

Building-up Fiscally Strong Local Governments – A Challenge For Ukraine

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1. Introduction

Until recently in Ukraine the local governments have played a role of the central government agents. Most of their expenditure assignments have been regulated and directly controlled by the central state; this creates a situation when demand for local fiscal autonomy concerning revenues is highly limited. It resulted in situation when local authorities are mainly accountable nor before citizens, but before the state. Such a system inherited from the socialist past still exists in its main features despite the new legislation proclaiming the autonomy of local governments.

According to legislation, there are two types of local authority in Ukraine. One is state administration on the oblast (region) and rayon (county) level. The elected councils on these levels have no executive bodies; the latter are incorporated into structure of the territorial state administration.

The other group comprises bodies of self-government (councils elected in communities) on the oblast, rayon, city, village and township level. The councils in cities, villages and townships form their own executive bodies. The current administrative-territorial composition of Ukraine since independence is presented in Table 1.

Table1. Administrative-territorial structure of Ukraine

Years	Autonomous republic	Oblasts	Rural rayons	Cities and towns total	Oblast capitals and cities of oblast significance	Urban districts	Townships	Villages
1990	-	25	479	436	145	120	927	8996
2001	1	26*	490	449	171	122	893	28651

* Includes two cities of national significance: Kyiv City and Sevastopol.

As the data above shows, the number of local communities has more than doubled since independence. The reason for this was that new legislation that proclaimed the independent authority building for all the rural communities. But until now only about 1/3 of them have had their own budget. The current discussions concerning readjusting the territorial composition to public needs concern all the levels of the present vertical governmental structure. It is obvious that these changes in public sector are supposed to be done with a great delay. The problem is that the most important changes of intergovernmental finance have been introduced since 2001 without any connection to territorial changes. A new approach to intergovernmental finance is simply pulled over the obsolete socialist administrative-territorial composition. That is why the change in it is more than timely.

There are suggestions as to the lessening the number of oblasts and rayons. But the most challenging one is about the number of rural communities (villages and townships). There is no doubt that their merging with neighbor towns or with other units of the same status would be the first step of administrative-territorial reform of the expected ones.

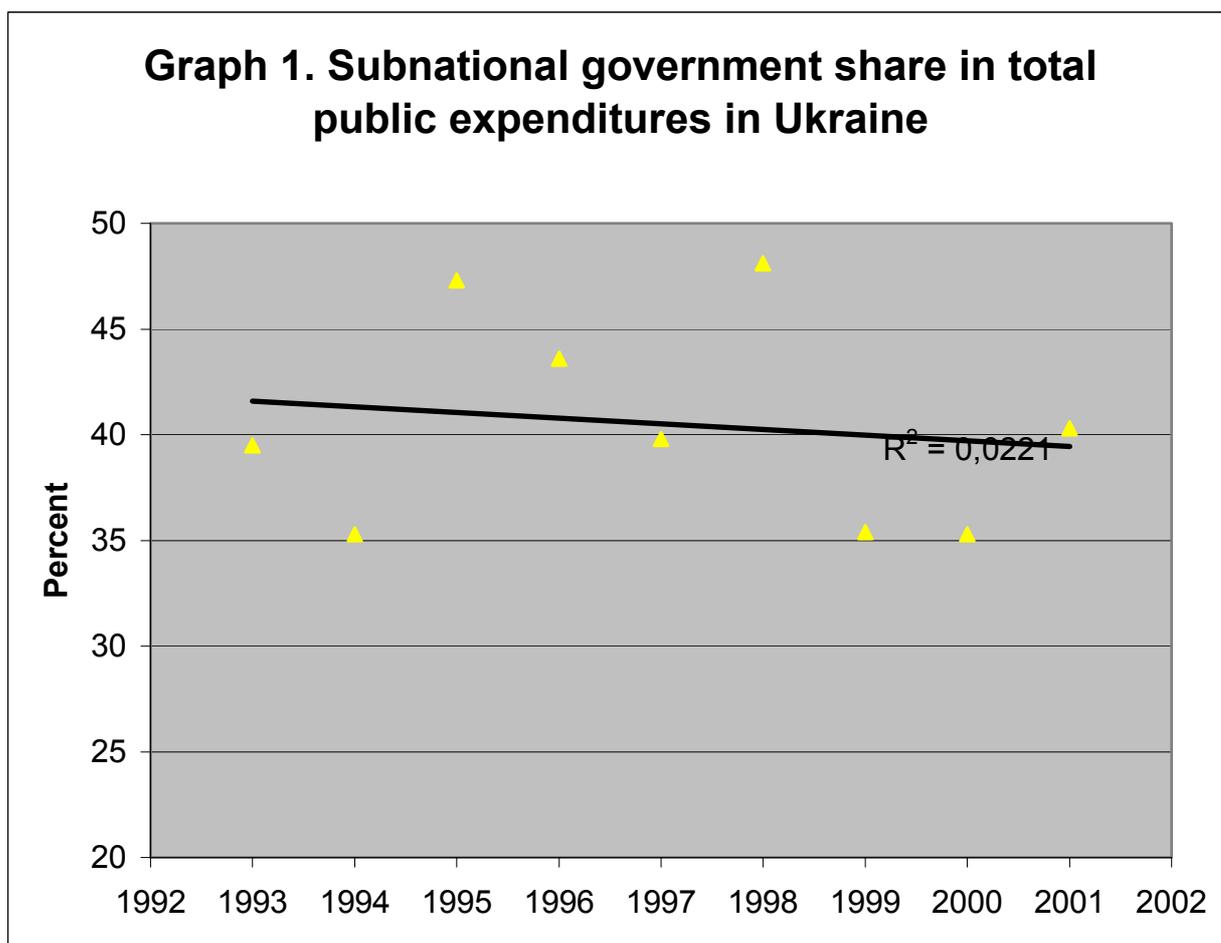
The existing administrative-territorial composition creates the replica fiscal statistics. Allowed for the fact that state territorial administrations are accountable for delivery of important chunk of local public services, this should mean that the overall fiscal data on local governments' involvement into economic activity (public service delivery) and revenue accumulation could be misleading (see Table 2) – the real role of the subnational sector of government should be much less significant than it is shown by statistics.

Table 2. Distribution of general government total expenditures and total revenues (without transfers and State Pension Fund outlays and revenues)

Levels of government	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Expenditures											
Central government	68.57	62.18	60.49	64.66	52.70	56.36	60.10	51.86	54.58	64.70	59.70
Subnational governments	31.43	37.82	39.51	35.34	47.30	43.64	39.90	48.14	45.42	35.30	40.30
Revenues											
Central government	54.08	52.44	53.28	57.96	47.62	52.43	56.82	54.31	60.03	70.86	67.38
Subnational governments	45.94	47.56	46.72	42.04	52.38	47.57	43.18	45.69	39.97	29.14	32.62

Source: Own calculation on MoF data.

There is a very important trend in expenditure and revenue assignment: the data above shows that up to 2001 there has been no clear trend towards decentralization of public revenues and expenditures in Ukraine due to the non-existent policy of decentralization. Only since 2001 when the first steps of budgetary reform were implemented, these shaky ups and downs turn on some clear path to decentralization. This statement could be proved by the Graph 1 below: even with the decentralization trend of the last years the overall situation demonstrates no definite growth in subnational government share as opposed to many other post-socialist countries, e.g. Russia.



All these facts mean: there exist in Ukraine some problems with subnational government fiscal performance and resulting from it level of accountability. Finding the ways to make the subnational authorities more self-reliant from the fiscal point of view will raise their capacity in responding local demands for public goods.

The paper below is aimed to analyze the developments in Ukrainian subnational finance since independence with a special stress given to issues in enhancing subnational government fiscal discretion.

