund the most important public services delivered by the respective government. But in the case of local levies being applied to a non-mobile tax base, it will lead to diminishing local revenues. From this line, the governmental estimate “to raise local revenues by three times” due to amendments to the Tax Code could be too optimistic, as some experts foresee⁹.

Some decentralization measures could be linked to the expenditure side, such as: extension of the list of expenditures (mostly in the education sphere) and voluntary amalgamation of rural territorial units up to size of 5,000 inhabitants with offering them additional target transfers (foreseen by the respective Law No. 157 as of February 5, 2015). This is undertaken in order to avoid further fragmentation of territorial units and to form more fiscally sustainable communities needing less support from the NG. The current situation in Ukraine is the following: 12,000 territorial units with separate budgets; average community size is less than 500 people. The territorial communities which decide to merge receive a special state subvention for infrastructure development due to such criteria as area and population; newly-established communities will have the status of a city of regional importance (it means also they could attract external borrowings) and enjoy direct relations with MoF. This was the carrot; and now the stick: if not amalgamated till October 2015, rural communities will have no possibility to administer delegated functions – virtually all budget institutions will be beyond control of the rural community since it will receive neither revenues from shared national taxes, nor equalization transfers or targeted subventions, staying at full discretion of the superior (district) authorities.

Generally speaking, amalgamation could be a step in the right direction because Ukraine has too much of a fragmented subnational sector. However, we doubt whether a fiscal incentive in the form of targeted fiscal transfer for developing new territorial unit’s objects of physical infrastructure will be sufficient for achieving the aim of having integrated and fiscally viable territorial units; at least the experience of many CEE countries showed that voluntary amalgamation will take time, which Ukraine does not have. It also requires changes to the Constitution and Law on Local Self-Governance.

However, the mere fact of existence of 1,000 territorial communities instead of 12,000 which are fiscally viable means a lot in terms of fiscal decen-

⁹ И. Сикора, *Деньги на места или на место*, „Зеркало недели” Украина, 13 Марта 2015.

tralization and efficiency in public good delivery. Firstly, bigger territorial units could attract much more capital as they could potentially offer better physical infrastructure and fiscal management. Secondly, they could realize economy of scale for many public services and provide them more efficiently. This could make space for yardstick competition amongst jurisdictions: a bundle, quality and price of local public goods will give community members and firms looking for a location for their facility an univocal signal about the quality of SNG management.

An additional point is introduction of a new equalization approach based on fiscal capacity. The previous one was based on expenditure equalization, which led to actual full equalization of *per capita* expenditures¹⁰. The new approach legalized by the recent amendments to the Budget Code includes the following innovations: I) substituting equalization transfers for targeted subventions (see Table 2 above); II) switching from expenditure need equalization to revenue equalization; III) incorporating significant incentive components into the equalization formula. The proposal to change the allocation principle (origin) has not been adopted.

The new equalization procedure is now based not on formulas involving dozens indexes and coefficients, but on the tax capacity measure such as index of actual *per capita* PIT (district and local budgets) and EPT (regions) proceeds to its average nation-wide level. As concerns other incentive components, the new approach foresees only limited revenue equalization: in case the SNG tax capacity measure falls into the 90-110 per cent bracket, there will be no equalization performed; in case it falls short of 90 per cent threshold, the respective budget will be supported by 80 per cent of amount needed to reach 90 per cent level; if tax measure exceeds 110 per cent, half of the amount exceeding threshold of 110 per cent will be extracted from the respective budget to the equalization fund.

We assume that this new approach raises local interest to attract more taxpayers by means of local fiscal policy because the equalization formula does not include local tax proceeds, but only proceeds from the two national ones assigned to the SNGs. It also makes impossible a full equalization for expenditures on delegated functions that are not funded by the targeted subventions; however, more affluent territorial donor units are still experiencing some kind of disincentive in comparison to the beneficiaries. One problematic issue is that this new approach is actually not a revenue potential equalization as it is based on the actual *per capita* tax proceeds of the previous year.

