

**Т.В. ПАЛІЙЧУК\***

*Всеукраїнська асоціація органів місцевого самоврядування  
«Асоціація міст України», м. Київ, Україна*

**С.В. ПЕТРУХА\*\***

*Університет «КРОК», м. Київ, Україна*

**Н.М. АЛЕКСЕЄНКО\*\*\***

*Державна навчально-наукова установа «Академія фінансового управління», м. Київ, Україна*

## **Фінансове вирівнювання в умовах реформування системи управління державними фінансами**

*У зв'язку із завершенням у 2020 році дії основоположних нормативно-правових актів, що координують реалізацію децентралізації, необхідними є актуалізація та визначення подальших напрямів реформування системи управління державними фінансами. Мета статті полягає у визначенні ефективних способів та напрямів подальшого удосконалення системи фінансового вирівнювання в Україні для формування прогресивнішої його моделі щодо ресурсів місцевих бюджетів, за якої було б досягнуто більш збалансованого соціально-економічного розвитку муніципалітетів та, як наслідок, максимального ступеня врахування потреб населення. Розкрито сутність та основні складові фінансового вирівнювання як інструменту бюджетного регулювання. Висвітлено зміст фіскального дисбалансу, горизонтального та вертикального вирівнювання, еволюцію способів усунення фіскальних диспропорцій. Охарактеризовано європейський підхід до подолання наслідків нерівного розподілу потенційних джерел фінансування видатків органів місцевого самоврядування. Розглянуто особливості та інваріацію реформування системи управління державними фінансами на засадах децентралізації, оновлення механізму фінансового вирівнювання. У результаті дослідження проаналізовано наслідки (здобутки та недоліки) функціонування інструментів вертикального та горизонтального вирівнювання у бюджетній системі України, впроваджених у результаті реформи фіскальної децентралізації. Запропоновано основні рекомендації щодо стратегії удосконалення механізму фінансового вирівнювання, спрямовані на подальше зміцнення та створення власної стабільної дохідної бази місцевих бюджетів, яка є фундаментом усієї бюджетної системи і фінансовою основою місцевого самоврядування, що забезпечить досягнення збалансованості інтересів усіх учасників міжбюджетних відносин.*

**Ключові слова:** *публічні фінанси, міжбюджетні відносини, місцеві бюджети, фінансове вирівнювання, горизонтальне вирівнювання, вертикальне вирівнювання, трансферти, дотації вирівнювання, субвенції, місцеве самоврядування, податкоспроможність.*

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**T.V. PALIICHUK**

*All-Ukrainian Association of Local Governments “Association of Ukrainian Cities”, Kyiv, Ukraine*

**S.V. PETRUKHA**

*“KROK” University, Kyiv, Ukraine*

**N.M. ALEKSEIENKO**

*State educational and scientific institution “Academy of Financial Management”, Kyiv, Ukraine*

## **Financial Equalization in the Conditions of Reform of the Public Finance Management System**

*In connection with the expiration, in 2020, of basic regulatory and legal acts coordinating the implementation of the decentralization, it is needed to actualize and determine further directions of reform of the public finance management*

\* **Палійчук Тетяна Володимирівна**, аналітик Всеукраїнської асоціації органів місцевого самоврядування «Асоціація міст України» (м. Київ), кандидат економічних наук.

\*\* **Петруха Сергій Валерійович**, доцент кафедри управління фінансово-економічною безпекою Університету «КРОК» (м. Київ), кандидат економічних наук.

\*\*\* **Алексєєнко Наталія Миколаївна**, здобувач Державної навчально-наукової установи «Академія фінансового управління» (м. Київ).

system. The purpose of the article is to determine efficient methods and directions of further improvement of the financial equalization system in Ukraine in order to form progressive local budget resource model, which by more balanced socio-economic development of municipalities will meet the needs of the population. The article addresses the essence and main components of financial equalization as a tool of budget regulation. The contents of the fiscal imbalance, horizontal and vertical equalization, evolution of methods of removal of fiscal disparities are highlighted. A European approach to overcoming the effects of the unequal distribution of potential sources of the financing of expenditures of bodies of local self-government is characterized. Features and invariance of reform of the public finance management system on the basis of decentralization, renewal of the financial equalization mechanism are considered. As a result of research, the effects (achievements and shortcomings) of the functioning of tools of vertical and horizontal equalization in the budget system of Ukraine implemented as a result of reform of fiscal decentralization, are analyzed. Basic recommendations aimed at further strengthening and establishing a stable local budgets base being a foundation for the whole budget system and a financial basis for local self-government, are proposed, on the strategy of improving the financial equalization mechanism that will provide achieving a balance of the interests of all participants in inter-budgetary relations.

