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SOCIAL AND ECONOMIC EFFECTS OF INTER-BUDGETARY RELATIONS' DECENTRALIZATION IN UKRAINE: ASSESSMENT AND CHALLENGES

Abstract. The modern stage of Ukrainian regions' economy development, on the one hand, shifts the accents towards administrative and financial decentralization with simultaneous transfer of resources, authorities and responsibilities to the local level, and on the other hand – stipulates efficient use of territories' internal capacity and orientation at «smart specialization», optimization of the system of authorities and prevention of regional asymmetries. In this sense, an efficient system of inter-budgetary relations is the key to balanced sustainable development of the country and its regions, which should minimize the disproportions of regions' development, provide efficient redistribution of budget resources inside the budget system caused by territorial asymmetries of revenue base and, therefore, serve as the key instrument to maintain sustainable territorial development. The paper aims to reflect on domestic experience of construction of the inter-budgetary relations model in conditions of financial decentralization in order to outline the perspective directions of its improvement. The paper assesses current functioning condition of the system of inter-budgetary relations in Ukraine according to the results of the first stage of financial decentralization. The risks and challenges of its aggravation for regions' social and economic development are outlined. The following of them are defined as the most essential: unbalanced local budgets; excessive transfer dependence; imperfect mechanism of subvention allocation for forming of CTCs (consolidated territorial communities) infrastructure; legally unregulated and non-transparent mechanism of investment subventions allocation among the regions; insufficient mechanism of allocation of additional subsidy granted for oblast budgets as compensation of revenue loses by local budgets emerging from delegated liabilities regarding funding the educational and healthcare institutions; accumulation of the volumes of temporarily free local governments' funds on deposit accounts in state banks. The range of practical recommendations is suggested in order to minimize the risks of inter-budgetary relations' decentralization, in particular improvement of the procedure of allocating the infrastructural subvention to CTCs and subvention for social and economic development of regions; delineation local governments' functional liabilities.

Keywords: decentralization, inter-budgetary relations, local governments, decentralization risks.

JEL Classification: H61, H72, H77

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СОЦІАЛЬНО-ЕКОНОМІЧНІ ЕФЕКТИ ДЕЦЕНТРАЛІЗАЦІЇ МІЖБЮДЖЕТНИХ ВІДНОСИН В УКРАЇНІ: ОЦІНКА І ВИКЛИКИ

Анотація. Реалізація започаткованої реформи фінансової децентралізації в Україні, яка спрямована на розширення повноважень органів місцевого самоврядування, надання їм більшої самостійності у вирішенні завдань місцевого масштабу, а відтак і поліпшення якості суспільних послуг для населення зумовлює необхідність переосмислення важливої сучасної проблеми державних фінансів – удосконалення наявних механізмів перерозподілу доходів бюджетів різних рівнів. Дано оцінку сучасному стану функціонування системи міжбюджетних відносин в Україні за підсумками першого етапу фінансової децентралізації. Виявлено ризики і виклики для соціально-економічного розвитку регіонів. Серед основних з них визначено: незбалансованість місцевих бюджетів; надмірну трансфертну залежність; недосконалий механізм розподілу коштів субвенції на формування інфраструктури ОТГ; законодавчу неврегульованість і відсутність прозорого механізму розподілу інвестиційних субвенцій між регіонами; недосконалий механізм розподілу додаткової дотації, що надається обласним бюджетам як компенсація втрат доходів місцевих бюджетів унаслідок переданих повноважень з фінансування видатків з утримання закладів освіти та охорони здоров'я; акумулювання обсягів тимчасово вільних коштів ОМС на депозитних рахунках у державних банках. Для нівелювання (мінімізації) ризиків децентралізації міжбюджетних відносин запропоновано низку практичних рекомендацій у частині: удосконалення процедури виділення субвенцій на соціально-економічний розвиток регіонів і на формування інфраструктури ОТГ; визначення уніфікованих параметрів і критеріїв розподілу додаткової дотації для місцевих бюджетів на делеговані повноваження в галузях освіти та охорони здоров'я; удосконалення розподілу функціональних обов'язків між ОМС шляхом ухвалення Закону України «Про адміністративно-територіальний устрій».

Ключові слова: децентралізація, міжбюджетні відносини, органи місцевого самоврядування, ризики децентралізації.

