

## The Economic Peculiarities and Problems of United Territorial Communities (UTCs) Forming in Ukraine

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**Abstract.** *In this article we have analyzed the process of reforming local self-government and budgetary decentralization in Ukraine. Special attention was paid to the formation of united territorial communities. Solving the problem of budgetary decentralization is an important problem of the ensuring the effective functioning of the multi-level budgetary system. Its' main destination is the creating conditions for the proper implementation by the local authorities due to their functional powers. The effective social-economic development of the regions is limited objectively by the level of its financial resources' provision. The basis of financial resources consists of local budget revenues. In this context process of the budgetary sphere are responsible for creating the economic incentives for local self-government bodies. It will help to develop their territories, expand own tax bases and use effectively budgetary funds.*

**Keywords:** *united territorial communities, budgetary decentralization, local self-government.*

**JEL Classification:** *H11, H61*

### Introduction

The experience of foreign countries shows that an important condition of economic country growth is the effectively operating mechanism of financial independence of local self-government bodies. Local issues can be effectively solved only at the local level. The government never comes to the problem of each village or town, each street or yard. The state government has only control and coordinating powers, the rest should be at the local level. The process of government's decentralization, which has begun in Ukraine in 2014, has led to the creation of the united territorial communities in 2015 («Why unification of territorial communities is needed»).

On April 1, 2014, the Cabinet of Ministers in Ukraine approved the concept of reforming local self-government and territorial governmental organization in Ukraine (Resolution of the Cabinet of Ministers of Ukraine). These reforms must create on the places a real municipality that in many questions will be independent from Kyiv. Decentralization of government need to create an effective governmental system in Ukraine that will be more plenipotentiary, more effective and more responsible for people. Today the main task for

government, especially local, is to create the safe and comfortable environment for human life.

Solving the problem of budgetary decentralization is an important problem of the ensuring the effective functioning of the multi-level budgetary system. Its' main destination is the creating conditions for the proper implementation by the local authorities due to their functional powers. The effective social-economic development of the regions is limited objectively by the level of its financial resources' provision. The basis of financial resources consists of local budget revenues. In this context process of the budgetary sphere are responsible for creating the economic incentives for local self-government bodies. It will help to develop their territories, expand own tax bases and use effectively budgetary funds.

### Problem statement

The process of creating the united territorial communities (UTCs) in Ukraine is regulated by the Law of Ukraine «About voluntary association of territorial communities», that was adopted in 2015 (Kavunets, Doroh). At the beginning of April 2018 725 UTCs were created in the course of the decentralization reform. The reform, which was

initially taken seriously by a few politicians, had surprisingly stood out and shows good dynamics and has all chances of success in 2020–2021. But at the creation of the united territorial communities local governments met a lot of challenges. Some experts see it as a chance for democratic development, while another think that it will lead to the decentralization of corruption and the potential emergence of the regional separatism.

The actualization of power decentralization, reforming the system of local self-government and budgetary decentralization in Ukraine are confirmed by numerous scientific works of leading scientists and practitioners. According to the question about decentralization of power and budgetary decentralization the following scientists were involved in improvement of the UTCs: O. Bezugliy, H. Vasylchenko, O. Gordeev, I. Zalutsky, D.L. Meadows, H. Daly and others. Though this issue needs to be researched more detailed.

### Results of research

In Ukraine the local government reform has been started with an approval by the Government of the “Concept of territorial organization of power”. The main purpose of this reform is to achieve optimal distribution of powers between the executive authorities at different levels of the administrative and territorial structures according to the principles of subsidiarity and decentralization. The reform of local decentralization ought to ensure the ability of local authorities to solve all local issues independently thanks to their own resources. Now the key to implementing local government reform and decentralization of power is to create the UTCs. Able communities should become a basis element of an effective governmental system in Ukraine.

Having analyzed the peculiarities of the UTC formation in Ukraine, it should be emphasized that a large number of communities with a population of less than 5000 people, the vast majority of whom are rural, are created. At the same time, if in 2015 their share was 31,4% of the formed UTCs, in 2016 – 35,8%, in 2017 – 35,0%. A significant increase in the number of UTCs created in 2018, against the backdrop of the decrease in the number of communities that have been UTCs, has come about due to the increased involvement of regional cities and even regional centers in the integration process (Kavunets, Doroh).