**Keywords:** public finance, inter-budgetary relations, local budgets, financial equalization, horizontal equalization, vertical equalization, transfers, equalization grants, subventions, local self-government, taxpaying capacity.

**Research urgency.** A euro-integrational vector of the foreign policy of Ukraine has gradually determined implementing the whole complex of internal reforms, as the integration is not limited to foreign policy aspects in the form of partnership and mutually beneficial cooperation but causes significant internal transformations. Among such advances over the recent years nationwide, the central position is occupied by reforming the state (public) finance management system, in general, and carrying out fiscal decentralization, implementing the grounds for mid-term budget planning, further developing the management by objectives, increasing in the level of transparency and accountability of budgetary spending units, in particular.

In the context of the integration of Ukraine into the European Union, it is required to implement new forms of cooperation between the central government and subnational bodies. Such domestic reforms include reforming the law-enforcement system, state governance, deregulating and stimulating entrepreneurship, judicial system and public prosecutor's office, making economic transformations and developing a market economy as well as transforming the public finance management system.

Conceptual grounds of reform of decentralization have been established, commencing from 2014 by adopting basic regulatory legal acts among which, there are, in particular, the Program of Activities of the Cabinet of Ministers of Ukraine, Sustainable Development Strategy "Ukraine – 2020", Public Finance Management System Reform Strategy for 2017–2020, State Regional Development Strategy, Concept of Reform of Local Self-Government and Territorial Organization of Power in Ukraine, amendments to the Budget and Tax Codes, Laws of Ukraine "On Cooperation of Territorial Communities", "On Voluntary Association of Territorial Communities", etc.

The Ministry of Finance of Ukraine as the main body within the system of central bodies of executive power providing forming and implementing the state financial, budget and debt policy in inter-budgetary relations and local budgets, emphasizes [1] that a matter of further development of the public finance management system is one of the key matters in the context of a bilateral dialogue between Ukraine and the European Union and other international partners, which expressed support to

the Public Finance Management Reform System Strategy for 2017–2020 [2].

In this context, the second iteration of the Strategy of Reform of the Public Finance Management System for 2017–2020 (the first one covered a program period of 2013–2016), has been carried out on the initiative of the Ministry of Finance of Ukraine, has made it possible not only to provide sustainability of a bilateral dialogue between Ukraine and the European Union but also to form single mental space for further reform of the public finance management system towards its European architecturing vector.

Europization of the fiscal and budgetary mentality in the context of the democratization of the Ukrainian society stipulates the need to rethink a budget process towards strengthening an institutional capacity of local self-government in forming financially self-sufficient territorial communities able to ensure providing socially significant services by implementing best European reform implementation practices for the decentralization, modernization of the public finance management system and passportization and personification of the relevant genotype of social services.

In connection with the expiration, in 2020, of basic regulatory and legal acts coordinating the implementation of the decentralization, it is needed to actualize and determine further directions of reform of the public finance management system.

The current financial equalization system, because of the low level of parity vs. an achieved level of fiscal decentralization (in opinion of Deputy Minister of Finance H.V. Plis, "a process of decentralization results in unbalancing, at this stage, revenue and expenditure powers of local bodies of power, most powers move from the local regions level to the ATG's (Amalgamated Territorial Community) level, however, in horizontal equalization the same criteria are applied for local regions budgets, budgets of cities of oblast significance and budgets of ATCs" [3]), precludes from implementing, to the full extent, ambitious tasks established in the Association Agreement between Ukraine and EU [4], in the Program of Activities of the Cabinet of Ministers of Ukraine [5], distorting the "spirit" of reform of local self-government and inter-budgetary relations, determining and actualizing such kind of research.