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СОЦИАЛЬНО-ЭКОНОМИЧЕСКИЕ ЭФФЕКТЫ ДЕЦЕНТРАЛИЗАЦИИ МЕЖБЮДЖЕТНЫХ ОТНОШЕНИЙ В УКРАИНЕ: ОЦЕНКА И ВЫЗОВЫ

Аннотация. Реализация начатой реформы финансовой децентрализации в Украине, которая направлена на расширение полномочий органов местного самоуправления, предоставления им большей самостоятельности в решении задач местного масштаба, а затем и улучшения качества общественных услуг для населения обуславливает необходимость переосмысления важной современной проблемы государственных финансов — совершенствование существующих механизмов перераспределения доходов бюджетов разных уровней. Дана оценка современному состоянию функционирования системы межбюджетных отношений в Украине по итогам первого этапа финансовой децентрализации. Выявлены риски и вызовы для социально-экономического развития регионов. Среди основных из них определены: несбалансированность местных бюджетов; чрезмерная трансфертная зависимость; несовершенный механизм распределения средств субвенции на формирование инфраструктуры ОТГ; законодательная неурегулированность и отсутствие прозрачного механизма распределения инвестиционных субвенций между регионами; несовершенный механизм распределения дополнительной дотации, предоставляемой областным бюджетам для компенсации потерь доходов местных бюджетов вследствие переданных полномочий по финансированию расходов по содержанию учреждений образования и здравоохранения; аккумуляирования объемов временно свободных средств ОМС на депозитных счетах в государственных банках. В целях нивелирования рисков децентрализации межбюджетных отношений предложен ряд практических рекомендаций.

Ключевые слова: децентрализация, межбюджетные отношения, органы местного самоуправления, риски децентрализации.

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Introduction. The modern stage of Ukrainian regions' economy development, on the one hand, shifts the accents towards administrative and financial decentralization with simultaneous transfer of resources, authorities and responsibilities to the local level, and on the other hand – stipulates efficient use of territories' internal capacity and orientation at «smart specialization», optimization of the system of authorities and prevention of regional asymmetries. In this sense, an efficient system of inter-budgetary relations is the key to balanced sustainable development of the country and its regions, which should minimize the disproportions of regions' development, provide efficient redistribution of budget resources inside the budget system caused by territorial asymmetries of revenue base and, therefore, serve as the key instrument to maintain sustainable territorial development. The conducted research confirms that the existing system of inter-budgetary relations is currently hardly the stable one, as far as it still doesn't perform its major functions to the fullest capacity.

Analysis of research and statement of problem. Analysis of scientific publications dedicated to the outlined subject revealed that the issues of functioning and improvement of a system of inter-budgetary relations are profoundly researched and are the subject of scientific findings of the range of domestic and foreign scientists [1-4]. Thus, I. O. Lunina made significant contributions to the research of the functioning problems of decentralized budget systems [2]. The need for aligning the regions' budget provision and improvement of financial independence of local budgets is emphasized by V. M. Oparin [1]. Theoretical and practical aspects of the use of budget funds in the context of economy development both at national and regional levels are shown in the works [3,4].

At the same time, the first results of financial decentralization reform in Ukraine testify to the emergence of the range of risks for efficient functioning of the system of inter-budget relations.

The paper aims to reflect on domestic experience of construction of the inter-budgetary relations model in conditions of financial decentralization in order to outline the perspective directions of its improvement.

Research results. Aligning of financial capabilities in Ukraine within the single unitary state is based on the principle of fiscal solidarity. At the same time, we are the witnesses of low correlation between the level of economic development and the volume of tax basis of the regions, on the one hand, and the level of local budgets' expenditures – on the other hand, as well as reduction of efficiency and responsibility regarding the use of budget funds. Therefore, violation of the principle of fiscal equivalency leads to the asymmetry in the sphere of local finances, which in its turn causes the braking of economic activity mechanisms in the regions, brings about the informal institutes related to redistribution and use of budget funds and forms the capacity of social tensions and foundations for centrifugal tendencies. Furthermore, while reducing the disproportions of regional development through redistribution of financial resources, it is necessary to divide the competences regarding making decisions about providing the social benefits in such a way that the financial resources of the country are optimally distributed by the principle of fiscal justice.

In this context, the range of problems causes the necessity of improvement of the system of inter-budgetary relations. The key one is the unbalanced local budgets. Thus, differentiation of Ukrainian regions by territorial feature, infrastructure development and the level of social and economic development is displayed on chronic imbalances of their local budgets. It is no secret that transformations of the system of inter-budgetary relations (stipulated by the launched financial decentralization reform) as well as not legally regulated key criteria of voluntary creation of territorial communities have caused the increasing asymmetries of local budgets' financial maintenance. Despite the fact that in the recent three years the situation has somewhat improved, still none of the regions has reached the 50% rate, excluding three oblasts (Dnipropetrovska, Kyivska, Odeska and city of Kyiv).

Excessive transfer dependency is the next problem, which is still relevant in the system of regions' local finances, because more than half of the growth of local budgets' revenues in Ukrainian regions is provided by transfers: over 60% in 2015, 54% in 2016, 54% in 2017) (Fig.1).

