

L. Benovska, I Muzyka  
"Institute of Regional Research  
named after M.I.Dolishniy of the NAS of Ukraine", Lvov

## **PROBLEMS OF FORMING FINANCIAL POTENTIAL OF THE LOCAL BUDGETS IN UKRAINE**

Reforms of the system of state management and finance in Ukraine, conducted over the past few years did not provide a transfer to a local level the powers and financial resources, but only a strengthening of centralization as administrative and financial resource took place. For today the existing low level of financial capacity of the local budgets is conditioned, on one hand, by excessive financial dependence of the regions on the center and a high deficit of budgets, which does not allow the territorial bodies to perform their functions in full, and on the other hand, low efficiency of management of forming and using of financial resources of the local budgets.

The aforementioned requires a comprehension of regularities of influence of instruments and levers of financial policy on social and economic development of the regions, a creation of an effective model of the regional financial policy based on harmonization of regional and nationwide interests in the financial sector, and also proves a need of development of mechanisms of increasing financial capacity of the regions through an implementation of financial potential.

The issues of strengthening a financial base of the local budgets were covered in the scientific works of S. Bukovynskiy [1], V. Vishnevskiy [2], O. Kyrylenko [3], O. Ivanova [4], I. Storonyanska [5]; Directions of conduction of optimization of the revenue base of the local budgets are reflected in scientific works of I. Zhuravleva [6].

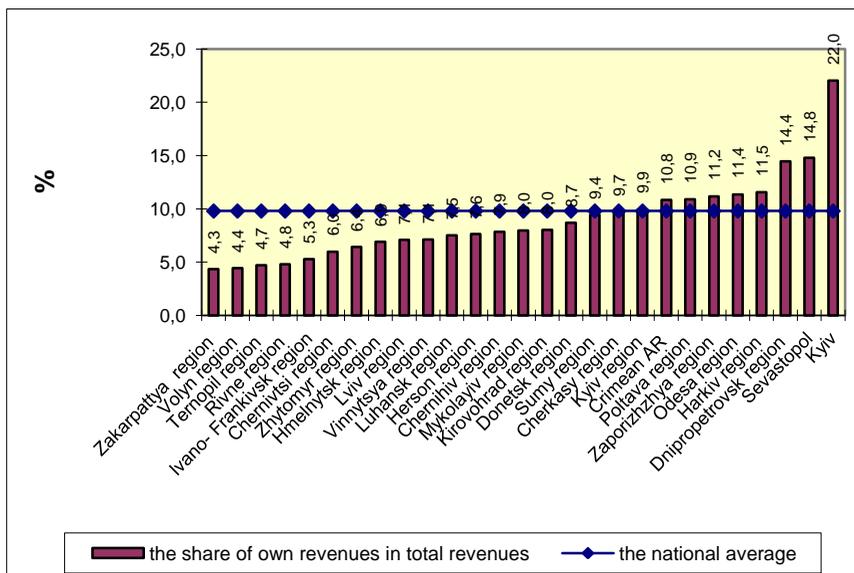
However, an increasing of financial potential of the local budgets requires an in-depth study of the problems of low financial capacity of the local budgets and a search of new tools and levers of financial policy aimed at providing a growth of financial resources of the local budgets.

The purpose of the article is to study basic problems of financial capacity of the local budgets of administrative and territorial units and to search the ways of strengthening their financial base.

First of all, the difficulties of implementation of the local budgets in Ukraine are because of their limited financial resources, and they gradually become systemic. Among the most significant problems of

low financial capacity of the local budgets we should note such important problems as a low level of own revenues in the structure of the revenue base of the local budgets and a strong dependence of the local governments on the state transfers.

Low levels of own revenues in the structure of revenue base of the local budgets. During 2006-2013 absolute amounts of revenues of the local budgets tend to increase, but it doesn't happen by own revenues, but by interbudgetary transfers. The share of own revenues in revenues of the local budgets in Ukraine in 2013 ranged from 4.3% in Zakarpattya region to 22.0% in Kyiv (Figure 1).