List of abbreviations:

- EPT enterprise profit tax;
- GDP gross domestic product;
- MoF Ministry of Finance of Ukraine;
- PIT personal income tax;
- SNG subnational government;
- STA State Tax Administration;
- TFIM tax-free income minimum;
- UAH Hryvnya (Ukrainian currency unit);
- VAT value added tax.

2. Local Government in Ukraine: changing responsibilities

Ukraine could be characterized as a country with quite big SNG portion in GDP (ranging between 10-15 percent). The data below (Tables 3, 4) demonstrates that there is a trend to decentralization of both public revenues and expenditures since 2000. But, as it was stated before, this data cannot characterize the real significance of SNGs functions within the sector of public administration.

The expenditures within general government show a very uneven distribution across governmental tiers. From this data a relative significance of governmental levels in public sector economy can be derived. The majority of functions are concentrated in the intermediate tier represented by governments of oblast and rayon levels.

Table 3. Governmental tiers' expenditure shares in GDP (without transfers and State Pension Fund), percent

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Consolidated general government	32.58	38.23	38.61	44.93	37.02	33.06	37.10	30.41	26.69	27.84	26.31
Central government	22.34	23.73	23.34	29.07	19.51	18.63	22.30	15.77	14.57	18.01	15.72
Total SNGs	10.24	14.43	15.24	15.88	17.51	14.43	14.80	14.64	12.13	9.83	10.59
Oblast governments	2.65	4.39	3.64	3.61	6.37	5.10	4.41	5.16	4.47	3.30	...
Total sub-oblast levels	7.59	10.04	11.60	12.27	11.14	9.33	10.39	9.48	7.66	6.53	...
Cities of oblast significance	4.11	5.90	7.28	7.99	6.30	5.23	5.87	5.21	3.93	3.3	...
Rayons	2.42	2.92	2.90	2.82	3.40	2.89	3.34	3.32	2.87	2.43	...
Total sub-rayon governments	1.06	1.21	1.42	1.45	1.44	1.21	1.18	0.95	0.86	0.77	...
Cities of rayon significance	0.22	0.28	0.34	0.34	0.34	0.33	0.30	0.25	0.21	0.19	...
Townships	0.24	0.28	0.34	0.34	0.31	0.26	0.26	0.22	0.19	0.17	...
Villages	0.60	0.66	0.74	0.77	0.78	0.62	0.62	0.48	0.45	0.41	...

Source: Own calculation based on MoF data.

Table 4. Share of subnational government revenue in GDP (without transfers and State Pension Fund), percent

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Consolidated general government	25.15	24.40	33.47	35.62	30.27	28.24	30.40	28.19	25.20	28.40	25.71
Central government	13.60	12.80	18.28	20.64	14.41	14.81	17.27	15.31	15.12	20.12	17.32
Total SNG	11.55	11.61	15.19	14.98	15.85	13.44	13.12	12.88	10,08	8.28	8.39
Oblast governments	2.47	3.50	5.44	4.57	7.50	6.42	6.61	6.38	4.87	3.45	...
Total sub-oblast levels	9.08	8.11	10.59	10.40	8.35	7.01	6.52	6.50	5.19	4.82	...
Cities of oblast significance	6.43	5.15	6.87	7.49	5.33	4.38	4.50	4.13	3.22	2.91	...
Rayons	1.58	2.12	2.94	2.13	2.28	1.94	1.34	1.74	1.45	1.38	...
Total sub-rayon governments	1.07	0.84	0.78	0.78	0,74	0.70	0.68	0.63	0.53	0.53	...
Cities of rayon significance	0.30	0.22	0.20	0.22	0.22	0.25	0.22	0.21	0.19	0.19	...
Townships	0.29	0.22	0.20	0.21	0.19	0.17	0.17	0.16	0.14	0.13	...
Villages	0.47	0.40	0.38	0.35	0.34	0.28	0.28	0.26	0.20	0.22	...

Source: Own calculation based of MoF data.

The data above demonstrates that the relative size of SNGs in the national economy since independence experienced wide fluctuations, but still remains quite high. The total economic instability affected greatly the state of the national public finance, so the governmental share in GDP had big amplitude. The independence contributed to the SNGs' share growth in GDP; this was followed by relative growth of the SNGs of different levels. The process of relative growth of SNGs continued until 1994; after this year the total general governmental quote in GDP began to shrink, arriving at the smallest figure of 26.31 percent in 2001. The relative size of the total government did not reach at the moment the state before independence; it has begun to grow since 2000, but at the expense of centralization of public moneys. Namely this year one can see the biggest drop in SNGs' GDP share.

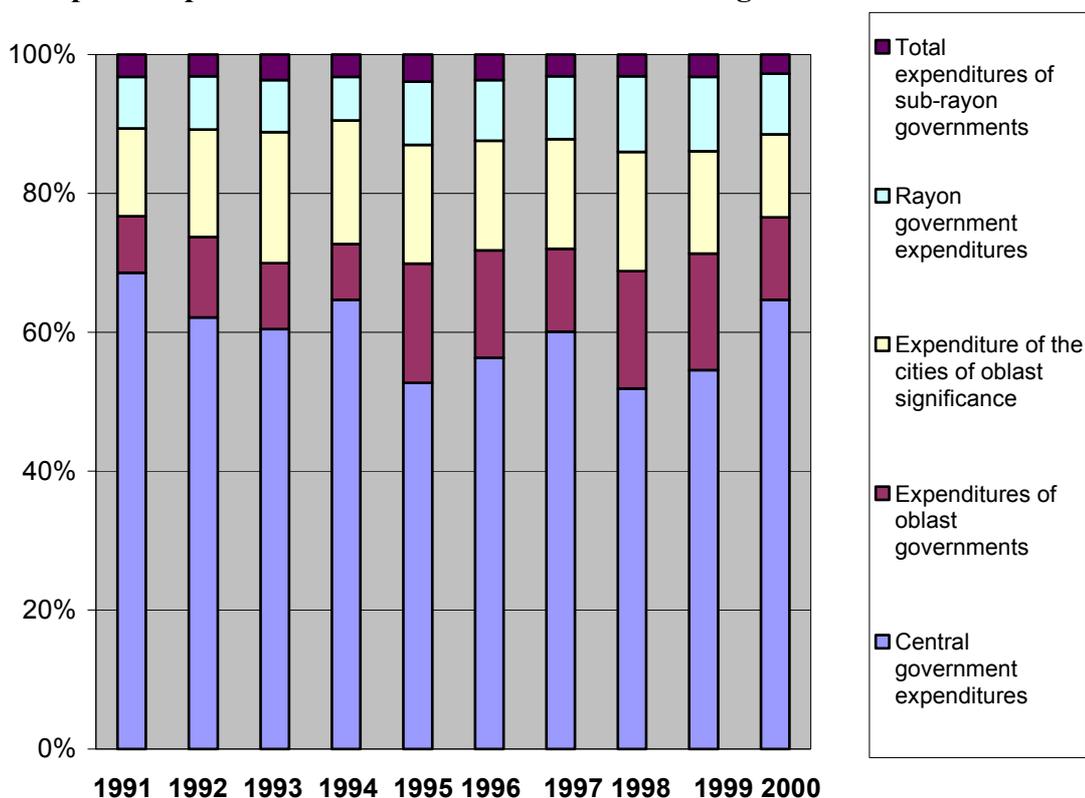
Since 1996 one could see a drop in SNGs' GDP share that concerns all the subnational levels; but the most severe drop occurred since 1998: the subnational share in 1998-2000 has fallen by 1/3, reaching the lowest level since independence – 9.9 percent in 2000. There was no significant drop in local government expenditure on the lowest level (villages and townships). The start of budgetary reform in 2001 depicted some relative growth of SNGs' share in GDP; further growth could be expected in 2002.