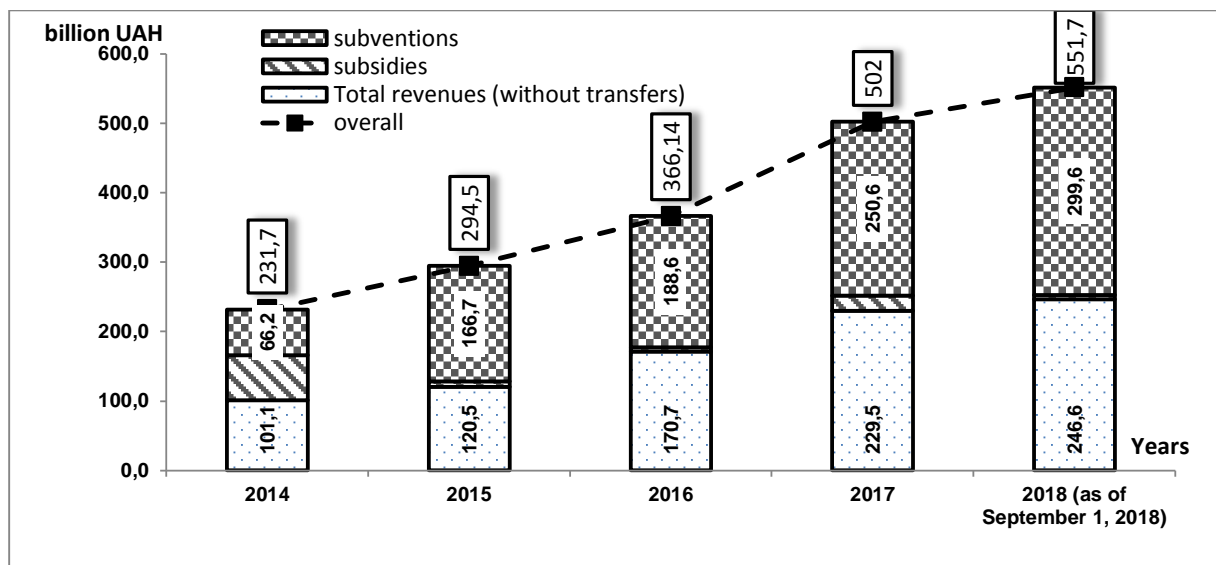


Fig. 1. Dynamics of local budgets' revenues in 2014-2018, billion hryvnyas

Source: developed using the data of State Treasury Service of Ukraine URL

<http://www.treasury.gov.ua/main/uk/publish/category/22813>

By the way, if in 2018 the basic subsidy of € 8.2 billion goes to 931 local budgets out of 1288 that have direct relations with state budget (including: 17 oblast budgets, 52 budgets of cities of oblast significance, 363 district budgets and 499 budgets of consolidated territorial communities [5]), for 2019 the Draft Law «On State Budget» stipulates € 10.3 billion for 935 local budgets: 19 oblast, 53 cities of oblast significance, 353 district, 510 budgets of consolidated territorial communities [6].

It is worth mentioning that the basic subsidy goes to local budgets with the Tax Capacity Index $< 0,9$ (these, for example, by personal income tax for 2019 are predicted for 8 Ukrainian oblasts, including Hersonska, Volynska, Rivnenska, Ternopilska, Ivano-Frankivska, Zakarpatska, Luhanska, Chernivetska). This problem along with somewhat declarative nature of financial decentralization in Ukraine and low tax capacity of most local budgets is confirmed by the distribution of inter-budget transfers in regional dimension in 2014-2017 (Fig. 2,3).

Therefore, if in 2014 there were 6 regions with the less than 50% share of transfers in the structure of revenues (Fig.3), in 2017 there were 4 of them (city of Sevastopol retreated due to annexation); the number of regions with 50-60% subsidy level increased from 5 to 9 respectively; the number of regions with the 60-70% transfers level remained unchanged (10). Certainly, reduction of the number of regions with 70% subsidy level is the positive point (Fig. 2,3): from 6 in 2014 to 2 in 2017. Furthermore, the border oblasts have the biggest breakthrough (Zakarpatska (+9.2 p.p.), Volynska (+9.4 p.p.), Rivnenska (+3.8 p.p.). Swift growth (more than 5 times) of local tax revenues was the key factor.