In 2020 the speed of decentralization like the UTCs can be described as “accelerated”. At the beginning of the year, 1,029 UTCs with a population of 11.7 million were created in Ukraine,

covering about 44% of the territory. In 2019, there was a tendency of increasing the number of created UTCs, comparing to 2018 by 63.2% (243 versus 141). First of all, this led to a 14% increase in local budget revenues and, consequently, to a rise in general government fund revenue for the 1st inhabitant by 23.4%. Own income per capita for 2019 amounted to about 6763.6 UAH. In addition, the process of joining the communities and cities of regional importance to the already established UTCs was intensified. With regard to the situation in the regions, the five outsider regions at the end of 2019 look like this: Kyiv, Lviv, Transcarpathian, Vinnytsia and Kirovograd regions. Also, about 57% of communities have not yet been united (4,698 united against 6,263 united), which undoubtedly worsen the prospects for their own development (Figure 1) (Negoda).

Before the determining the problematic aspects of UTCs’ creation and existence, we should study the process of legal organization of local self-government in Ukraine, to analyze the normative-legal support of the rights of municipal formation and to evaluate the state of bringing national legislation to the standards of declared international documents in the field of local self-government development.

Nowadays, one of the main legal basis is European Charter of Local Self-Government 1985. The Charter is a major international legal instrument for the member states of the Council of Europe as it contains standards for the organization of local governance on the basis of local self-government. The Charter seeks to protect and strengthen local autonomy in Europe, as it obliges the parties to apply basic rules that guarantee the political, administrative and financial independence of local self-government bodies from government. Accordingly, the appearance of the Charter has been caused by the increased multi-level integration, including at the local and regional level. That has led to the comparison of local government systems in different countries and the search for unified approaches to further development (Lelechenko, Vasilyeva, Kuybida, Tkachuk).

International legal standards in the field of local self-government are important for the development of local democracy, cross-border economic and social cooperation of territorial communities and local authorities, and other aspects of the functioning of this institution in the world. They are enshrined in relevant international legal instruments, including the European Charter of Local Self-Government (European Charter of Local Self-Government), the European Framework Convention on Transfrontier Co-operation between Territorial Communities or