**Literature review.** A weighty contribution to researching for a matter of architectonics of the public finance management system in the context of evolving inter-budgetary relations, developing tools of fiscal decentralization, financial equalization technology in the conditions of “decaying” the economic dynamics, increasing in the role of uncertainty in local finance, in general, and in the matters of extending a revenue base and increasing in the level of financial support of local self-government, has been made by both domestic and foreign scientists and practitioners, in particular: A.Ye. Buriachenko [6], I.S. Volokhova [7], S.S. Hasanov [8], L.M. Demydenko [9], V.H. Demianyshyn [10], T.I. Yefymenko [8; 11], O.V. Zabrotska [12], T.H. Zatonatska [13], O.P. Kyrlylenko [14], P.M. Leonenko [15], I.O. Lunina [16], V.P. Kudriashov [17], Ye.Yu. Kuzkin [18], M.L. Kulchytskyi [12], I.O. Liutyi [8], V.M. Oparin [19], O.V. Slobozhan [20], O.V. Shyshko [21], V.M. Fedosov [15; 22], S.I. Yurii [22], P.I. Yukhymenko [23], N. Akai [24], R. Barro [25], R. Bahl [26], P.M. Beard [27], R.W. Boadway [28], P. Bodman [29], S. Golem [30], S. Homburg [31], J. Kim [32], R. Musgrave [33], P.J. Morgan [34], W.E. Oates [35], J. Orestrom [36; 37], A. Scotto [38], C. Tiebout [39], A. Shah [40], L.P. Feld [41], R.P. Fredericks [42].

Despite a sufficiently high level of scientific works in progress by domestic and foreign scientists and practitioners, it is urgent and necessary to review a financial equalization model in Ukraine in the conditions of further reform of the public finance management system. These problematics are of special importance for Ukraine as a state that has chosen a course to decentralization and integration into the European space. This stipulates a choice of a research topic and its urgency.

As of today, the system of distribution of inter-budgetary transfers is characterized by structural unbalances. The budget system of Ukraine does not sufficiently meet the local economic needs and bodies of local self-government are not in the position to pursue a proper policy of territory development within their competence. This poses a risk to the prospect of sustainable development of territories, incl. rural ones, that determines the need to find defects in the current model (technology) of financial equalization in Ukraine and the ways of their removal.

**The purpose** of the article is to determine the efficient ways and directions of further improvement of the financial equalization system in Ukraine in order to achieve its more progressive local budget resource model whereby more balanced socio-economic development of municipalities and, as a consequence, the maximum degree of allowing for the needs of the population would be provided.

**Results and discussion.** Financially capable self-government is a sign of an actually democratic state. The development of Ukraine based on democratic values and, as a consequence, the need for the functioning of capable self-government and removal of resource consumption asymmetry in making budget decisions in the conditions of representative democracy have stipulated

implementing the reform of the public finance management system on the basis of decentralization. A feature of the budget process at the local level in Ukraine is its subordination to the stages of the formation of the state budget, in particular, in respect of inter-budgetary transfers and financial equalization implementation, since asymmetric socio-economic development of territories is objectively inherent to the state. For the purpose of adjusting disparities available in the taxpaying capacity of local budgets and balanced development of each administrative and territorial unit of Ukraine, various budget regulation tools should be applied, the most widespread of which is the application of inter-budgetary transfers for removing unbalances between budgets of different levels.

For the purpose of increasing in a role and significance of local self-government, providing compliance of the living standard with the international norms, the state must create all conditions to provide bodies of local self-government with the independence in solving financial matters by transferring expenditure and revenue powers, since, although the state shall guarantee and finance the delegated powers, it quite often fails to find funds to cover expenditures for them.

Bodies of local self-government not infrequently face a problem of the deficiency in financial resources for exercising expenditure powers. However, even with the most efficient distribution of expenditure and revenue powers in the vertical of the budget system, there will be territorial communities, which will have conventionally surplus financial resources and those, which will have insufficient budget funds. The reason for this is that the initial distribution of expenditure and revenue powers is oriented on the mean level of socio-economic development of administrative territorial units, while, actually, these levels are different.

In order to balance the budgets at the equal quality level of social services, vertical and horizontal fiscal unbalances shall be determined and evaluated. A vertical fiscal unbalance is the inconsistency between volumes of financial resources of bodies of power of various levels to fulfill functions and tasks imposed on them, which – the inconsistency – shall be removed by assigning additional tax sources to local bodies of power. A horizontal fiscal unbalance is the inconsistency between volumes of financial resources of bodies of power of the same level to fulfill functions and tasks imposed on them.

Fiscal disequilibrium arises because of the static and dynamic unbalance. The static unbalance is the excess of the scope of obligatory expenditure powers of the local power over its own revenues, while the dynamic unbalance is faster rates of increasing in the sizes of the expenditure side of local budgets vs the revenue side. The availability of the fiscal gap requires to carry out financial equalization, during which a vertical and horizontal financial equalization concurrently takes place. Its financial purpose is to create equal opportunities for socio-economic development of regions.