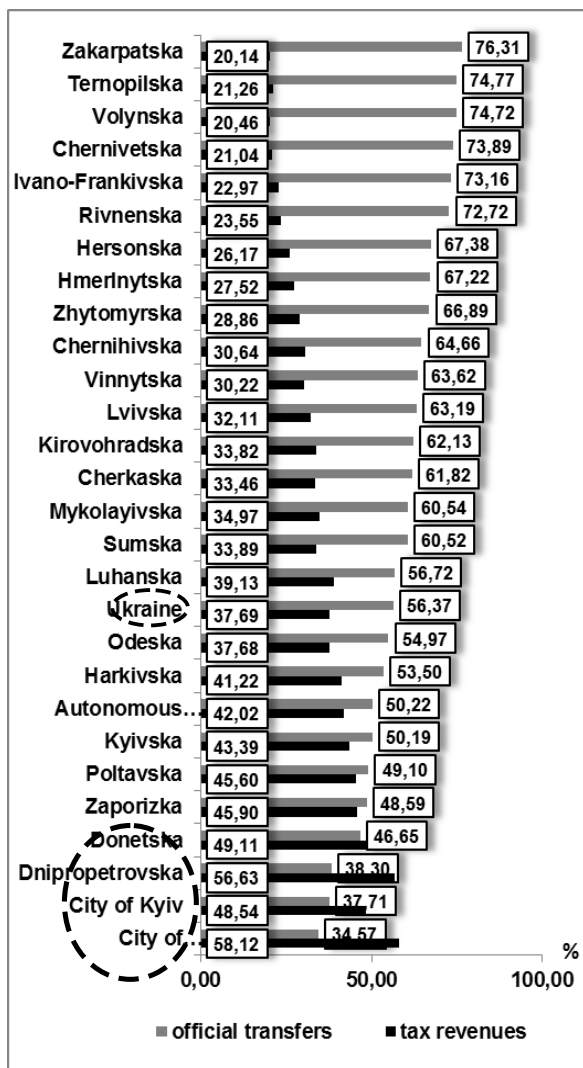


Fig. 2. The share of transfers and tax revenues in local budgets' revenues in 2014, %

Source: developed using the data of State Treasury Service of Ukraine URL <http://www.treasury.gov.ua/main/uk/publish/category/22813>

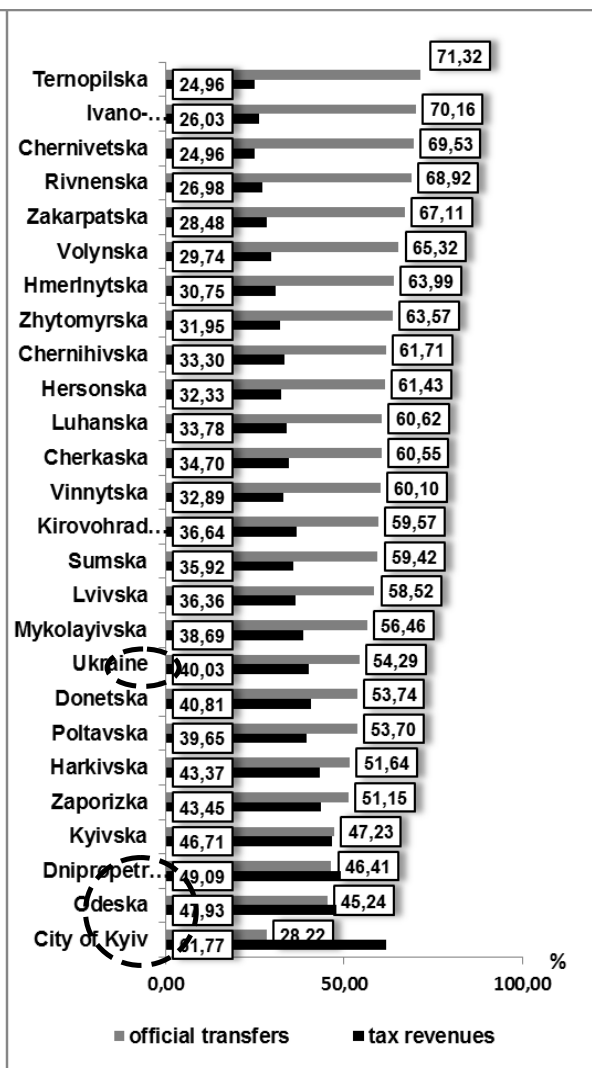


Fig. 3. The share of transfers and tax revenues in local budgets' revenues in 2017, %

Source: developed using the data of State Treasury Service of Ukraine URL

In this sense, it is worth mentioning that all regions of Ukraine had the tax revenues lower than official transfers, except 4 of them (Donetska and Dnipropetrovska oblasts and Kyiv and Sevastopol cities) in 2014 and 3 (Donetska and Dnipropetrovska oblasts and Kyiv) in 2017. Only 10 oblasts in 2017

had the Tax Capacity Index ≥ 1 (Dnipropetrovska, Kyivska, Poltavska, Zaporizka, Mykolayivska, Harkivska, Odeska, Sumska, Kirovohradska, Donetska and Lvivska). Chernivetska, Ternopilska, Ivano-Frankivska and Luhanska oblasts have the worst rates (0.5-0.6).

The next challenge of financial decentralization derives from insufficient mechanism of distribution of subvention funds for forming of CTCs infrastructure. The point is that fast growth of the number of CTCs hasn't provided the voluntary consolidation of territorial communities declared by financial support. As a result, it demotivates them and reduces opportunities of social and economic development, which should undoubtedly be efficiently planned. Thus, if in 2016 subvention for forming of CTCs' infrastructure amounted to € 1 billion and was distributed among 159 CTCs in proportion to community's area and the number of rural population, in 2017 the volume of this subvention was € 1.5 billion and the funds were distributed among 366 CTCs and in 2018 the volume of subvention is € 1.9 billion for 655 CTCs created in 2015-2017. It is obvious that newly created communities will receive much less money for the development projects than those created in previous years.