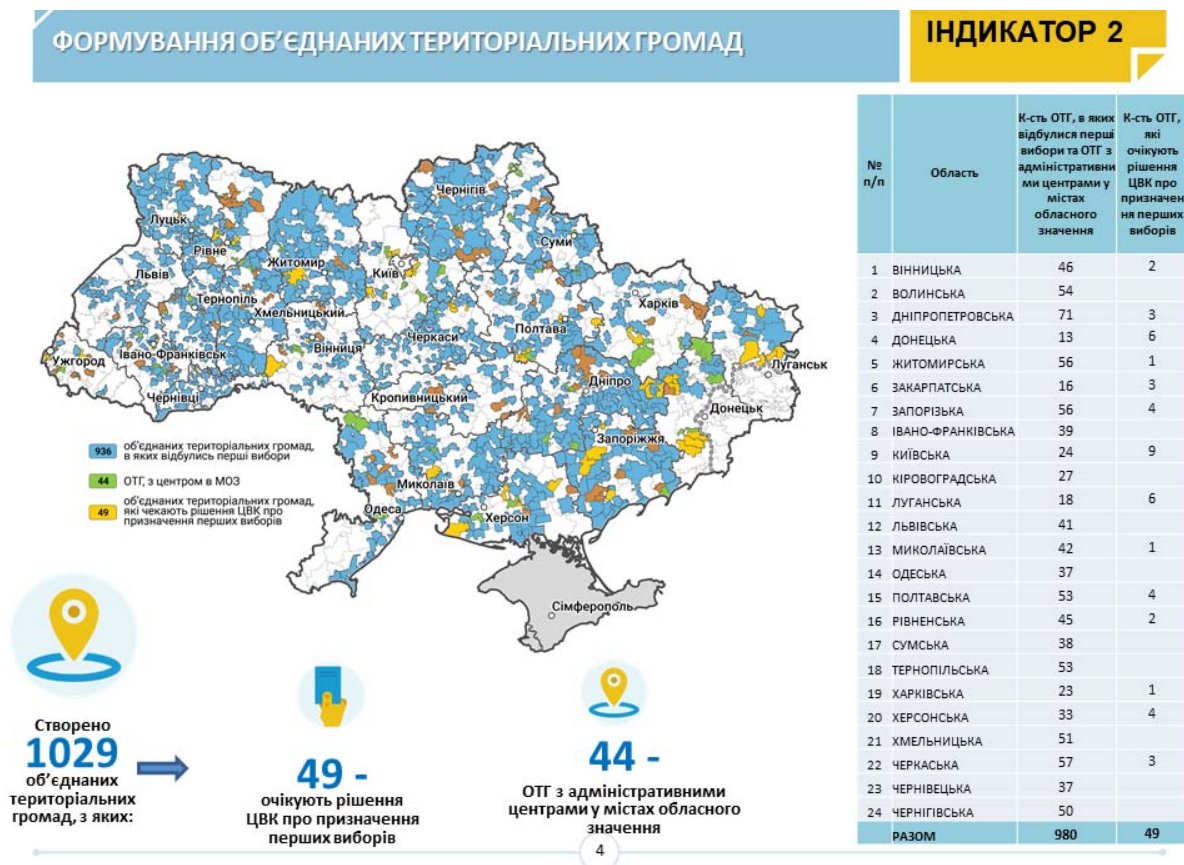


Figure 1 The formation of UTCs between 2015 and 2020

Authorities (European framework convention), the Declaration on Principles of Local Self-Government in Participating States local municipality.

This Charter obliges each party to abide by legal provisions that guarantee the administrative, financial and political independence of local authorities. The Charter, like most such documents, consists of a Preamble and 18 articles, which are divided into three parts. Let us analyze the main provisions of the Charter, which are of the nature of international standards, which are of general importance for the formation, development and functioning of the local self-government system, and profile – in the context of their implementation in the legislation of individual countries. The preamble defines the aims of the Council of Europe and states that local self-government is an integral basis for a democratic system. Like the European Social Charter, this document emphasizes the importance of civil rights (Lelechenko, Vasilyeva, Kuybida, Tkachuk).

Ukraine ratified the Charter in July 1997. This was a period when, after the Verkhovna Rada of Ukraine adopted the Constitution, a fierce struggle was underway to determine priorities in the field of local self-government. Following the adoption of the Law of Ukraine "On Local Self-Government

in Ukraine", the Parliament ratified the Charter without any reservations, which aimed to balance the system of local self-government. However, this approach of the parliament caused almost constant conflict between Ukraine and the Council of Europe, since neither politically nor legally our country could fulfill the obligations of the Charter for a long time.

Ukraine's ratification of the text of the Charter without any reservations immediately led to problems with its practical implementation. However, the difficulties of its implementation were not limited. Thus, the Verkhovna Rada of Ukraine ratified the Charter in 1997, and its official translation and publication took place in 2002. That is, for five years the Charter was virtually out of force, since no judicial authority could invoke its provisions.

Therefore, for a long time, the legal issues of implementation, harmonization and harmonization of the Charter and the legislation of Ukraine on local self-government in many cases remained practically unresolved. Legislatures, the executive, and local governments approached the implementation of the Charter more for social and political reasons than for legal reasons. Following the official promulgation of the Charter,

new problems have arisen in its implementation: overcoming legal nihilism among civil servants and local government officials responsible for the application of this international act, etc.

It should be noted that the current legislation on local self-government does not yet fully comply with the principles of the European Charter of Local Self-Government in matters of organizational, legal

and financial and economic autonomy of territorial communities.

To summarize the substance of the Charter, it is possible to identify the following essential principles, which are fundamental to the formation of a modern European model of government at subnational territorial levels (European Charter of Local Self-Government):