A notion of financial equalization is quite controversial in the financial sphere. Some scientists and practitioners hold an opinion that equalization is carried

out in order to redistribute financial resources in favor of administrative territorial units not having a required size of own revenue base. The other point of view is that equalization is a process of bringing budget expenditures in line with the state-guaranteed minimum level of social goods and services.

N.V. Fesenko, H.M. Yarova [43, p. 298] understand by financial equalization the multi-faced and complex notion reflecting the content of the set of such relations and measures establishing the conditions, upon which residents of different regions are provided with social goods and services in the harmonious combination of the principles of quality and social justice.

In the opinion of A.H. Zahorodnyi, H.L. Vozniuk, T.S. Smovzhenko, financial equalization is a process of redistributing financial resources by central bodies of state power in favor of administrative territorial units not having a sufficient size of own revenues [44, p. 411].

O.P. Kyrylenko interprets the notion of “financial equalization” as a way of bringing expenditures of budgets (according to economic and functional classification) to the state-guaranteed minimum level of social services per person, removing significant disparities in undertaking expenditures of particular territories [45, c. 47].

However, it is common for different points of view that the basic task for financial equalization is to create equal opportunities for socio-economic development of municipalities.

The European Charter of Local Self-Government, which Ukraine ratified in 1997, having obliged to fulfill its provisions since 1998 [46, pt. 5 art. 9], states that “the protection of financially weaker local authorities calls for the institution of financial equalization procedures or equivalent measures, which are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden they must support. Such procedures or measures shall not diminish the discretion local authorities may exercise within their own sphere of responsibility”. Further, the Charter provides that “as far as possible, grants to local authorities shall not be earmarked for the financing of specific projects. The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction”.

According to the Law of Ukraine “On Local Self-Government in Ukraine” [47], the material and financial base of local self-government shall be movable and immovable property, revenues of local budgets, other funds, land, natural resources, being in the communal ownership of territorial communities of villages, settlements, towns/cities, districts in cities as well as items of their joint property managed by region and oblast councils.

Appropriate in this context, is the principle of efficiency and effectiveness, enshrined in the Budget Code of Ukraine, for the budget system, according to which, when drawing up and executing budgets, all participants in the budget process shall seek to achieve the objectives planned on the basis of the national value system and tasks of innovative development of the

economy by ensuring the quality provision of public services in attracting the minimum size of budget funds and achieving the maximum result in using the budget-established size of funds.

So, financial equalization is a tool of removing vertical and horizontal disparities providing: a) bringing expenditures of municipality budgets to the state-guaranteed minimum level of social services per person; b) redistributing financial resources, by central bodies of state power, in favor of administrative territorial units not having sufficient own revenues, with concurrent stimulation and motivation of more financially-backed municipalities for socio-economic growth, attraction of investments and implementation of innovative technology.

A need for financial equalization is stipulated by a number of objective reasons, in particular, such as: a difference in the taxpaying capacity of municipalities and between delegated expenditure powers of different levels of the budget system; inequality between the volumes of required expenditures to fulfill an identical set of delegated powers by bodies of local or regional self-government; provision of transfers to ensure the stabilization of an economic conjuncture, equalization of incomes of the population and other nationwide objectives.

A distinction is made between two forms of financial equalization:

– vertical equalization, which task is to equalize budgets with revenues and expenditures by assigning revenue sources and fiscal powers to budgets and distributing expenditure obligations to the levels of the budget system as well as stimulating bodies of local power to increase in budget receipts from own revenues, and increasing in the efficiency of budget expenditures;

– horizontal equalization is a process of redistributing tax receipts between local budgets by the approved formula to remove or decrease the inequality in the tax potential of territories, providing the population with equal access to social services at the same value and quality level regardless of the territory of their residence.

Vertical financial equalization is carried out in international practice through: reducing in the expenditure side of that level of power where a vertical disparity has arisen by transferring a portion of obligations of the power of the higher territorial level; introducing additional taxes on that territory where there is an unbalance; transferring a portion of tax receipts from the central budget to the local budgets; granting transfers by the central power [49, p. 199].

The basic task of transfers is to solve the problem of vertical disequilibrium being an effect of the inconsistency between the responsibility for taxes and the taxpaying capacity. Local budget revenue formation system based on transfers from other budgets represents a system of inter-budgetary relations, with granting minimum financial independence to those levels of state power, which receive funds [50, p. 55].