The dynamics in public participation in economy shows on the one hand the lack of consistent and radical economic reforms in the country. This causes the stably significant role of the public sector in economy. On the other hand, there was a lack of reforms in the sector of public administration itself – a trend towards centralization being the indicator. Both factors deliver the true evidence that Ukraine is still far behind the other transitional nations from the point of view of economy reforming.

The conclusion concerning the lack of fiscal decentralization could be strengthened by the evolution of expenditure distribution (Table 2 above). The share of the central government in public sector total expenditures has grown, the SNGs' share – diminished. Most affected were the share of SNGs which generate the most significant part of public revenues – of the cities of oblast significance; in opposite, the share of intermediate governments (oblast and rayon) has increased.

The data in Table 2 and a diagram built on it basis (Graph 2 below) demonstrates that for the time period 1991-2001 the SNGs' share in total public expenditure has been increasing during 5 years (1992, 1993, 1995, 1998, 2001) reaching the maximum in 1998; decreasing during 5 years (1994, 1996, 1997, 1999, 2000) reaching its minimum in 2000 (when not taking into consideration the year 1991). The division of expenditures between the central government and SNGs has fluctuated widely: e.g. in 1995 the SNGs' expenditure share has grown by 12 percent points (up to 1/3); the similar occurred in 1998.

Graph 2. Expenditure distribution between levels of government



By the year 2000 the distribution of total public expenditures between governmental tiers had actually returned to the state before independence. It is likely that full implementation of Budget Code provisions will make some corrections in this field. Fiscal decentralization started; at least, the results of the fiscal year 2001 give some reasons to draw such a conclusion: the central government portion in public expenditure has dropped by 5 percent points.

During a long period of time the intergovernmental finance in Ukraine suffered from the lack of clarity in the function delineation between levels of government. The actual functional distribution was done through the annual budget laws and central government ad hoc regulations. The basic Law On Self-Government approved in 1997 made the situation clearer introducing two main categories of expenditures of SNGs – the own and delegated ones. But the SNGs' own competence in expenditure policy was formulated in a very loose way through such terms as “administrating”, “securing”, “organizing”, “fostering” and similar that have little to do with real fiscal flows in the sector of public administration. The expenditure competence of governmental units were not differentiated according to their ability to be a public service provider – big cities and small villages have the same responsibilities. This Law contains some provisions concerning obligatory

delegation of the most important functions assigned to the self-governmental bodies (such as education, health care, social care, etc., up to budget execution on rayon and oblast level) to the local state administrations directly subordinated to the President Office. This approach made the real self-governance in rayons and oblasts very doubtful; the only exception could be the cities of oblast significance where there were no state administrations. The elected bodies of small cities, as well as townships and villages delegated their functional authority to the bodies of rayon and oblast levels. So, in fact, about 90 percent of total expenditures performed on the subnational level were delegated ones, that is, they were performed by the state bodies or under direct control of the central government. The unclear competence delineation between governmental levels made the fiscal endowment of local public facilities very complicated: they received budgetary moneys from different governmental levels.

The enactment of the Budget Code (2001) made the situation a bit clearer. The Code made a delineation in delegated expenditure competence between governmental tiers (oblasts, rayons, cities of oblast significance, other types of SNGs), but it did not touch the function distribution and assigning expenditures on the own functions of SNGs. So there is a need to improve the basic legislation to reach more compliance between distribution of functions and expenditures.

As the Table 5 shows, the shifts in expenditure distribution among governmental tiers in Ukraine are obvious: (i) the SNGs began playing a bigger role in financing economics (first of all this is subsidizing the industries); this is especially true for oblast governments; (ii) the expenditures on housing and amenities have been redistributed in favor of SNGs. In other spheres of public sector there were no significant changes though the time since independence.

Table 5. The distribution of expenditures by function within sector of public administration

Sphere	Year	Central government	SNGs	SNGs of oblast level	Rayon government	Cities of oblast significance	Cities of rayon significance	Townships	Villages
Total expenditures	1992	62.2	37.8	11.5	7.7	15.5	0.7	0.7	1.7
	2000	67.4	32.6	11.8	8.7	12.0	0.7	0.6	1.5
	2001	59.7	40.3	...	...	...	...	...	...
Social protection	1992	35.0	65.0	31.7	9.3	22.9	0.4	0.3	0.4
	2000	61.8	38.2	10.1	13.8	13.9	0.2	0.1	0.1
	2001	51.2	49.8	...	...	...	...	...	...
Economy	1992	84.0	16.0	5.1	1.5	8.4	0.6	0.4	0.1
	2000	63.9	36.1	28.3	2.1	5.2	0.2	0.2	0.2
	2001	77.3	22.7	...	...	...	...	...	...
Housing and amenities	1993	5.3	94.7	15.7	4.2	65.8	4.7	3.4	1.1
	2000	0.2	99.2	18.9	15.5	56.0	5.3	3.2	0.8
	2001	0.01	99.9	...	...	...	...	...	...
Total social branch	1992	24.9	75.1	13.5	20.45	31.6	1.8	1.9	5.8
	2000	29.6	70.4	18.4	20.3	25.3	1.6	1.5	3.4
	2001	29.6	70.4	...	...	...	...	...	...
Education	1992	33.9	66.1	6.6	17.0	28.1	3.0	3.1	8.3
	2000	38.8	61.2	8.0	20.0	23.2	2.5	2.3	5.1
	2001	38.0	62.0	...	...	...	...	...	...

Health	1992	10.1	89.9	22.2	25.6	39.3	0.4	0.6	1.8
	2000	14.8	85.2	31.8	21.7	29.8	0.3	0.4	1.1
	2001	17.4	82.6	...	...	...	...	...	...
State administration, judiciary, law enforcement	1992	75.3	24.7	7.4	3.2	7.6	0.5	0.9	4.8
	2000	84.4	15.6	4.3	1.8	5.9	0.4	0.5	2.6
	2001	87.0	13.0	...	...	...	...	...	...

Source: Own computation based on MoF data.

From the point of view of expenditures one could detect that the model of intergovernmental fiscal relations in Ukraine is characterized by dominating agent approach whereas the local governments play a role of the central government's agent depending highly on its desire to control all the activities on the subnational level. This situation corresponds with the structure of SNGs' finance.

3. Local Government Finance¹

The SNGs' finance in Ukraine depicts a high reliance on the central government fiscal assistance. The structure of revenues of subnational levels is characterized by the domination of the indirect or indirect transfers. As Table 6 below shows, the tax share in SNGs' revenues is quite high – around 55-65 percent; but almost all of these proceeds are national ones, ceded to the SNGs or shared with them. The portion of local taxes is insignificant (less than 3 percent of total revenues). As to user charges, their importance is quite high, but they are not statistically assessed due to current methodology; only subventions covering the deficits of communal units (transportation, water treatment, sanitation etc.) are reflected in the budgets of the SNGs. The share of official transfers is also quite high – about 1/3 of the total revenues; they are disbursed mainly as the equalization grants. The dominating number of rayon governments as well as small towns, townships and villages cannot perform their activity without having massive fiscal support from the state budget or budgets of higher levels.

Table 6. Subnational government revenues in Ukraine

Revenues		1999	2000	1999	2000
		Thousand UAH		Percent	
Tax revenues		10962095	11757007	55.26	62.91
<i>Taxes on revenue, profit, market value increase</i>		7935693	8494878	40.01	45.45
	PIT	3111491	6377739	15.69	34.12
	EPT	4824202	2117139	24.32	11.33
<i>Property taxes</i>		296233	529498	1.49	2.83
	Motor vehicle tax	296233	529 498	1.49	2.83
<i>Fees for special usage of natural resources</i>		1170781	1460542	5.90	7.81
	Fee for forest usage	10588	9902	0.05	0.05
	Fees for water usage	38715	39698	0.20	0.21
	Mineral resource tax	31161	34537	0.16	0.18
	Land tax	1090317	1376403	5.50	7.36
<i>Internal taxation of goods and services total</i>		1017689	562300	5.13	3.01
Excises on domestic goods total		584280	150591	2.95	0.81
	Alcohol	–	125900	-	0.67
	Tobacco	–	6196	-	0.03
Licenses for entrepreneurial and professional activity total		138932	144180	0.70	0.77

¹ The issue of Ukrainian local government finance was analyzed by the author in detail in several publications: Slukhai (1999); Slukhai (2000); Slukhai (2002).