1. Recognition of local self-government in national legislation and, if possible, in the constitution.	12. Independence of local self-government bodies in defining their own internal administrative structures, taking into account local needs and the need to ensure effective management.
2. The reality of local self-government, which determines its content as the right and ability of local authorities to regulate and manage a substantial proportion of public affairs.	13. Creation of appropriate conditions of service and career of municipal employees, which should allow the involvement of highly qualified personnel in local self-government bodies.
3. The sub-laws of local self-government as a power acting within the law.	14. Free mandate of deputies of representative bodies of local self-government (free exercise of their functions).
4. Defining the nature of local self-government as a public authority acting on the one hand in the interests of the local population (territorial community), on the other – is derived from sovereign state power, since the main powers and functions of local self-government are determined by the constitution or law.	15. Financial compensation of expenses incurred during the performance of the mandate of deputies of representative bodies of local self-government, as well as in case of necessity of compensation of lost income or remuneration for the performed work and appropriate social insurance.
5. Assignment to local self-government entities of both territorial communities and local self-government bodies, provided that local self-government representative bodies are elected by secret ballot on the basis of direct, equal, universal suffrage.	16. The definition of a function or activity as incompatible with the mandate of a deputy of a representative body of local self-government, solely by law or on the basis of fundamental legal principles.
6. The autonomy of local self-government as a power, which has the right to freely resolve any matter that is within its competence.	17. Restrictions on administrative supervision of local self-government in the following circumstances: first, the form and grounds – it can be carried out only in accordance with the procedures and in cases provided for by the constitution or laws; secondly, by appointment – it is only intended to ensure compliance with the law and constitutional principles; third, the adequacy of the measures taken by the supervisory authorities to the interests which they should protect in the course of administrative oversight.
7. Subsidiarity (optimal decentralization and real management of the territory, which implies, firstly, the exercise of municipal functions by those territorial levels of government that have the closest contact with the citizen, and secondly, consideration of the scope and nature of the task and requirements achievement of efficiency and economy at separation of powers between territorial levels of authority.	18. Guaranteeing the right of local authorities to their own financial resources, provided that: first, the adequacy of the volume of these resources to the functions and powers of local self-government; secondly, the formation of at least a portion of them through local taxes and fees, the amount of which is set by local governments within the law; third, the diversified and upward-looking nature of the financial systems on which the financial basis of local self-government is formed. These systems should provide an opportunity to align the financial resources of local self-government with the real increase in the cost of performing its tasks; fourth, the financial equalization of territorial communities (communities) through the introduction of procedures for eliminating financial imbalances to overcome the effects of the unequal distribution of funding sources and the financial burden they must bear; Fifth, informing local governments about the allocation of redistributed resources to them; sixth, the irrelevance of local government policy with the subsidies provided to them; seventh, local government access to the national capital market.

<p>8. The powers of local self-government, the inalienability and inviolability of its powers – the powers of local self-government must be complete and exclusive. They may not be abolished or restricted unless otherwise provided by law.</p>	<p>19. Guaranteeing the right of local self-government bodies to freedom of association and cooperation with local self-government bodies of foreign countries</p>
<p>9. Adaptation of the exercise of powers delegated to local self-government to local conditions.</p>	<p>20. Local self-government redress – the right of local self-government bodies to use remedies to ensure the free exercise of their powers and respect for the principles of local self-government.</p>
<p>10. Participation of local self-government in the resolution of all issues of public importance, which although not covered by its competence but affect its rights and interests.</p>	<p>21. Application of the principles of the Charter to all categories of local self-government bodies existing within the territory of the state.</p>
<p>11. Integrity and inviolability of the territories of the subjects of the right to local self-government – change of territorial boundaries of local authorities requires coordination with the relevant territorial communities (communities).</p>	<p>22. Guaranteeing everyone the right to participate in the affairs of local self-government bodies.</p>

The European Charter of Local Self-Government is the first multilateral legal instrument on local self-government, the result of many initiatives and long-standing cooperation between different European structures, as well as a testimony that local self-government is one of the necessary attributes of any democratic society.

The introduction of a proportional electoral system in local elections has put the principle of free mandate of deputies of representative bodies of local self-government under threat in Ukraine, since their activity in the council today is determined not so much by the interests of voters as by party-corporate interests.

Legal guarantees for the realization of the right of local authorities to their own financial resources, which would adequately meet the needs of exercising the functions and powers of local self-government, have not been created yet, the procedure of judicial and extrajudicial protection of his rights and legitimate interests has not been elaborated.

Today, after their formation as a legal entity, territorial communities form the budget of local self-government and dispose of these funds independently or through the local self-government body created by them. It is up to the community to decide whether or not they need to pool some of their funds at the district or region level. Local government reform also offers real opportunities for community development, as well as certain benefits for citizens to grow businesses in their territory without being subject to a cumbersome and inefficient Tax Code, since some taxes remain at the disposal of the territorial community.