A matter of building an efficient mechanism of financial equalization is stipulated by two aspects. On the one hand, it is needed, based on the conceptual grounds

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of the fiscal decentralization, to legislatively clearly distribute and assign expenditure obligations to the relevant level of the power, on the other hand, – to envisage equalization of potentials of bodies of power for mobilizing funds to budgets of all levels on the basis of assigning their tax and non-tax sources and powers.

In providing sufficient equilibrium of the budget by revenues and expenditures, namely, provided that its tax and non-tax revenues cover most obligations, a stimulating function of the budget regulation is implemented.

Basic tools of financial equalization of territories are:

a) distribution of tax sources between different links of the budget system to overcome the inconsistency between volumes of financial resources of bodies of the same level to fulfill functions and tasks imposed on them;

b) grants, subventions, funds transferred from one budget to another to remove the inconsistency between volumes of financial resources of bodies of different levels to fulfill functions and tasks imposed on them.

The efficiency of using tools of financial equalization depends on the budget policy course. Making the redistribution of financial resources between the links of the budget system, it is needed to remember an important rule: improving the financial status of recipients shall not adversely affect the status of donors. Moreover, reaching such compromise shall aim at activating the whole resource potential. Of course, in all administrative territorial units, the good and service production resource value related to electricity, wage level etc., is different [51, p. 88].

In 2014, as stated, a process has started to reform the administrative territorial structure, public finance management system on the decentralization basis. Basic objects of reform have become: an administrative territorial structure (excessive fragmentation of inhabited localities and, as a consequence, inefficient approach to their management); budgetary resources (a low level of self-provision of territorial communities and a high level of dependency of local budgets on the state budget); distribution of expenditure and fiscal powers (non-compliance with the principle of subsidiarity, scale effect, tax efficiency and justice [46; 52; 53]). Reform of local self-government and public finance is established to be one of the government's priorities. The government has adopted the Concept of Reform of Local Self-Government and Territorial Organization of Power in Ukraine, approved a relevant Plan of Action for its implementation, the parliament has introduced amendments into the budget and tax legislation on the distribution of revenue sources between different links of the budget system and inter-budgetary transfer system.

Fiscal decentralization has provided introducing amendments into the system of revenue sources and fiscal powers assigned to budgets and distribution of expenditure obligations by the budget system levels, i.e., reviewing the vertical financial equalization mechanism, in particular:

a) in respect of revenue sources and fiscal powers, an extended local budget revenue base available by:

a.1) transferring, from the state budget, the payment for the provision of administrative services, state duty;

a.2) percentage increasing in crediting ecological tax from 35 to 80 %;

a.3) assigning, to local budgets, stable sources – individual income tax under new standards (budgets of cities of oblast significance, local regions – 60 %, oblast budgets – 15, budget of Kyiv C. – 20 %) tax on profits of enterprises of the private sector of the economy (oblast budgets – 10 %);

a.4) introducing, from 2015, fee for retail sale of excise goods (beer, alcoholic beverages, tobacco products, petroleum products), instead of fee for wine growing, gardening and hop growing, which will go to local budgets;

a.5) extending, from 2015, a real estate tax base by including commercial (nonresidential) property for taxation;

b) in respect of expenditure powers, the decentralization of powers in the socio-cultural sphere and clear distribution of competences on the subsidiarity principle is implemented. The following expenditures are transferred from the state level to the regional and local levels: for specific events and establishments in the educational and medical spheres; for support of local councils of fitness and sports societies, their sports bases and Olympic training bases; for certain national and state libraries, museums, reserves, circuses, national theaters, national artist collectives, concert organizations relating to social, labor and professional rehabilitation of the disabled and social protection of Chernobyl liquidators; aimed at housing construction for certain categories of citizens etc.

Base and reverse grants have become basic elements of the renewed horizontal equalization mechanism. A base grant is a transfer from the state budget to local budgets. A reverse grant is made up of funds transferred from local budgets to the state budget for horizontal equalization. Under the conditions of the renewed mechanism, equalization is carried out for two taxes: tax on profit of enterprises of the private sector of the economy (10 %) – for oblast budgets; individual income tax – for budgets of cities of oblast significance, local regions and oblast budgets, budgets of amalgamated territorial communities. Equalization of the taxpaying capacity of territories is determined depending on the level of receipts per resident.