	Craft tax	13771	14177	0.07	0.08
	License and certificate issuance duty	5763	1356	0.03	0.01
	Duty for registration of business entities	11316	14362	0.06	0.08
	Duties on issuance of licenses on alcoholic beverages and tobacco retail trade	99165	112342	0.50	0.60
	Trade patent duty	294476	267528	1.48	1.43
<i>Other taxes</i>		541696	709788	2.73	3.80
	Local taxes and duties	441524	485495	2.23	2.60
	Unified tax for small businesses	62376	178276	0.31	0.95
Non-tax revenues		551643	1782496	2.78	9.54
<i>Incomes from property and entrepreneurial activity</i>		215811	299656	1.09	1.60
	Interest on bank deposits	50076	57174	0.25	0.31
	Incomes from property privatization	127804	215747	0.64	1.15
<i>Administrative duties and payments. incomes from non-commercial sales</i>		134171	151241	0.68	0.81
	Rent	41077	62454	0.21	0.33
	State duty	88522	88060	0.45	0.47
<i>Fiscal penalties</i>		99254	102529	0.50	0.55
<i>Other non-tax revenues</i>		102406	1229068	0.52	6.58
<i>Own revenues of budgetary institutions</i>		2202	1066258	0.01	5.71
	Special funds	2202	581308	0.01	3.11
	Earmarked funds	-	283979	-	1.52
	Other revenues	-	200970	-	1.08
Capital revenues		7225	22963	0.04	0.12
Earmarked funds		1631492	749318	8.22	4.01
Environmental tax		48271	85317	0.24	0.46
Road tax		1523930	489335	7.68	2.62
Other funds		17058	12220	0.09	0.07
Regional and local earmarked funds		42231	162 446	0.21	0.87
Revenues without transfers		13152456	14311785	66.30	76.58
Official transfers		2942338	4377989	33.70	23.42
<i>From the bodies of state administration of other levels</i>		2942338	4377989	14.83	23.42
	General donations from the state budget	2029185	4126462	10.23	22.08
	Mutual settlements	795078	68910	4.01	0.37
	Special subventions form the state budget	50000	102328	0.25	0.55
	Budget borrowing	-	80289	-	0.43
	Fuel subventions	3741858	-	18.86	-
Total revenues		19836653	18689775	100.0	100.0

Source: MoF.

The development of SNGs' revenues could be characterized as very instable. Until 2001 the SNGs' revenue share in GDP demonstrated a downward trend (by about ¼ since independence); respectively, the central government revenue share soared (more than 20 percent in 2000). This drop could be attributed mostly to negative financial development on the subregional level. As it was stated before concerning expenditures, the same trend to centralization was observed concerning revenues; the changes took place only after approval of the Budget Code. This also

witnesses that the SNGs' possibility to express one's own view on how the fiscal sources should be spent was shrinking.

The SNGs' revenue patterns in Ukraine were inherited from the Soviet time when the sub-national bodies were funded mainly through the system of indirect and direct transfers used as tools of fiscal equalization.

The revenue sources in SNG sector are traditionally distributed into three main categories: (i) own revenues in broad sense (local taxes and local non-tax revenues together with so-called ceded national taxes²); (ii) regulating (shared) taxes; (iii) general and earmarked transfers.

After the approval of the Budget Code, the category of shared taxes has been abolished in relations between national government and SNGs; but it still remains in relations between subnational levels (PIT and land tax are shared due to fixed rates).

This states explicitly that Ukraine has shifted from the system of shared taxes to the more progressive system of ceded taxes.

The method of calculating local shares used before 2000 was based on central assessment of local expenditures and granting them funding through regionally and locally differentiated shares of selected national taxes; the territories experiencing deficits after this procedure received official transfers in amount sufficient for bridging the gap. In 1995, this system was modified by the Law On Budget System (the marginal sharing rates were introduced), but its main features did not change: selective tax sharing, annual corrections of sharing rates, revenue distribution based on origin principle. One of the main problems with this system was its instability caused by turbulence of national fiscal system. As Table 7 shows, the chaotic experiments with shared taxes and sharing rates seem to come to an end by the year 2000 when the PIT became essentially the ceded tax.

Table 7. National tax sharing rates in Ukraine, 1992-2002.

Tax	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
VAT	D	D	20	D	D	0	0	0	0	0	0
Excises on domestic goods	D	D	20	20	20 ^a	50	0	D	D ^b	D ^c	D ^c
PIT	100	100	50	50	50 ^a	100	100	D	100	100	100
EPT	D	D	50	70	70	100	100	D	D ^{b*}	D ^{b*}	D ^{d*}

Legend: D means that sharing rates are regionally differentiated.

^a AR Crimea and Sevastopol retain 100 percent. ^b AR Crimea and Kyiv City retain 100%.

^c AR Crimea retains 50 percent. ^d Kyiv City retains 50 percent. ^e AR Crimea retains 100 percent.

* The regional governments received 1.5 percent of EPT proceeds for financing expenditures on house constructing for military servants.

Source: Respective annual budget laws.

The national tax sharing delivered a dominating portion of subnational revenues up to the fiscal year 2000: it accounted for 50 to 80 percent to total on the average (Table 8). The data in Table 7-8 demonstrates the permanent turbulence of the assignment of national taxes to SNGs. As a result, this practice made the subnational fiscal planning and sound fiscal management almost impossible and subnational fiscal autonomy – insignificant. Under the precondition of prevailing portion of national tasks in SNGs' activity it is small wonder that they preferred to piggyback central government revenue sources instead of generating their own ones.

Table 8. Percentage of the most important national taxes in SNGs' revenues (transfers included)

Taxes	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
VAT	23.0	32.9	20.6	30.5	28.7	0.0	0.0	0.0	0.0	0.0

² Under ceded national taxes such taxes which proceed are fully attributed to subnational budgets are understood; on the subnational level they could be shared.

Excises on domestic goods	3.5	5.2	2.5	1.0	0.9	3.2	0.1	3.6	0.8	1.4
PIT	16.6	10.9	10.9	8.7	11.1	22.6	23.7	19.3	34.1	44.8
EPT	17.0	33.4	45.6	36.0	33.3	39.6	37.5	30.0	11.3	10.2
Total	60.1	82.4	79.6	76.2	74	65.4	61.3	52.9	46.2	56.4
Shared taxes total	43.5	71.5	79.6	76.2	74.0	62.2	0.0	52.9	12.1	11.6

Source: Own computation based on MoF data.

Why was the system of tax assignment in Ukraine so unstable? The answer may be found in the specifics of function that was vested on tax sharing by the MoF: minimizing the number of regional budgets subsidized by the state budget. By given fluctuation in annual normalized expenditures and disbursed (due to origin principle) revenues, the mismatch to be dealt with has changed from year to year. This made the reassessment of national sharing rates permanent. Of course, the process of reassessment affected the interests of regional governments, so some kind of bargaining process between center and subnational authorities concerning list of shared taxes and – especially – sharing rates took place. But this process was conducted in a very non-transparent way that causes wide deviations of the actual territorial revenue distribution from the legislated one.

The effective sharing rates appeared higher than the planned ones because the deficiency of budgetary planning claimed for “manual” budget execution. The data below demonstrates the non-motivated changes in national tax sharing. As some scholars emphasized, under such circumstances the sound budgetary planning even in the short run is merely impossible (Kravchuk, 1999:392).