Financial decentralization is one of the most important conditions for the independence and viability of local authorities. The main sources of local budget revenues include tax revenues (national taxes, which are legally assigned to local budgets, local taxes and fees, as well as deductions from national taxes), funds derived from municipal funds generated by the activities of municipal enterprises. and organizations owned by territorial communities, and payment for services provided by local governments as well as local loans. The ratio of these major sources in the structure of local finances determines the degree of autonomy of local budgets (Tataryn, Voytovych).

According to results of the financial decentralization in Ukraine there is not significant growth of local budgets. In 2014 the share of the own revenues in local budgets was 5,1% in GDP. During the period of UTCs' development this index has increased on 1,7% and was 6,8% in 2019 (Figure 2) (Negoda).

During the period from 2014 to 2019 the amount of state financial support of local and regional development has increased by 41,5 times. Besides in 2019 there was a subvention for construction, reconstruction, repair and maintenance of public roads of local importance in the amount of UAH 14.7 billion (Figure 3) (Negoda).

But today in the Ukrainian village there is a big problem with the development budget as such. In rural communities with a population of up to 500 people, the development budget is not formed at all; with a population of 500–1000 people, the development budget has 11% of these rural

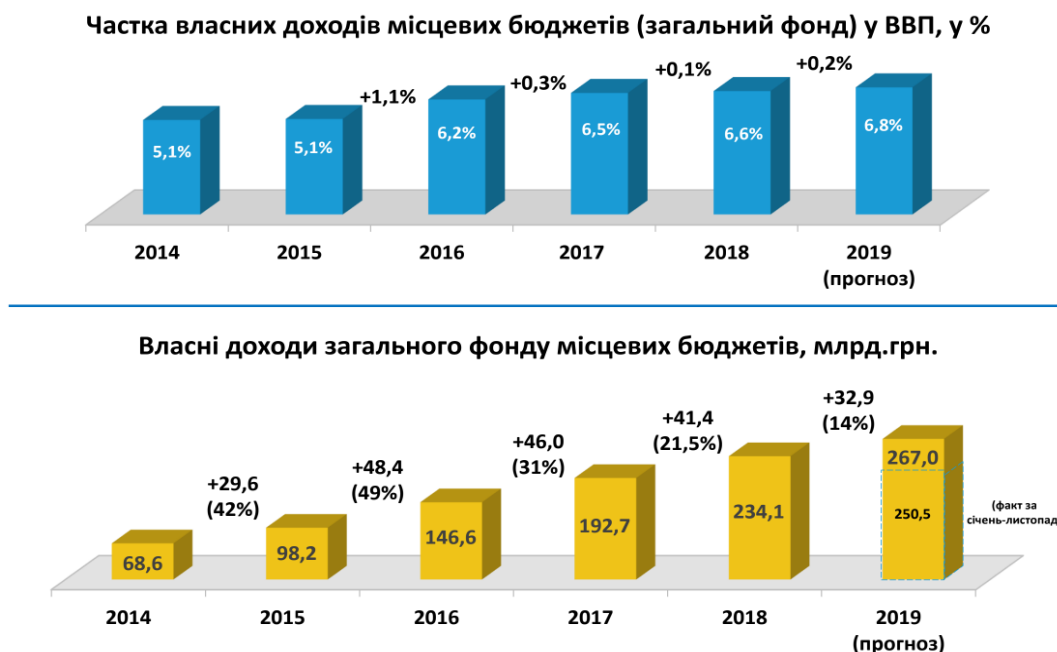


Figure 2 Results of financial decentralization, growth of local budgets (2014–2019)