**Fig.1.** The share of own revenues in the structure of the consolidated budgets of the regions (2013)

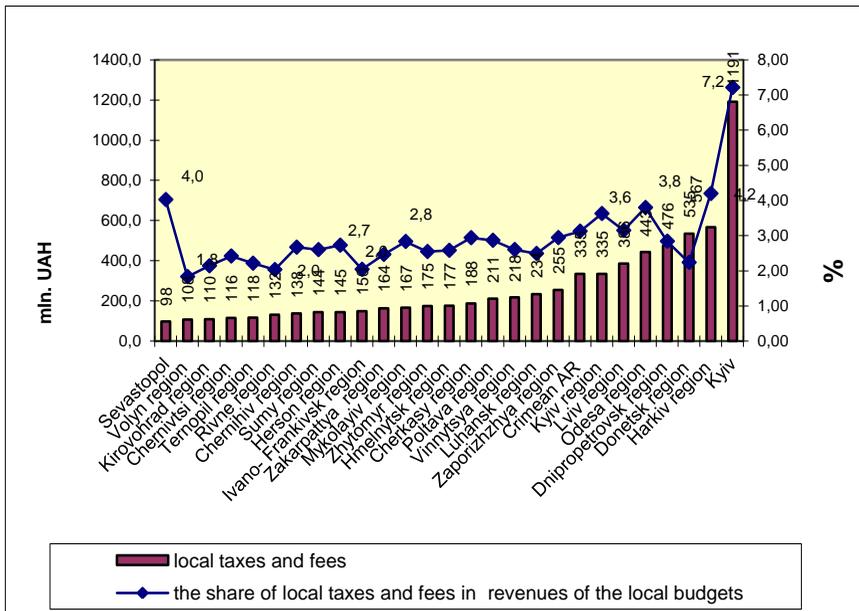
Herewith in seventeen regions the share of own revenues in the structure of revenues was lower than the average Ukrainian value (9.9%). Main source of formation own revenues of the local budgets was a land fee (55.8% on average in 2013 for Ukraine) and local taxes and fees (31.9%). We should emphasize at such a spatial feature of formation of own revenues of the local budgets: western regions are characterized by much higher share of local taxes (Lviv region- 40.0%, Volyn region- 42.2%, Ternopil region- 47.2%, Chernivtsi region -

40.5% ) and relatively lower level of revenues from the land fee in comparison with the industrial regions. This is due to the objective factors - a concentration in the western regions smaller amounts of land resources and sophistication of the business sector of economics, which provides formation of a single tax (a main component of the local taxes).

Insufficient impact of the local taxes and fees on the amounts of revenue share of the local budgets. Until 2010 the share of local taxes and fees in revenues of the local budgets was very scanty and varied from 1.6% in 2006. to 1.0% in 2010. In some regions it was lower than 1%. In 2010 with the adoption of the new Tax Code and abolition of fifteen kinds of taxes and fees that have existed since 1993 and an introduction of five (property tax, a single tax, a fee for certain types of business, a fee for a place parking vehicles, tourist tax), the situation has changed somewhat for better: the share of local taxes and fees in all revenues of consolidated budget of the country in 2013 amounted to 3.12%. It was higher than average in such regions as Kyiv (7.2%) Kharkiv region (4.2%), Odessa region (3.8%), Kyiv region (3.6%), and the lowest in the Volyn region (1.8%) (Figure 2).

In the structure of the local taxes and fees the greatest weight had a single tax for small businesses, the share of which was 90.7% in 2013. The share of newly created property tax is enormously insignificant (real estate - except land plot 0.3% in Ukraine) ( maximum value in Lviv region - 2.2%, minimum value in Odessa region - 0.2%). Despite the considerable expectations, the revenues derived from this tax do not affect the level of financial capacity of the regions.

Starting from 2015 with the amendments to the Budget and Tax Codes the situation with a formation of local revenues has slightly changed towards a decentralization of financial resources [7; 8]. A filling of the local budget should grow by introduction of new taxes (excise tax from final sales), changes in base and rates of real estate tax, changes in the distribution between the budgets of different levels such taxes as income tax, tax on personal income, environmental tax (Table 1).