Despite the fact that the volumes of subventions are slightly but still growing, the growth of the number of newly created communities leads to the increased area and population, which are the key indicators for calculation of this transfer. At the same time, we have seen that the increased number of CTCs doesn't always provides the growth of funding. For example, in 2017 the growth paces of subventions in Hmelnytska, Ternopilska, Odeska, Luhanska, Zakarpatska and Kyivska oblasts were below 100%, although there are those with significant growth of this subvention (Mykolayivska, Hersonska, Vinnytska, Sumska, Zhytomyrska).

Moreover, the CTCs proportional by area and number of population received different volumes of subventions in 2016 and 2017, exactly due to reduction of annual volumes. It is obvious that under such conditions we can't talk about considering the needs of CTCs' social and economic development. In this sense, it is worth mentioning that the existing model of funds distribution by this subvention does not provide the predictability and transparency of CTCs development planning, because it is hard to predict the number of created CTCs as well as the volume of funds allocated for subvention in state budget.

Subvention for activities in social and economic development of certain territories is granted for investment programs (projects) from state budget to local ones, in compliance with certain peculiarities defined by the Budget Code of Ukraine (chapter 2 article 97). Despite the constructive idea and really good mechanism of regional policy implementation, and therefore funding of regional development, one should recognize that this subvention still remains to be a «tempting» instrument in the hands of politicians. Unfortunately, the process of its allocation from state budget to local ones remains to be excessively «politicized», and the approval procedure for the list of objects the funds are allocated for is non-transparent, incomprehensible and not regulated. Current subventions granting procedure does not define the principles and rules of financial resources' distribution between the regions [7].

For example, the Law of Ukraine «On 2016-2018 State Budget» provides: subventions - € 3.3 billion, € 6.2 billion and € 5.0 billion respectively, while SRDF (State Regional Development Fund) funding is € 3.0 billion, € 3.5 billion, € 6.0 billion. If to analyze the CMU (Cabinet of Ministers of Ukraine) Resolutions in 2016-2017 with amendments and the data of State Treasury Service of Ukraine about the use of subventions received from state budget by local budgets, we can confirm that funds distribution by oblasts is quite unequal, without clear details and directions of application (Fig.4) [8-10].

Moreover, it is easy to notice that such oblasts as Ivano-Frankivska, Harkivska, Dnipropetrovska (absolute champion!), Vinnytska, Odeska and Kyivska are constant leaders by this subvention, while Luhanska, Ternopilska and Zakarpatska are the outsiders. It is interesting than in the last four years only four oblasts Donetska, Luhanska, Ternopilska, Zakarpatska and city of Kyiv had the larger volumes of funding of development projects under the SRDF than by the subvention. Dnipropetrovska oblast, by the way, was diametrically opposite: the volumes of «parliamentary» subventions were 2.8 times larger than the SRDF financing (Fig.5). In other words, if to consider the financing of regional development projects, the money to strive for, stipulated by strategies with clear distribution of resources by the formula (referring to SRDF), are of smaller amount than the money allocated by «parliamentary» subvention. Certainly, this shameful practice, which eliminates positive steps of state regional policy

forming and questions the decentralization reform, should be overcome. For this matter, it is necessary to improve the procedure of selection of the objects to be funded by this subvention, their assessment, selection of assessment criteria, etc. CMU should allocate money for qualitative projects and programs selected according to transparent procedure (like SRDF, for instance), otherwise there is no sense to apply such a mechanism of regional development funding in general, at least in the eyes of European community.