Table 9. The effective sharing rates at the national level for the most significant taxes

Tax	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
VAT	42.9	50.1	33.1	66.3	55.7	0.0	0.0	0.0	0.0	0.0
Excises on domestic goods	53.2	54.5	31.3	25.1	16.1	38.8	0.0	37.0	8.4	12.3
PIT	100.0	100.0	67.1	53.8	52.1	100.0	100.0	70.2	100.0	100.0
EPT	55.3	60.9	66.7	72.9	73.6	100.0	100.0	75.9	27.5	25.6

Source: Own calculations based on data of MoF.

Another problematic issue in tax sharing was that the bodies of the higher level (state administrations) were vested the right “to regulate” the budgets of the bodies of the lower level. “Regulation” meant applying the deliberately differentiated sharing rates on the territory of own jurisdiction. This is why the instability on the national level was aggravated by instability and non-transparency on the regional level. The latter relations were even more characterized by unfairness and arbitrariness because there was no legal procedure for calculating the sharing rates on the regional level. This was especially true for the biggest donors of the Ukrainian budgetary system – cities of oblast significance who lacked fair distribution of funds badly. As it was observed in many cases, decisions of the local state administrations concerning tax sharing were motivated not economically (e.g. existing public facilities in designated area), but politically (Parhomenko, 1998:87), often being used as a tool of pressure on the city governments to push them to pursue the prescribed expenditure policy or even to compromise the body in power before the electorate.

The most serious disputes have been between oblast administration and cities of oblast significance: in many cases the cities with quite large original revenue bases were artificially

made the ones with budgetary deficit by using the shared-tax-mechanism. This deficit has to be bridged then by donations from the oblast budget.

This analysis might be concluded by the statement that the most important argument to maintain this system through years was the desire of the center to pursue strict control over fiscal flows within the sector of public administration. The negative results of this system for sustainable SNGs' finance, accountability and sound fiscal management resulted finally in its abolishing in 2001.

Since that year, the PIT became a ceded tax that delivers the dominating share of subnational revenues. It makes up for about half of subnational proceeds. But it should be recognized that this change did not solve the problem of sustainable local revenues due to the nature of this tax. On the one hand, it makes subnational budgets more vulnerable to economic performance because of pro-cyclic development of the proceeds. On the other hand, the national government may try to use this tax as a tool of macroeconomic regulation. This will endanger the local budgets and cause a significant resistance to changing the taxation of personal incomes. If the external sources of economic growth become exhausted, the state will try to create more favorable conditions for internal investments by lowering the quite high income tax rates. Finding a source of compensation for the short-term drop in subnational revenues will be not an easy task. That is why the current debates in the Parliament concerning introducing 10 percent flat rate for PIT has not resulted in any positive decision³.

The structure of SNGs' expenditure by function as presented in Table 10 below suggests that the most important functions of SNGs are education, health care and social protection – all together they comprise about 60 percent to total. These functions are those delegated to SNGs by the state because they are considered national public goods with free access granted to all the citizens regardless of the place where they live. These functions are funded through ceded national taxes (PIT and land tax) and expenditures on them are subject of equalization throughout the country.

The tight fiscal situation made the SNGs spend almost all the money they receive on current expenditures. Although the Budget Code introduced the division of budget items into current and capital ones (“current budget” and “budget of development”), it could be easily seen that capital expenditures play a very humble role in local expenditure policy – their portion is only about 3 percent to total and tends to diminish with the course of time.

Table 10. Subnational expenditures by function in Ukraine

Expenditures	1999	2000	1999	2000
	Thousand UAH		Percent to total	
Public administration	493429	735288	3.07	3.99
Legislative	4662	7302	0.03	0.04
Executive	482884	717740	3.00	3.90
Judiciary	4634	1279	0.03	0.01
Science	6542	9873	0.04	0.05
National defense	8358	7033	0.05	0.04
Law enforcement and security	174547	259698.6	1.09	1.41
Education total	3470605	4334546	21.59	23.53
Preschool education	566752	788048	3.53	4.28
General secondary education	2155794	2563791	13.41	13.92
Educational institutions for those who need social care and rehabilitation	320640	396803	1.99	2.15
Off-school education	113403	146667	0.71	0.80

³ In case the drafted Tax Code would be adopted, the PIT proceeds will drop by ¼ due to MoF estimations. Only about half of this amount is supposed to be compensated to the SNGs through new taxes assigned to them: tax on bank deposits and real estate transactions. Being realistic, there is a big doubt that, first, these taxes will be introduced; second, that proceeds will enough effectively compensate for the revenue drop even up to 1/2.

	Vocational schools	18088	23263	0.11	0.13
	Higher education	106279	166479	0.66	0.90
	Post-diploma training	22809	36576	0.14	0.20
	Other educational facilities and activities	166838	212917	1.04	1.16
Health care		3449656	4165938	21.46	22.62
	General hospitals	2093510	2368007	13.02	12.86
	Specialized medical institutions	820819	1034359	5.11	5.62
	Clinics and ambulances	120702	152734	0.75	0.83
	Specialized clinics	22468	38223	0.14	0.21
	Dentistry	43794	87340	0.27	0.47
	Obstetric centers	45810	52646	0.28	0.29
	Sanitarian service	125135	193407	0.78	1.05
	Other institutions	175946	229201	1.09	1.24
Social care and social protection		2166364	2286762	13.48	12.42
Benefits to veterans of war and labor		650626	468379	4.05	2.54
Benefits to families with children		240310	397878	1.50	2.16
Other kinds of assistance		916394	947941	5.70	5.15
	Benefits for covering communal services costs	822809	805107	5.12	4.37
Boarding schools		35887	43105	0.22	0.23
Shelters for adolescents		10373	14429	0.06	0.08
Adolescent social protection		2044	2631	0.01	0.01
Homes for disabled and elderly		155949	191429	0.97	1.04
Social programs for families, women, youth and children		25642	37582	0.16	0.20
Other institutions and activities in social policy branch		129135	183265	0.80	1.00
Housing and amenities		1154330	1081650	7.18	5.87
Housing		610352	409470	3.80	2.22
	Capital renovation	116388	155107	0.72	0.84
	Subventions to housing branch	482924	155760	3.00	0.85
Amenities		513809	614283	3.20	3.34
	Urban amenities	459164	534125	2.86	2.90
Culture and art		351873	500596	2.19	2.72
Mass media		52204	59450	0.32	0.32
Physical culture and sports		132582	143040	0.82	0.78
Fuel and power		124527	2522	0.77	0.01
Construction		728244	732551	4.53	3.98
	Capital investments	692384	618253	4.31	3.36
Farming, forestry, fishery, hunting		218355	357289	1.36	1.94
Transportation, roads, communication, telecommunications and informatics		1736418	1249138	10.80	6.78
	Road transportation	81141	105188	0.50	0.57
	Water transportation	474.8	1261	0.00	0.01
	Rail road transportation	23379	28848	0.15	0.16
	Other types of transportation	154319	15101	0.96	0.85
	Roads	1475862	955392	9.18	5.19
Environment and nuclear security		4300	4549	0.03	0.02
Prevention and abolishing the emergency situations and results of natural disasters		59765	53875	0.37	0.29

Earmarked funds	120346	220790	0.75	1.20
Fund for environment preservation	40479	64039	0.25	0.35
Regional and local earmarked funds	36867	154934	0.23	0.84
Non-disbursed expenditures	1347403	719870	8.38	3.91
Reserves	66206	57926	0.41	0.31
Elections	1104	4452	0.01	0.02
Repayment of arrears	922962	488145	5.74	2.65
Budget borrowings	152738	-52856	0.95	-0.29
Expenditures subtotal	15815811	16994001	98.39	92.27
Contributions to the state budget	228647	1228322	1.42	6.67
Mutual settlements	29570	4660	0.18	0.03
Subventions to the central government	-	190757	-	1.04
Payment of fuel subventions	3741858	-	23.28	-
Expenditures total	16074030	18417741	100.00	100.00

Source: Own computation based on MoF data.