**Fig.2.** The role of local taxes and fees in the revenues of consolidated budgets of the regions (2013)

Table 1

**New approaches to the formation of revenues of the local budgets according to the amendments to the Budget and Tax Codes in 2015**

Type of tax	Adopted changes
Excise duty on final sales (beer, alcoholic beverages, tobacco products, petroleum products)	New tax
Single tax	Transfer of income from the tax of special fund to the general
Real Estate Tax	Changing of base and tax rates; Inclusion to the tax base commercial (non-residential) property. Transfer of income from the tax of the special fund to the general

Environmental tax	Change in the distribution of tax - 20% to the state and 80% to the local budgets (previously to the local budgets - 35%); transfer of income from the tax of the special fund to the general
Fee for certain types of business	Canceled
Fee for parking place vehicles	Canceled
Tourist tax	Canceled
Income tax	Consolidation by regional budgets and the budget of Kyiv 10% income tax of enterprises which belongs to private sector
Fees for the other administrative services	Transfer of 100% from the state budget to the local budgets
State duty	Transfer of 100% from the state budget to the local budgets
Income tax	Setting of new regulations of tax deductions on personal income (the budgets of regional centers and districts - 60%, the regional budgets - 15% the budget of Kyiv - 40%)

Because of the strong dependence on the government transfers, local authorities practically don't have real incentives to the management of revenues of the local budgets. Distributions of transfers «by expenditures» do not prompt local governments to use financial potential of the areas effectively. Dynamics of transfers of the state budget to the local budgets attests about a strengthening of the trends of financial equalization, the share of which reaches more than half in the revenues of the local budgets and increases from year to year. If the share of transfers was above 60% in six regions in 2006, then their amount increased up to 10 regions in 2013. The share of transfers from the state budget was below 40% only in Kyiv (21.9%), Sevastopol (27.2%), Donetsk region (33.7%), and Dnipropetrovsk region (34.9%). There are also reverse interbudgetary transfers, when the local budgets transfer funds to the state budget, but only the capital of Ukraine, Kyiv transfers to the state budget more than it receives from it.

In the structure of the state transfers to the local budgets about a half of transfers is a subsidy of equalization. Total subsidy of the local budgets impulses us to doubt about an effectiveness of the existing system of financial equalization. Indeed, over 90% of the local budgets in Ukraine require the subsidy of equalization. Western region of Ukraine (except Lviv region) such as Vinnytsia, Zhytomyr, Chernihiv, Kirovohrad, Kherson regions get the largest share of subsidies per capita (Figure 2). The share of budgets- donors reduces from year to year. If in 2002 there were 89 units (or 13% of the total amount), then in 2013 there were only 33 units, or 4.8% [6].

In fact, the state withdraws a significant part of revenues, collected in the regions, and then distributes them between the budgets, which does not stimulate the development of economics of the regions. Therefore, in the system of interbudgetary relations in Ukraine there should occur gradual fiscal decentralization by increasing the financial capacity of the local budgets and reforming of the system of transfers for transition from equalization of the transfers to stimulation. It will allow to reduce interregional asymmetries of social and economic development of the regions.

In a structure of grants from the state budget, a part of grants for social and economic development of the regions is very small, while the grants of social issues dominate. Thus in 2013 only grants from the state budget to the local budgets for the payment to families with children, low-income families, people who are disabled since childhood, disabled children and a temporary state care for children were 72.2%. Due to the social subsidies redistribution of funds among the regions occurs, depending on the number of consumers of such programs. By absolute amount of subsidies from the state budget to the local budgets in 2013 the leaders were Donetsk, Dnipropetrovsk, Lviv, Kharkiv, Odessa regions and Kyiv, but the share of subsidies in the revenues of the local budgets and an amount of subsidies per capita were the highest in Rivne, Volyn, Zakarpattia, Ivano-Frankivsk regions.