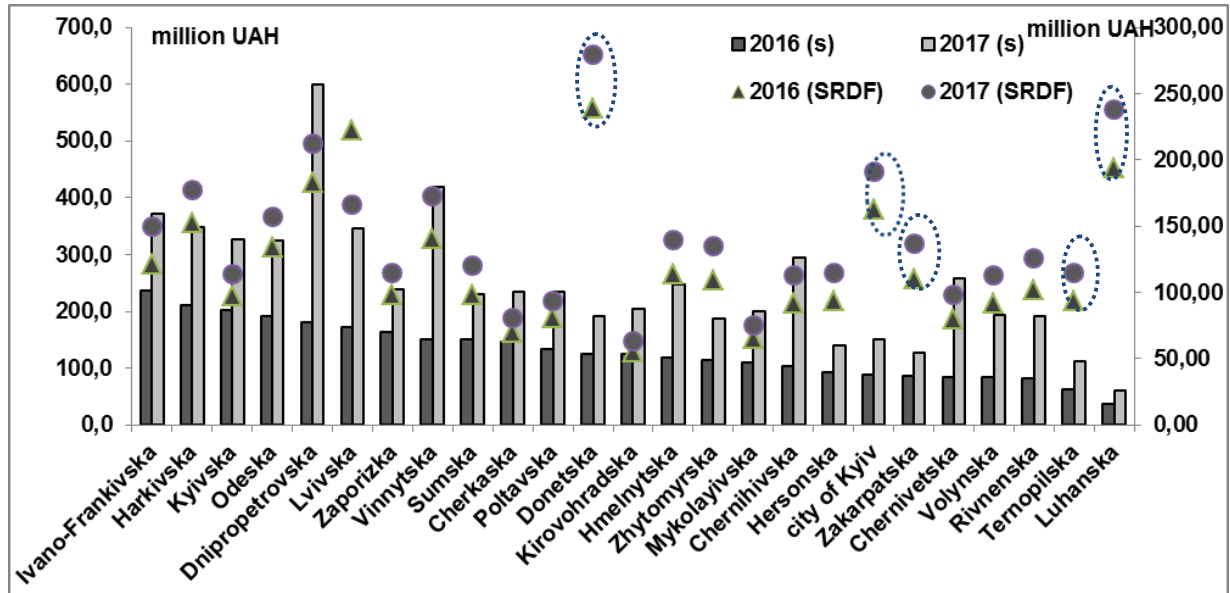


Fig. 4. Dynamics of subventions distribution for activities in social and economic development of certain territories and SRDF funds across regions of Ukraine in 2016-2017

Source: developed using the data of State Treasury Service of Ukraine URL http://www.treasury.gov.ua/main/uk/doccatalog/list?currDir=400657&&documentList_stind=21

Despite the fact that financial decentralization has opened new opportunities both for communities' development and for forming of local budgets, at the same time the new challenges that can significantly impact the further introduction of financial decentralization reform have arisen. Thus, in 2017 according to the Law «On 2017 State Budget» the Government transferred all expenditures to the level of local budgets, except for labour remuneration costs for teaching staff in general education establishments. This is despite the fact that all expenditures on pre-school and extracurricular education are completely financed by own funds of local budgets. The same situation was observed for health care facilities as well.

According to experts, such additional burden amounted back then to € 23.5 billion. To partially maintain funding of liabilities transferred to local level in 2017 the State Budget provided additional subsidy amounting to € 14.9 billion: to oblast budgets – € 5.9 billion, district budgets – € 7.66 billion, CTCs budgets – € 1.312 billion. It was distributed among all local budgets that had transferred to direct inter-budgetary relations with state budget (excluding the cities of oblast significance). Instead, in 2018 this subsidy amounting to € 16.5 billion is distributed only among oblast budgets, taking into account the number of population, local budget' revenues in the oblast and Tax Capacity Index of the oblast consolidated budget in equal proportions to present population in the oblast and the Relative Tax Capacity Index of oblast consolidated budget. Moreover, this subsidy is not granted to the local budgets, which have the reverse subsidy according to the Law «On 2018 Ukrainian State Budget» or if their Tax Capacity Index exceeds 1 (the reserve is created) [5]. Therefore, if last year the mechanism of this additional subsidy allocation granted the more or less equal conditions of receiving the funding, in 2018 the allocation of additional subsidy among the local budgets for educational and healthcare costs is conducted according to the procedure defined by Oblast State Administrations and approved by decisions on oblast budgets (according to Chapter 5 Article 103-6 of the Budget Code of Ukraine) [12]. By the way, regarding Lvivska oblast,

in 2018 the allocation of additional subsidy for the budgets of the cities of local significance was set at the level of 50% of the calculated volume. For other local budgets, it is not less than 60% and not over 90.5% of the same rate for 2017. Rivnenska oblast approved the following distribution of additional subsidy from state budget to exercise the transferred liabilities: 38.3% for oblast budget and 61.7% for district and CTCs budgets. Moreover, allocation of subsidies among local budgets within the oblasts was of subjective and biased nature. This was repeatedly emphasized by the experts of Financial Monitoring Group in the Central Reform Office [13].

Many experts and administrators of funds mention that accomplishment of 2018 budget shows the following risks this situation brings: firstly, delayed and incomplete transfer of additional subsidy funds to the local level led to salary and energy sources arrears in budget sphere, etc. By the way, in Lvivska oblast in 9 months of 2018 the deficit of labour remuneration costs in education amounts to ₴ 193 million, in health care – to ₴ 140 million. Secondly, financing of delegated liabilities by local governments, which are not financially ensured, weakens the financial capacity of local budgets (because it diverts own financial resources), which for sure is not the final goal of financial decentralization. Thirdly, it is an open question whether we can talk about the improvement of the quality of public services in such conditions. All the abovementioned does not contribute to improvement of the system of inter-budgetary relations, and therefore – to strengthening of financial decentralization.