The minor role of investment expenditures in SNGs' budgets should not create the impression that SNGs' investments are not so important in comparison to the national ones; just the opposite: the local participation in investments within public sector are relatively growing, as the data in Table 5 above revealed.

Due to legal requirements, the budgets of most types of SNGs should be balanced. So no deficit budget planning for oblasts, rayons, urban districts, townships and villages is allowed. The fiscal shortcomings happening in the course of the fiscal year in these units could be bridged by short-term (three months due) borrowings from the budget of the higher level that are supposed to be paid back by the end of the fiscal year at the latest.

Some SNGs (AR Crimea, cities of oblast and rayon significance) are allowed to have a deficit only in their development budgets that could be bridged by borrowings.

4. Reconsidering the 'Original' Local Government Revenue Sources

As it was stated before (as presented in Table 6), the local revenue sources play a minor role in SNGs' revenues. The dominating proceeds in the SNGs' budgets are national duties ceded to them to finance the delegated functions. The portion of local revenue sources does not exceed 2-3 percent to total – that is quite equal to those in the Soviet time.

There is not so much available information on the user's fees that could be an important source of local revenues. The current statistical appraisal of the SNGs' activities that are paid due to the benefit principle is not sufficient. The SNGs operate a lot of public utilities that are run through economically independent bureaus (transportation, sanitation, water treatment, power and gas delivery, amenities). The communal units delivering these services collect the user's fees, the tariffs are set in a way so that the service is affordable to the most population. That is why the communal services and utilities are subsidized by SNGs throughout Ukraine; only the balance of fiscal flows is appearing in the budget sheets: that is the amount of subsidies paid to communal enterprises. This means that most types of communal economic activity are reflected in the expenditure side of the budget only.

It is remarkable that the non-tax revenues have increased very rapidly (they tripled in 2000 comparing to 1999) and reached a relative value of about 10 percent to total SNGs' revenues. The important components of this revenue category are administrative payments and fines. The share of interest on bank deposits in this revenue category is not too high and will diminish with the time down to zero due to mandatory shifting of all SNGs' accounts from commercial banks to the State Treasury with no interest payments.

After enacting the Ukrainian legal act concerning local taxation (1993), it was quite rapidly introduced by many SNGs: e.g. in 1995 54.7 percent of local communities have not introduced at least one type of local taxes or duties; in 1996 the number was 6.3 percent (Kyrylenko, 2000:225).

Currently, the list of levies that could be imposed by SNGs in Ukraine counts quite many positions (most of them were enacted by the Decree of the Cabinet of Ministers in 1993): advertisement tax, communal tax, hotel duty, parking fees, marketplace fees, fees for permission to lease a private apartment, resort fees, fees for usage of local symbols, local auction and lottery fees, fees for crossing the territory of the bordering regions (the only local duty introduced by oblast council), permission fee for establishing a trading facility, fees for shooting movies and TV programs, several duties on trotting matches, permission fees for office placement in the central part of populated areas, dog possession fee, fees for acquisition of foreign currency, imported goods selling fee⁴. The system of local taxes and duties is summarized in the Table 11 below.

Table 11. Current local taxes and duties in Ukraine

Tax or duty	Object of taxation	Tax rate	
		Legal persons	Individuals
Advertisement tax	Value of service (actual cost by self-advertising); space and number of carriers	0.1 percent of value of one-time service; 0.5 percent of value of long-lasting service	The same
Communal tax	Total enrollment (public entities and agrarian businesses excluded)	Marginal rate 10 percent to TFIM (17 UAH) for each employee	N/A
Duty for the issuance of a permit to locate vending and service facilities	Permit	85-300 UAH for permanent vending and service activities; 8-50 UAH one-day permit; 1-20 one-time permit	The same
Local symbol usage tax	Value of manufactured goods sold and services provided with the use of local symbols	0.1% to value	5 TFIM
Market place duty	Selling activity	0.2-2 TFIM per day	0.05-0.15 TFRM per day
Hotel duty	Value of service	Marginal rate 20 percent to the accommodation cost	The same
Vehicle parking fee	Parking time duration	Marginal rates 3 percent to TFIM in fit-out spots; 1 percent to TFIM in non-fit-out spots	The same
Resort duty	Service consumption	N/A	Marginal rate 10 percent to TFIM minimum non-taxable income (residents); 1-2 minimum non-taxable income (non-residents)
Fees for permission to lease a private apartment	Permit	N/A	30 percent of TFIM

⁴ The detailed description of the local taxes and duties in Ukraine is presented by Rozputenko et al (2000).

Fees for shooting movies and TV programs	Cost of organization of activity	Actual cost	N/A
Local auction and lottery fees	Value of goods or emission	Marginal rate 0.1 percent to value of goods or emission	The same
Fees for crossing the territory of the bordering regions	Motor vehicle to cross the border depending on type	Marginal rate 0.5 TFIM for residents, 5-50 USD for non-residents	The same
Dog possession fee	Dog possession	N/A	10 percent to TFIM
Permission fees for office placement in the central part of populated areas	Area of space	Marginal rate 0.5-2 TFIM per square meter	N/A
Fees on participation in trotting matches	Horse	Marginal rate 3 TFIM	The same
Fees on prizes on trotting matches	Sum of prize	N/A	Marginal rate 6 percent
Fees on participation in bidding	Payment for participation in bidding	N/A	Marginal rate 5 percent

Source: Decree of the Minister Cabinet On Local Taxes and Duties (1993, updated and amended).

The most important tax from this list is communal tax that delivers about ½ of proceeds from local taxation; the second one by importance is the marketplace duty.

As this list shows, the main part of local levies is supposed to be paid by individuals, but in fact, the dominating part of taxation proceeds is borne by businesses. Some of the so-called “fees”, like hotel duty, foreign tourism fee, fee on usage of local symbols, resort fee etc. are in fact taxes because they do not suggest the delivery of any service from the local authorities.

The competence of the SNGs in levying local taxes is formally quite broad: imposing local taxes and duties, granting tax credits, reduced rates and privileges to the payers to the local budgets (item 18 of the Minister Cabinet Decree). But the real discretion in this filed is very limited because the list of levies granted to SNGs, the tax bases, and the marginal tax rates are determined centrally. It must be stated that the SNGs do not have direct authority in administering their own taxes because the most important levies are collected and administered by the local offices of the State Tax Administration.

The local taxation may play different role depending on the SNGs’ type and location. As Table 12 suggests, it delivers quite a significant portion of revenues in cities of rayon significance and townships (around 15 percent to the total revenues net of direct transfers in the last years). The trend is also quite remarkable: the relative size is likely to grow over the time.

Table 12. Local taxation portion in SNGs’ revenues (direct transfers for the governments of higher level excluded)

Year	Combined local budgets	Oblasts	Cities of oblast significance	Rayons	Cities of rayon significance	Townships	Villages
1992	0.03	0.00	0.05	0.01	1.54	0.83	0.61
1993	0.13	0.00	0.27	0.03	0.34	0.10	0.63
1994	0.51	0.02	0.83	0.12	2.54	1.56	0.49

1995	1.46	0.35	2.96	0.35	8.86	6.94	1.90
1996	2.63	0.67	5.28	0.63	13.14	12.90	4.33
1997	2.94	0.78	5.42	1.24	15.38	14.38	5.21
1998	2.97	0.41	2.40	5.80	15.66	16.43	5.93
1999	3.36	0.29	3.16	6.66	14.59	16.41	6.88
2000	3.65	0.28	5.92	3.35	12.23	14.27	5.29

Source: Own computation based on MoF data.