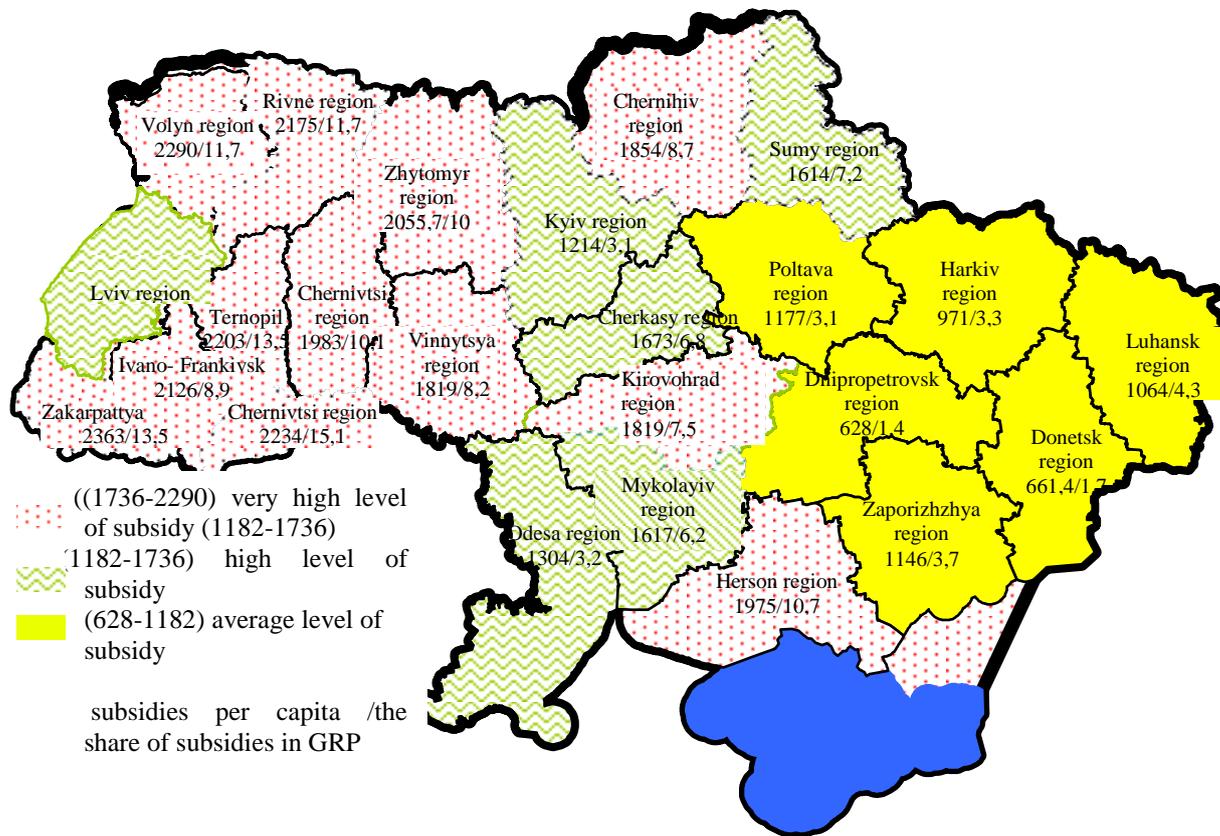


Fig. 3 Grouping of the regions of Ukraine by level of subsidy per capita in 2013

In 2015 with the amendments to the Budget Code of Ukraine a significant changes in a formation of the local budgets took place, connected with the use of financial equalization of the tax capacity of the areas. In particular it was liquidated a concept of revenues and expenditures which is or isn't considered when determining interbudgetary transfers. The transfers from the state budget will be given only for equalization of tax capacity of the areas depending on the level of income per capita.

A mechanism of equalization implies that the local budgets with the level of income below 0.9 average for Ukraine will receive a basic subsidy 80% of a sum, which is necessary to achieve indicator 0.9. Equalization will be carried out by two indicators: income tax of enterprises for the regional budgets and tax on personal income for the budgets of cities, districts and the regional budgets. Equalization by the other payments will not be run, and will remain fully available to the local authorities. It should be noted that a system of equalization is more progressive than a system of balancing, because it promotes an interest of the local authorities to draw additional revenues and to expand an existing tax base.

Low amounts of revenues to the budgets of development weaken an investment component of the local budgets. Amounts and share of development budget in revenues of the local budgets are so small that they do not allow to finance scale investments. For example, in 2013 the revenues of the budget development of the local budgets of Ukraine (including local borrowings) amounted to 8.3 billion UAH, which is 2.2 billion UAH less than the amount of revenues of the previous year. While calculating per capita in the country development budgets received only 188 USD. During the last three years in the formation of the development budgets significant structural changes took place which are connected with the inclusion of a single tax to the sources of its formation. An effect of inclusion associated with increase and indexation of the rates of a single tax. However, it was in fact the only fiscally promising source of revenues of the development budget. Since 2015 the situation has worsened considerably, because in the amendments to the Budget Code there is provided a transfer of revenues of the single income tax from the special fund to the general one.