The data on budget execution for the first half year of 2015 demonstrates that the Ukrainian intergovernmental finance reform has started bringing some expected fruits. For the first time in many years, SNGs in total over-executed

¹⁰ S. Slukhai O. Komashko, *Efficacy of Interregional Fiscal Equalization Policy in Ukraine*, [in:] O. Cherniak, P. Zakharchenko (eds), *Modern Problems in Development Forecasting of the Complex Socio-Economic Systems*, Berdiansk 2014, pp. 153-155.

their budgets, and their total budget revenue exceeded that of the previous year by more than 18.8 per cent¹¹. One of the signs of positive development is the fact that the share of equalization fund beneficiaries decreased from 96.3 per cent in 2014 to 74.6 per cent; the number of SNGs making contributions to the equalization fund has increased from 3.7 per cent in 2014 to 15.2 per cent; about 10 per cent of local governments achieved balanced budgets (in 2014 there were none such). However, this does not mean that the final goal of decentralization has been achieved. A long way lies ahead, because too little is done as concerns reaching real subnational fiscal autonomy.

Conclusions

Recent changes in Ukraine concerning intergovernmental finance give hope that this time, the public rhetoric on advantages of fiscal decentralization will be supported by definite steps in this direction. Latest changes in the Tax Code and the Budget Code create a basis, starting from which decentralization efforts will bring results. Hopefully, they won't be undermined by some external factors, e.g. further deterioration of the national economy caused by the war in the first line. The changes in governmental transfer policy due to which fiscal support is granted mostly by means of conditional transfers (subventions) could be considered a temporary measure. It should be relaxed after adjusting the current administrative-territorial composition to modern standards. Despite all this, the grade of fiscal autonomy remains quite low in Ukraine. In order to make it higher, caps for local tax rates should be eliminated or pushed up, and new local levies introduced.

However, it is obvious that the scale of local responsibilities should be extended in order to make local authorities more motivated to generate higher revenues and nurture their revenue base.

Bibliography

- ✓ Bergvall D., Charbit C., Kraan D.-J., Merk O., *Intergovernmental Transfers and Decentralized Public Spending*, "OECD Journal on Budgeting", 2006, Vol. 5 (4), pp. 111-158.
- ✓ Cabinet of Ministers of Ukraine, *On Approval of the Concept of Reforming Local Self-Governance and Territorial Power Organization in Ukraine*, Ordinance No. 333 as of April 1, 2014.
- ✓ IBSER, *Budget Monitoring: Analysis of Budget Execution in January-June 2015*, Kyiv 2015.
- ✓ Oates W.E., *Fiscal Federalism*, New York 1972.

¹¹ IBSER, *Budget Monitoring: Analysis of Budget Execution in January-June 2015*, Kyiv 2015.

- ✓ Oates W.E., *Searching for Leviathan: An Empirical Study*, “American Economic Review”, 1985, Vol. 75, pp. 748-757.
- ✓ Slukhai S., Komashko O., *Efficacy of Interregional Fiscal Equalization Policy in Ukraine*, [in:] Cherniak O., Zakharchenko P. (eds), *Modern Problems in Development Forecasting of the Complex Socio-Economic Systems*, Berdiansk 2014, pp. 148-170.
- ✓ Slukhai S., *Ukrainian Public Finance after 20 Years of Independence: Leaping Forward or Going in Circles?*, [in:] *Papers presented at the 20th NISPAcee Conference (May 22-25, 2012, Ohrid, Republic of Macedonia)*, Bratislava 2012 (CD-R).
- ✓ Slukhai S., *Fiscal Decentralization efforts in Ukraine: Tax Competition on Agenda?*, [in:] *Insourcing and/or Outsourcing: How Do They Contribute to the Public Administration Reform. Presented Papers from the 23th NISPAcee Annual Conference (May 21-23, 2015, Tbilisi, Georgia)*, Bratislava 2015 (CD-R).
- ✓ Лунина И., Серебрянская Д., *Декларации и реалии бюджетной децентрализации*, „Зеркало недели”, Украина, 13 ноября 2015.
- ✓ Мисенг В., *Провести децентрализацию так, чтобы были довольны все, невозможно. Главное – начать*, „Зеркало недели”, Украина, 11 сентября 2015.
- ✓ Сикора И., *Деньги на места или на место*, „Зеркало недели”, Украина, 13 Марта 2015.