Financial equalization must not be full, since, in such case: “the provision of the population with social goods shall not level out to a greater extent than by private goods, because users will start “appreciate” social goods higher than private goods [31, p. 314]; territorial units (both donors and recipients) will lose interest in increasing in own financial base [54, p. 328], as well as a more progressive approach is incorporated into a renewed approach to stimulate socio-economic development of territories.

The equalization mechanism provides that local budgets with a level of receipts lower than 0.9 of the average indicator across Ukraine receive a base grant (80 % of the amount required to reach the indicator of

0.9) to increase the level of their provision. For local budgets with the level of receipts within the 0.9 to 1.1, equalization is not carried out. However, a reverse grant to the state budget in the size of 50% of excess of the taxpaying capacity index of 1.1 over the average value across Ukraine is provided from budgets with a significant level of receipts per resident (exceeding the index of 1.1).

In the conditions of the effect of budget sphere changes related to the implementation of reform of fiscal decentralization, the revenues of local budgets (including inter-budgetary transfers), have increased, within 2014–2019, 2.4 times – from UAH 231.7 B in 2014 to UAH 560.5 B in 2019. Own revenues of local budgets have increased 2.9 times – from UAH 101.1 B in 2014 to UAH

300.2 B in 2019 p. Further, a significant positive structural shift should be noted – a share of inter-budgetary transfers of revenues of local budgets has decreased by 10 pps, that is mainly caused by changing in the financing of social security and healthcare services – a share of the expenditures will be re-decentralized in favor of the state budget (Figure 1).

Local budget revenue share (excluding inter-budgetary transfers) for the analyzed period was, on the average, at the level of 7.2 % of GDP of the country, including inter-budgetary transfers, this indicator makes 15.5 %. However, only less than 1/4 of revenues of the consolidated budget falls on local budgets – the average value of the share of their revenues of the consolidated budget for 2014–2018 makes 21.7 % (Table 1).

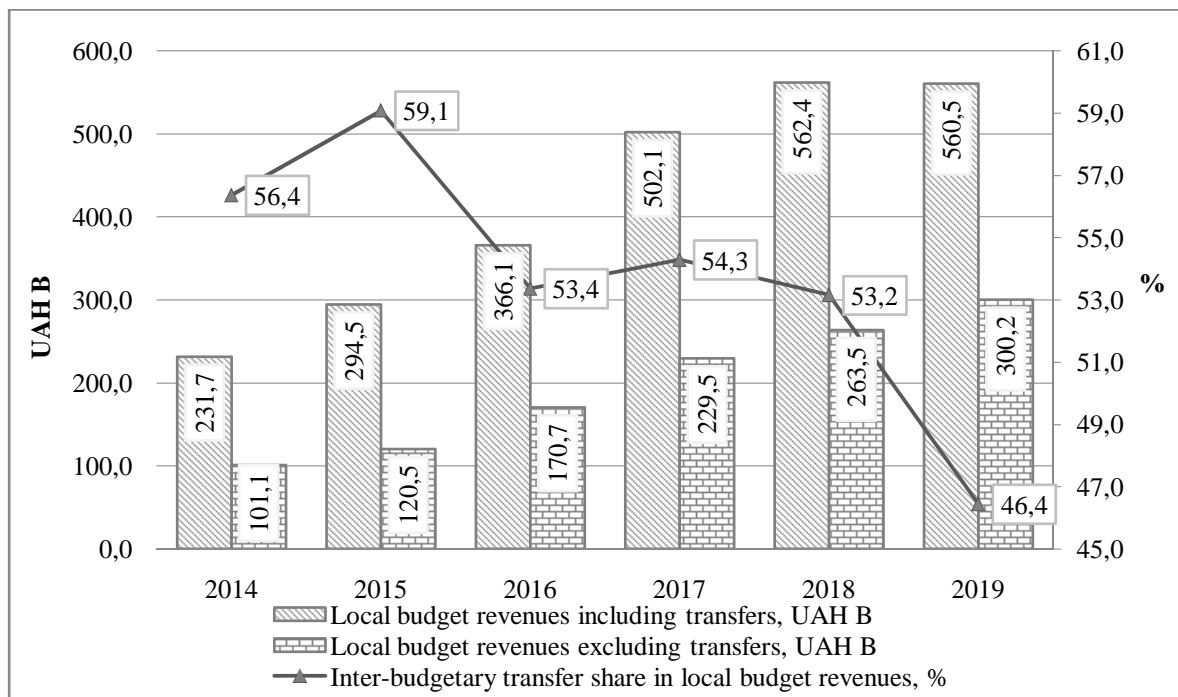


Figure 1. Local Budget Revenue Dynamics

Source: constructed and calculated by the authors based on the data of the State Treasury Service of Ukraine.