Accumulation of the volumes of temporarily free local governments' money on deposit accounts instead of investing them in the projects that boost economic activity and sustainable growth in the future is the next challenge linked to the reform of authorities and resources decentralization that should be eliminated in the system of inter-budgetary relations. Thus, revolutionary changes in budget sphere (redistribution of revenues and fiscal changes) in 2014-2017 in fact contributed to positive dynamics of local budgets' revenues. The latter has caused the growth of volumes at deposit accounts in banking institutions. According to State Treasury Service, as of October 1, 2018 288 local budgets deposited ₴ 13.7 billion in governmental banking institutions. The first significant changes in this field took place in 2016 (the balances of deposit accounts increased more than 30 times compared to 2015). Analysis across regions shows that in the recent years Donetsk, Dnipropetrovska, Zaporizka, Poltavaska, Kyivska, Odeska and Vinnytska (especially in 2018) oblasts have been actively depositing their funds (Fig.5).

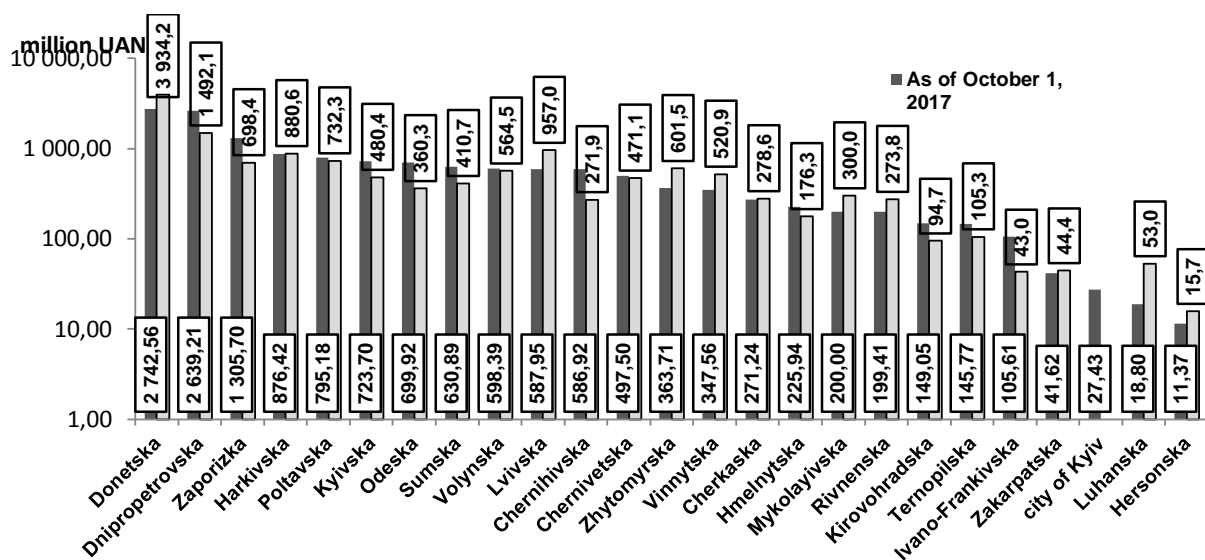


Fig. 5. Balances of temporarily free funds of local budgets on deposit accounts in banking institutions as of reporting date, million UAH.

Source: developed using the data of State Treasury Service of Ukraine URL http://www.treasury.gov.ua/main/uk/publish/category?cat_id=23608&page=0

Analysis across local budgets shows that, for example, only in 2018 the number of those deposited money increased three times: from 91 in January, 2018 to 288 in October, 2018. The effect from decentralization was the most essential for the cities Dnipro, Harkiv, Odesa, Lviv, Cherkasy, etc. In the end of October, 2018 there were 74 of them (Fig.6).