Since the relative importance of local taxation is a measure of local fiscal autonomy, one could draw the conclusion that fiscal autonomy of Ukrainian SNGs is very low despite the fact of positive changes in the last period of time.

The existing system of local taxation is not in the position to deliver a basis for the local fiscal autonomy because (a) the levies granted to SNGs do not have any significant revenue potential (most SNGs do not have the appropriate tax basis), and (b) most of these levies are connected with heavy administrative costs that make the tax collection inefficient.

Of all the local taxes and duties listed above only five (communal tax, hotel duty, permission fee for establishing a trading facility, market place duty and advertisement duty) are quite important and deliver about 95 percent of local taxation proceeds. Five local levies are quite rarely introduced (e.g. fees from trotting matches have been collected only in two regions out of 27) and could be excluded from the list because of their administrative inefficiency.

One of the striking facts is the low portion of local taxes in revenues of big cities: they do not have effective stimuli to exploit this source of revenues because of its insignificant role.

The problems of the Ukrainian local taxation are connected with:

- (1) Very low revenue potential of local revenues. Table 13 below delivers data showing that per capita local taxes and duties are not high – less than 10 UAH in 2000 (or \$1.85). Of course this amount is not sufficient for covering a significant portion of the local expenditure programs.
- (2) The latter pushes the local authorities to perform activities in the revenue policy that could not be judged as fully legal ones. They introduce some levies disguised as ‘voluntary’ contributions of local businesses to SNG budgets (e.g. fee for fighting mosquito or local certification duty on alcoholic beverages, contribution to purchasing rocking chairs for the disabled and similar)⁵. According to the Law On Local Self-Government, the voluntary contributions could be imposed by general meeting of local inhabitants (so called “self-taxation”), but in many cases this provision had been neglected. Another way to raise discretion concerning revenues is introducing off-budget funds that are operated by local administrators without any accountability to the public. One more way is direct financing of expenditures to be borne by subnational budgets through “voluntary” earmarked contributions of businesses and households. E.g. in 1999 only 68 percent of local expenditures on education were funded through public budgets, and the rest – by non-public entities (Vassylyk, 2001:183).
- (3) Low elasticity of the most local levies: the marginal rates (especially the ones based on TFIM value) were set in national legislation in 1993 and have not been adjusted ever since. This means that in real numbers the proceeds from local revenues cannot be regulated by SNGs; the positive changes in economic situation of widening the scope of local levies may improve the state.

⁵ The list of local taxes and duties abolished lately as illegal include the following examples: fee for being called to be presented by the commission of the local council; fee for the temporarily attendance of the Russian citizens on the Ukrainian territory; duty on reference issuance; fee for pedestrians’ crossing the border; duty on cattle grazing; fee on property separation by divorced couples and many others.

- (4) The legislation does not impose the obligation to levy local taxes⁶ unequivocally. The result is that some local communities (especially in little townships and villages) do not impose any local taxes because they do not have a tax basis of mandatory levies and do not want to introduce facultative ones; some local governments do not collect even service payments. This kind of “local communism” has been performed in order to raise prestige of some local administrators, but sometimes it was forced by the local economic developments. Some years ago the local transportation services in Odessa were free, the same for the public telephone service in Kyiv City.
- (5) Very uneven distribution of the local taxation basis across the regions. The most affluent are big cities, e.g. Kyiv City and some cities of oblast significance. Table 13 below shows the differentiation of regions concerning the exploiting of local revenue sources. This means that taken alone the local taxation in its existing form creates very heavy revenue differentials claiming for a strong equalization policy performed by the center.

Table 13. Ranking of Ukrainian regions by local revenue proceeds, UAH per capita

Region	1993	1996	2000
AR Crimea	1.8	5.2	10.1
Vinnitsa	0.0	4.0	6.7
Volyn	2.8	4.8	10.8
Dnipropetrovsk	7.9	6.6	9.4
Donetsk	0.6	5.4	9.0
Zhytomyr	1.3	5.2	7.6
Zakarpattia	5.5	4.1	3.8
Zaporizhzhya	3.3	6.9	11.3
Ivano-Frankivsk	1.4	3.6	6.7
Kyiv	1.5	4.2	6.3
Kirovohrad	14.4	4.0	6.2
Luhansk	4.2	6.2	7.7
Lviv	18.7	5.9	8.8
Mykolayiv	0.7	3.7	7.7
Odesa	0.0	5.5	12.3
Poltava	11.3	5.3	9.7
Rivne	6.7	4.6	7.6
Sumy	0.7	4.3	6.3
Ternopil	2.5	3.3	5.2
Kharkiv	12.9	8.1	12.0
Kherson	0.8	4.0	7.1
Khmelnyski	9.2	6.4	11.2
Cherkassy	5.9	4.8	6.8
Chernivtsi	3.2	5.6	13.0
Chernihiv	7.9	5.1	7.7
Kyiv City	18.8	10.7	25.8
Sevastopol	5.3	4.4	13.2

⁶ A Law On Self-Government (item 69) requires that the self-government bodies *can* impose local taxes and duties. It leaves the issue of imposing local levies to discretion of SNGs. An attempt to make the local taxation obligatory was undertaken in the Presidential Decree On Local Taxes and Levies (1999) that declared some types of local levies (communal tax, advertisement tax, foreign tourism tax, hotel duty, market place duty and some others) as an obligation of the SNGs. This Decree was abolished because the corresponding law draft was cancelled. Some levies were declared obligatory for imposing according to provisions of the Law On Tax System (1997): communal tax, parking fee, market place duty, fee for permission to lease a private apartment, duty for the issuance of a permit to locate vending and service facilities, dog possession fee.

Average	5.9	5.6	9.7
Variation coefficient	0.93	0.28	0.42

Source: Own calculation based on MoF data.

From this, we may conclude that the local taxation in Ukraine needs urgent reforming. The part of original local revenues should be much more significant in order for some feasible degree of local accountability to be achieved.

The composition of the local revenues shows that they do not contribute to the SNGs' accountability. Since most revenues are national ones, SNGs are obliged to be accountable for their spending to the central government, not local voters. The spending of moneys is strictly controlled by the State Treasury that holds the accounts of SNGs. The low accountability is strengthened by the way the local administration is functioning. As it was mentioned above (Section 2), most expenditures are performed or directly controlled by the territorial state administrations. Since the heads of these administrations are not elected but appointed, they objectively should be accountable to the central government. In order to make them more active in solving local problems, the central Executive uses administrative punishment. So in 2002 several oblast governors were dismissed because they do not care much for the development of the local business activity.

Making heads of territorial units politicians, not mere state administrators (this is at the moment under discussion in the Presidential administration), by making them being elected could improve the situation in some way. But this will not alter the high level of dependence of SNGs from the central government. This financial bond should not be as tight as it is now.

5. Local Borrowing

Borrowing, a common source of local revenue in developed countries, as well in some post-socialist ones, has not yet occupied any significant role in local budgetary policy. There are two types of borrowing allowed by legislation: the short-term one for covering current budgetary deficit (the lender could be the SNG of the upper level) and long-term one, to cover the deficit in SNGs' development budget. The debt servicing is done by allotments from the current budget.

It is stipulated that local long-term borrowings are the full responsibility of the respective subnational government: the central state bears no responsibility for it.

The pioneer issues of municipal bonds in the years 1995-1998 remained experimental ones only, with no special positive outcomes and no further development. One of the main reasons for such a result was a very subjective, non-systematic regulation of the matter.

The Budget Code created some legal basics for regulating the procedure of local governments' borrowings on the fiscal markets. The borrowing practice in Ukraine is a subject of very strict limitations. The local governments of the basic level (this means no oblast, rayon, urban district ones) are allowed to borrow money only for specified investment programs. Debt servicing could not exceed 10 percent of the general fund of expenditures of any fiscal year in which the servicing is planned. In case of breaking the terms of the repayment schedule in any year the guilty SNG will be suspended for new borrowing activities for the period of 5 years. Each borrowing is to be empowered by the Minister Cabinet's separate regulation.