Table 1

Specific Fiscal Decentralization Indicator Dynamics

Indicator	2014	2015	2016	2017	2018	2019
Local budget revenue share including inter-budgetary transfers of GDP, %	14.8	14.9	15.4	16.8	1.8	15.1
Local budget revenue share (excluding inter-budgetary transfers) of GDP, %	6.4	6.1	7.2	7.7	7.9	8.4
Local budget revenue share of consolidated budget, %	22.2	18.5	21.8	22.6	22.2	23.3

Source: calculated and constructed by the authors according to the data of the State Treasury Service of Ukraine and State Statistics Service of Ukraine.

At the same time, a share of expenditures of local budgets (excluding inter-budgetary transfers) of GDP for 2014–2019 made, on the average, 14.9 % of GDP [55; 56]. And, of expenditures of the consolidated budget for 2014–2019, it was equal, on the average, to 43.1 %

(maximum value in 2017 – 45.7 %, minimum value in 2015 – 40.7 %) [56].

One of the objectives of implementing fiscal decentralization has been established providing budgetary autonomy to local budgets and increasing in their financial independence [57], whereas the more inter-

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budgetary transfers there are in the local budget revenue structure, the lower is the level of financial autonomy and independence of local self-government. Data analysis shows that, during a researched period (2014–2019), the

size of inter-budgetary transfers from the state budget to local budgets has decreased – from 56.4 % in 2014 to 46.4 % in 2019, i.e., the said fiscal decentralization objective is being gradually implemented (Table 2).

Table 2

**Ukraine’s Local Budget Receipt Structure Dynamics (including inter-budgetary transfers), %**

Analyzed year	Tax receipts	Non-tax receipts	Other receipts	Inter-budgetary transfers
2014	37.6	5.3	0.7	56.4
2015	34.1	6.8	0.7	59.1
2016	34.5	4.4	0.6	60.5
2017	40.0	5.2	0.5	54.3
2018	41.3	5.0	0.5	53.2
2019	49.2	3.7	0.7	46.4

Source: calculated and constructed by the authors according to the data of the State Treasury Service of Ukraine.

A share of transfers directed from the state budget to local budgets made for the analyzed period, on the average, 54.9 % that shows that the tax base of local self-government of Ukraine is not sufficient for the independent financing of all functions and tasks, which fulfillment is imposed on the local power. Fiscal decentralization needs to be further deepened – by reviewing a structure of distributing revenues between different levels of the budget system, seeking additional sources of filling local budgets.

During 2014–2019, positive shifts took place in the local budget structure by the grant receipt indicator, namely: a share of “grant-receiving” budgets has decreased from 96.4 % in 2014 to 71.0 % in 2019, a share of “donor” budgets has increased from 3.6 % in 2014 to 17.5 % in 2019, a new group of balanced local budgets has been formed, which share in 2019 made 11.5 %. However, during the functioning of the renewed horizontal equalization system (2015–2019), the structure of local budgets remains at the relatively stable level by the grant receipt indicator (Table 3).

Table 3

**Grant Receiving Budgets, “Donor” Budgets and Balanced Budgets within Local Budgets of Ukraine Share Dynamics, %**

Conventional cluster budget group name	2014	2015	2016	2017	2018	2019
Grant receiving	96.4	72.7	73.5	74.0	72.3	71.0
“Donors”	3.6	16.5	16.0	13.6	17.3	17.5
Balanced	0.0	10.8	10.5	10.3	10.4	11.3

Source: calculated and constructed by the authors according to the data of state budget indicators for relevant years.

Positive shifts within the structure of local budgets by the grant receipt indicator are stipulated by changing the distribution concerning budgets of cities of oblast significance: decreasing in the share of grant receiving budgets from 86.9 % in 2014 to 36.2 % in 2019, increasing in the share of “donor” budgets from 13.1 % in 2014 to 45.0 % in 2019, forming a balanced layer of budgets of cities of oblast significance (in 2019 – 18.8 %) (Table 4). For all local budgets, relatively stable indicator dynamics are observed during 2015–2019, that actualizes

a matter of the need to take corrective measures to provide the efficiency of the further functioning of the horizontal equalization system.