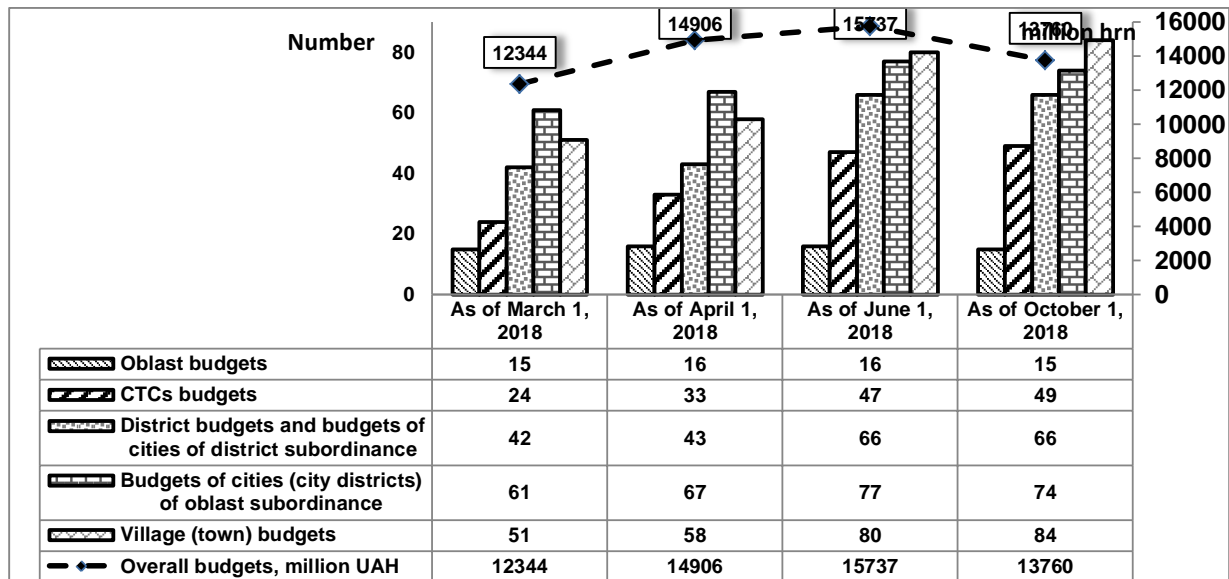


Fig. 6. Volumes of deposits in banks and the number of local budgets as of reporting date

Source: developed using the data of State Treasury Service of Ukraine [Internet resource] URL <http://www.treasury.gov.ua/main/uk/publish/article/421908>

The processes of financial decentralization enabled the residents to surpass tax revenues and therefore accumulate certain funds. In addition, this raises certain dilemma. On one hand, such tendencies testify to the fact that local governments gradually become financially capable, and therefore they can work for their development and use depositing of local governments' money as an instrument of attraction of additional funds (and it's not strange, in particular due to the fact that government has introduced the amendments to the Budget Code providing this opportunity to communities. These temporarily free funds are already stipulated by budgets for certain programs in the reporting periods). On the other hand, it diverts state finances against the deficit of state budget.

In this situation, in our opinion, the issue should be considered in whole new way (not to bait local governments for «freezing» the temporarily free funds or find out new mechanisms of liabilities distribution) – forming of new motivation mechanisms or incentives for boosting of local governments' activity so they aspire and are able to use budget funds in the shortest possible time.

Conclusions. Therefore, all the abovementioned confirms the existence of substantial challenges in the sphere of inter-budgetary relations in general and in management of budget funds in particular. Modernization of the system of inter-budgetary relations in Ukraine on the principles of financial decentralization is not always consistent and rational, causing the range of discussions. The further reforming of the system of inter-budgetary relations requires the range of activities able to accelerate positive changes, in particular:

- in order to streamline the principles and conditions of granting subventions for social and economic development of regions the amendments should be introduced to current Budget Code, with the view to provide a separate standard to regulate the procedure and conditions of granting the subvention to local budgets;
- elimination of «financial injustice» in the course of subvention allocation for forming of CTCs infrastructure can be achieved by reduction of the volumes of such assistance for the consolidated territorial communities, which have already received it in the previous periods, and (or) by legally established minimum amount of infrastructural subvention;

- the negative practice of distribution of additional subsidy for delegated liabilities in education and healthcare by Oblast State Administrations can be minimized and the comprehensiveness and quality of financial maintenance can be improved due to defining of unified parameters and criteria of this transfer distribution. In this sense, it is necessary to return to allocation of additional subsidy to all budgets at central level considering the reserve for oblast budgets (here we agree with experts' opinion [14]) and therefore guarantee the unbiased distribution of funds among all budgets within the oblast, or to support the suggestions of LOSA (Lvivska Oblast State Administration) Financial Department regarding the improvement of subsidy allocation mechanism based on the number of pupils – 60%, number of population – 20%, Tax Capacity Index – 20% in the oblast in order to increase the subsidy volumes and to not retrieve communities' financial resources for delegated liabilities [15];
- the first results of financial decentralization confirm that it is not enough to take into account only the territorial accessibility to providing the services to consumers in the process of liabilities distribution in the local governments' system of various levels, because substantial financial resources are needed for accomplishment of transferred liabilities. Low financial capacity of functions transferred to local levels grows without proper financial assistance, let alone the violation of the subsidiarity principle. As a result, it hampers the qualitative providing of public services. With each year, the number of transferred expenditures grows and not always corresponds to their financial provision. These steps eventually do not contribute to increased financial capacity of local budgets, most of them are unbalanced, and therefore it eliminates an opportunity to guarantee public services of proper quality in full. In our opinion, adoption of the Law of Ukraine «On administrative and territorial structure» will contribute to distribution of functional liabilities among the local governments. The following provisions should be taken into consideration: local governments should receive constitutional guarantees of their independence; duplication of functions of district councils and administrations should be eliminated.

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