Most current bond issues are being subscribed by international investors.

The special legislation for local borrowing is still to be approved, so there has not been much development in this field till the last time.

6. Enhancing Local Fiscal Capacity and Democratic Accountability

The current reforming activities seem do not seem too radical. The list of local taxes presented by STA to be included into Tax Code (see the Table 14 below) does not incorporate some new affluent sources of local revenues; it suggests shortening the list of duties up to 10 through abolishing several levies (including communal tax) and introducing the new one – school tax. This novelty would obviously not solve the fiscal problems of local authorities in general.

Table 14. Proposed local taxes and duties in Ukraine

Tax or duty	Object of taxation	Tax rate	
		Legal persons	Individuals
Advertisement tax	Value of service (actual cost by self-advertising); space and number of carriers	5% of value of service; 5-8 UAH per m ² of carrier with special discount for domestic products	N/A
Duty for the issuance of a permit to locate vending and service facilities	Permit	85-300 UAH for permanent vending and service activities; 8-50 UAH one-day permit; 1-20 one-time permit	The same
School tax	Value of goods and services sold	1-2% to tax base	The same
Local symbol usage tax	Value of manufactured goods sold and services provided with the use of local symbols	0.1% to value	85 UAH
Market place duty	Selling activity	50 UAH	1-4 UAH
Hotel duty	Value of service	10-20% to the accommodation cost	The same
Vehicle parking fee	Parking time duration	0.5-2.0 UAH	The same
Resort duty	Service consumption	N/A	0.5-1 minimum non-taxable income (residents); 1-2 minimum non-taxable income (non-residents)
Performers' touring duty	Proceeds from the ticket sell	3% to the object for non-domestic performers	N/A
Duty on issuance of permits to construct	Total area of a land plot	Differentiated according to settlement type and purpose of construction	Differentiated according to settlement type and purpose of construction

Source: Draft Tax Code of Ukraine.

An opposite view was argued by a group representing academic community and local authorities: they suggest introducing about a dozen new local taxes, among them a local property tax.

Summarizing the ongoing discussion, one can conclude that the reform of local taxation in Ukraine could include the following strategies:

- (1) making some national levies (currently assigned to SNGs to finance delegated state functions) the real local taxes by granting full discretion over them to the municipalities;
- (2) introducing new taxes that are the best candidates for being local ones (taxes on real estate in the first turn);

(3) granting more discretion in setting local tax rates.

The prospective candidates to be included into local levies are taxes on land and property, local motor vehicle tax. The tax on land is still a national one; motor vehicle tax is a national levy assigned to SNGs' budgets. Assigning these taxes fully to the SNGs, the center should retain control by the legal determination of the tax basis and marginal rates of taxation. The suggestion to make PIT and EPT the local taxes expressed by some researchers (Kyrylenko, 2000:235) seems to be non-applicable to the current Ukrainian situation.

Imposing a local property tax is a point under dispute. This problem has been an object of intense discussions for many years. There are a lot of issues that still did not find any reasonable solution: (i) who is a tax payer (legal persons or individuals); (ii) what is a tax base (buildings, inventories or luxuries in possession); (iii) how to assess the value of property by given underdeveloped market relations; (iv) the rates to be implemented; (v) means of social protection of disadvantaged households. The intense draft legislation (there were several variants of the law on property taxation drafted in 1995-2001) did not have any feasible result. There is no doubt that this tax should be implemented and assigned to the local authorities, on the one hand. On the other hand, it will make the distribution in society fairer by pushing the better-off social groups (they concentrate very valuable property objects) into the position of making more contribution to funding public outlays. The current situation when the redistribution of wealth in society is merely excluded from the tools of public policy is very frustrating⁷.

The introduction of the property tax assigned to the subnational budgets will benefit the urban communities in the first line. The big cities of national and oblast significance will receive a generous source of revenues. But the rural communities will not benefit greatly from this innovation because valuable property objects are concentrated in cities or in neighboring localities. To endow them with revenue sources, one should look for other options.

Surtax could be an interesting option. In case the modest surcharge to be imposed on PIT, it would give the SNGs a mighty (and highly elastic) revenue source.

Making local taxation a more affluent source of revenues requires taking some measures in strengthening local discretion in setting tax rates. The current practice of capping marginal rates and linking them to TFIM makes local revenues very inelastic. A better way of pushing SNGs to pursue the effective revenue policy of their own will be setting fixed minimum tax rates with freeing SNGs to choose for an appropriate value of rate in order to optimize relation between business activity and local public needs. The only type of taxes that has no limitation at the moment is the so-called self-taxation practiced mainly in small settlements like villages. They are collected as a fixed sum linked to some object (like household, number of horses or machinery etc.) to cover specific expenditures (like maintenance of the road, bridge etc.). As such, it cannot be used in the big territorial communities.

The portion of local revenues in Ukrainian SNGs' budgets should and may cover up to 1/4-1/3 of their revenues. That will guarantee (to a certain degree) much more discretionary power compared with the present state.

All these measures should be supported by certain institutional improvements such as creating an independent local tax administration in order to give the SNGs' the tools of real control over fiscal flows on the territory of their jurisdiction.

The important part of making SNGs more accountable is accomplishing the territorial-administrative reform. The current borders of the subnational governmental units in Ukraine were cut decades ago, in the Soviet time, without paying much attention to their ability to provide local public goods to the population effectively. The on-going discussions in Ukraine in

⁷ The reluctance of the center to introduce property taxation made some regions to do it by themselves. So in February 2003 AR Crimea legislated the regional tax on real estate.

this matter are still far from being completed. What should be important – this is synchronization in changing in territorial borders of SNGs and making them more flexible in collecting revenues. Until this issue does not receive a decent solution, all attempts to make the local governments more accountable will bring a very modest result.

Another important issue will be enhancing SNGs' administrative and technical capacities. This is of special importance in small communities like townships and villages. In these SNGs the administrative staff is often limited to council head and his secretary. The merging of such units will improve the situation in some way, but there is a great need in providing local officials with basic training on fiscal management and with some technical equipment.

7. Summary and Conclusions

The history of Ukrainian public sector on the whole demonstrates that the remains of the old (Soviet) system of public administration are still deeply rooted in the current intergovernmental relations. The attempts to overcome the reluctant behavior of the subnational authorities that are accountable to the state not to the population will have no success without critical reassessment of what we have now.

The enhancing of SNGs' accountability in Ukraine requires significant changes in their revenue basis. Without implementing serious reforms in this field, it could hardly be possible to make them more responsible in meeting local population's demand for public services. Making the locally generated revenues a significant portion of regional and local incomes will ensure the relative growth of own (not delegated) responsibility in service delivery.

Recent steps in reforming intergovernmental fiscal relations as presented in the Budget Code do not affect many important aspects of this issue. Pure own revenues remain an insignificant part of the budget proceeds especially in big territorial units.

What should be recommended for implementation?

Firstly, re-shifting the public revenue sources by making some of them really subnational "own revenues".

Secondly, there is time to introduce a sustainable revenue source that could be the basis for a subnational fiscal autonomy. The best candidate could be local personal property tax because namely it can secure stable inflow for budgets of all kinds of territorial communities.

Thirdly, the state regulations in SNGs' spending policy should be made softer in order to clear space for local initiative.

And last, all these steps will bring good results in case institutional reforms will take place. The most important one of these is the reform of territorial-administrative composition of the country aimed at the creation of more fiscally self-reliant territorial units. On the other hand, the institutional strengthening of regional and local authorities needs re-introducing the link between elected bodies and the executives on the oblast and rayon level.

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