It should also be emphasized that among the proposed changes to the Budget and Tax Codes a proposal of fixing an amount of development budget of at least 10% of revenues of the general fund

corresponding local budget was left without reviewing. In fact, local budgets will no longer have development budget, since the most profitable sources are transferred to the general fund, and there are no compensatory mechanisms. This situation threatens the possibilities of development of municipalities.

Essentially a new tax - excise duty on final sale (beer, alcoholic beverages, tobacco products, petroleum products) is partially responsible for provision of capital expenditures. The revenues from this tax (planned 5941.0 mln. UAH in 2015 in Ukraine) will be partially used for construction, reconstruction, repair and maintenance of streets and roads of communal property instead of existing subsidies from the state budget. However, the problem is that different localities will have different opportunities concerning the filling of the local budgets with revenues from this tax. In particular, an advantage will have those which have well developed commercial network, a presence of petrol stations and also a situation will be quite complicated with the administrative units that are remote from the city center and highways.

One more important issue we should pay attention is a problem of inefficient structure of the local budgets, in particular their vertical and horizontal imbalances. A cumbersome structure of the local budgets causes a number of problems of effective management of the budget resources. These problems include: a complexity of managing a large number of the local budgets (for Lviv region it is 731, Odessa region - 516, Chernihiv region - 593, Kharkov region - 485); a presence of large number of local communities with a number of residents less than 1,000 people (for example in Lviv region - 381); difficulties with defining clear boundaries of territorial units; a large number of self-government levels (3); heterogeneity of self-government units [2].

Thus, the main problems of financing of the local budget expenditures in Ukraine related to the limited financial resources of the local budgets and a low efficiency of expenditures. Changes in budgetary policy of the state towards a provision of decentralization of financial resources which are enshrined from 2015 in the Budget and Tax Codes to some extent contribute to a better filling of the local budgets. However, they have a negative impact on a structure of their expenditures particularly they negatively impact on the formation of budget development.

### Referens:

1. Bukovynskiy C. (2007). Zmiznennya finansovoi basy miscevoho samovryaduvannya yak chunnyk economichnoho zrostanya [Strengthening of the financial base of local self-government as a factor of economic growth]. Visnyk nazional'noho banky Ukrainy - Nunciate of the National Bank of Ukraine, 2, pp. 9-15;
2. Vishnevskiy V. (2001). Miszevi podatky i zbory v rynkoviy ekonomizy [Local taxes and fees in market economy]. Finansy Ukrainy - Finance of Ukraine, 1, pp. 11-20;
3. Kirilenko O.P. (2001). Finansova nezalezhnist miscevoho samovryaduvannya [Financial independence of local self-government]. Finansy Ukrainy - Finance of Ukraine, 1, pp. 34-39;
4. Ivanova O. Yu. (2014). Teoretikometodychne zabezpechennya vdoskonalennya systemy podatkovobyudzhethnyh vidnosyn [Theoretical and methodological provision of improvement of the system of fiscal relations]. Ekonomika rozvitku -Economics of development, 4 (72), pp. 42-53;
5. Storonyanska I. Z., Kozoriz M. A., Davymuka S. A., Vozniak G. V. etc., 2013, Upravlinnya finansamy mistsevich byutzhetyv Lvivshyny: problemy ta napryamy pidvischennya efektyvnosti, IRD NAN Ukrayiny, L'viv;
6. Zhuravleva I. V. Optimizatsiya dohidnoi bazy miscevyh byutzhetyv [Optimization of revenue base of the local budgets]. [Electronic resource]. - Access: [http://www.hneu.edu.ua/web/public/moved/hneu/NAUKA/Nauka/prezentacii\\_kafedr/Optimizacija-dohidnoi-bazi-miscevih-bjudzhetyv.pdf](http://www.hneu.edu.ua/web/public/moved/hneu/NAUKA/Nauka/prezentacii_kafedr/Optimizacija-dohidnoi-bazi-miscevih-bjudzhetyv.pdf);
7. Podatkoviy kodeks Ukrainy [Tax Code of Ukraine] 02.12.2010, №2755-VI.-[Electronic resource].-Access: <http://zakon2.rada.gov.ua/laws/show/2755-17>;
8. Byudzhethniy kodeks Ukrainy [Budgetary Code of Ukraine] 09.07.2010, №2456-VI.-[Electronic resource].-Access: <http://zakon1.rada.gov.ua/laws/show/2456-17>.