Analysis of grant receipt of budgets of amalgamated territorial communities (ATC) shows that over 70 % of their budgets are grant receiving that, in turn, confirms the need for further complex reform of the public finance management system incl. the financial equalization system (Table 5).

Table 4

**Grant Receiving Budgets, Donor Budgets and Balanced Budgets of Cities of Oblast Significance Share Dynamics**

Conventional cluster budget group name	2014	2015	2016	2017	2018	2019
Grant receiving	86.9	35.3	35.8	35.8	35.1	36.2
“Donors”	13.1	41.8	42.6	43.2	44.6	45.0
Balanced	0.0	22.9	21.6	20.9	20.3	18.8

Source: calculated and constructed by the authors according to the data of state budget indicators for relevant years.

## Grant Receiving Budgets, Donor Budgets and Balanced Budgets of ATCs Share Dynamics

Conventional cluster budget group name	2016	2017	2018	2019
Grant receiving	78.6	80.1	74.9	72.9
“Donors”	14.5	13.1	16.1	16.9
Balanced	6.9	6.8	9.0	10.2

Source: calculated and constructed by the authors according to the data of state budget indicators for relevant years.

Therefore, as evidenced by local budget indicator analysis, the financial equalization system requires further improving financial capacity of territorial communities, as well as more efficient stimulating local authorities to increase in the budget revenue base, increasing in the expenditure efficiency, decreasing in dependency in inter-budgetary transfers.

**Conclusions.** A strategy for improving the financial equalization mechanism consists, first of all, in strengthening and establishing own stable local budget revenue base being a foundation for the whole budget system and a financial basis for local self-government that promotes achieving the balance of the interests of all participants in inter-budgetary relations.

Self-governance of territorial communities, their autonomy is based on the financial capacity of local self-government. Taxpaying capacity is an important indicator of the level of such capacity. Territories with a low level of taxpaying capacity have, therefore, a low level of financial capacity and are grant receiving, and inversely – territories with a high level of taxpaying capacity are balanced or “donor” budgets and have a higher level of financial capacity. As was shown by the analysis of indicators of local budgets of Ukraine, they depend, to a significant extent, on the receipt of equalization grants from the state budget and a sensitive deficit of funds for financial support for providing social services at the local level determines the need for carrying out financial equalization by the state.

Under the effect of internal and external factors, inter-budgetary relations in Ukraine have changed and require further using corrective measures to provide the efficiency of their functioning in dynamically changing conditions. Directing funds to local budgets through the horizontal equalization system is one of the ways, which will enable to increase in the level of capacity of local self-government and, thus, support providing the population of each community with state-guaranteed social services at the equal quality level.

For further improving financial equalization, it is needed to take the following measures in Ukraine: approve the distribution of specific types of taxes between the levels of the budget system for a long-term period; increase in the role of own revenues by implementing them on the basis guaranteed by the state power; divide inter-budgetary transfers into two groups – a fixed group (to be set for a mid-term period) and a variable group (to be set annually when approving budgets and reviewed, if necessary, during a budget year).

It makes sense to introduce adjustments to the mechanism of horizontal equalization of taxpaying capacity of budgets of cities of oblast significance,

budgets of ATCs, local regions budgets, namely, when equalizing, allow for the indices of sizes of base and reverse grants as follows: 1) when the index is within 1.0–1.1 – equalization shall not be carried out; 2) less than 1.0 – a base grant shall be provided to the relevant budget in the size of 100 % of the amount required for such index to achieve the value of provision of the relevant budget of 1.0; 3) more than 1.1 – a reverse grant shall be transferred from the relevant budget in the size of 20 % of the amount exceeding the value of 1.1 of such index.

In addition, as evidenced by the experience of European countries, for objective and transparent financial equalization, it is needed to apply a formal approach when distributing inter-budgetary transfers, in particular, a formula for the distribution of specific transfers of the budget system of Ukraine should be reviewed. Formulas shall be maximally fair and, to this effect, it is worth allow for the features of administrative territorial units, number of consumers of goods, for which a subvention is granted, a level of socio-economic development of territories etc. Further, a share of target transfers should be reduced to improve expenditure autonomy of local self-government.

Proposed measures will promote strengthening stability of receipts to budgets of all levels and increase in interest of bodies of state power and local self-government in increasing in revenue sides of their budgets, increasing in financial autonomy of local budgets, increasing in the material and financial basis of local self-government.

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