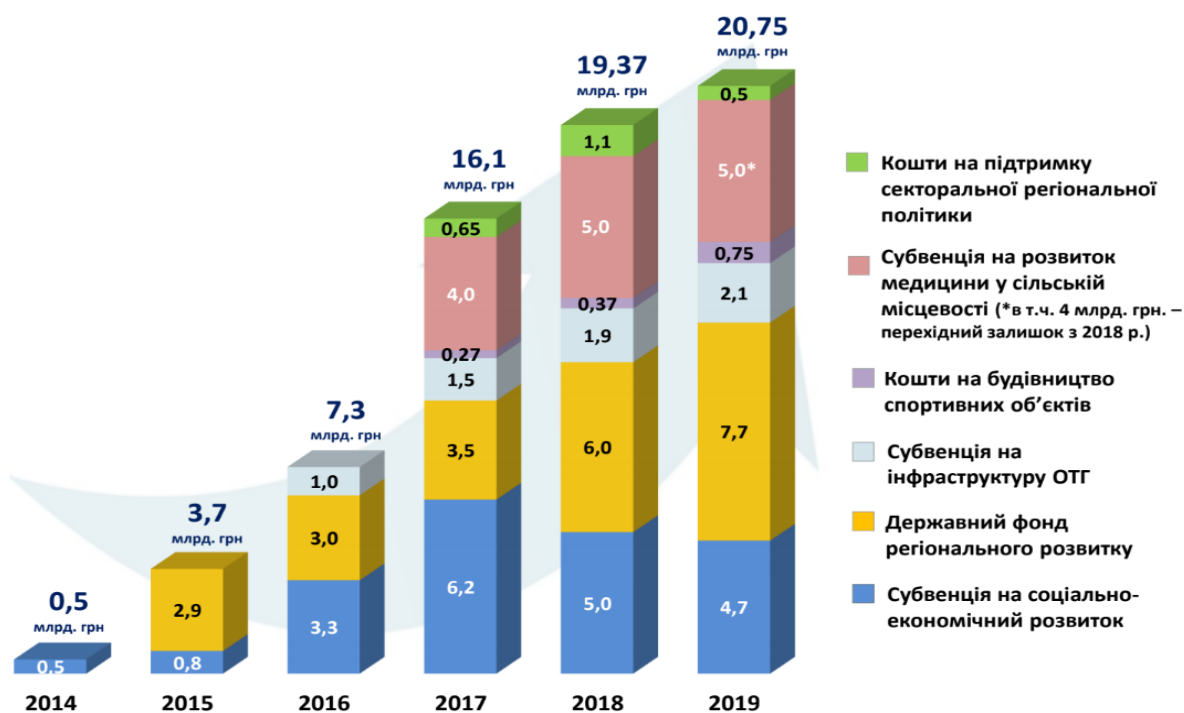


Figure 3 State financial support in Ukraine (2014–2019)

communities. In villages with a population of more than 5000 people it is about 66%. And this is evidence that there are budgets for self-development. In addition, in a community with a population of 500–1000 people, the development budget is approximately 2.5% of the total budget of the territorial formation, and in the community of more than 5000 people – 27%. As you can see, for the development budget alone, it is necessary

to carry out administrative-territorial reform, which will ensure the consolidation of territorial communities and, accordingly, local budgets.

In the context of the amendments to the Budget Code of Ukraine, the list of sources included in the development budget has been increased. In addition to existing sources – funds from alienation of property, receipt of dividends, funds from repayment of loans, borrowings, etc., will also

be included in the development budget: a single tax for small businesses, local guarantee fee, part of the proceeds from the sale of non-agricultural land (Pelekhata).

Ideally, 90–95% of all local problems should be solved at the territorial community level, but today nothing can be implemented in a timely and qualitative way for one reason: in our country, most of the resources are accumulated in the state budget, which testifies to the high dependence of local government resources on public funds and their low autonomy.

The state budget provides for the creation of a regional development fund, the funds of which are directed to the implementation of investment programs and projects of regional development (including projects of cooperation and voluntary association of territorial communities) aimed at the development of regions, the creation of infrastructure of industrial and innovation parks and comply with the priorities set out in the State Regional Development Strategy and relevant regional development strategies. Local governments have the opportunity to compete for investment programs and projects on a competitive basis regional development. Funds from this fund may also be raised by voluntarily united communities to improve infrastructure in their territory, which once again serves as an incentive for voluntary association (Kyrylenko, Malynyak, Pysmenny, Rusin).

The specificity of managing the finances of the united territorial communities is due to a number of important factors. First, the finances of the united territorial community cover the territory of several settlements. Involvement of representatives of all settlements in the management process leads to increased control over the complete filling of the budget and intensifies the competitiveness of individual administrative units in the full filling of the budget of the united territorial community.

Secondly, Ukraine has no experience in managing the finances of a united territorial community. This factor limits the maintenance of a high pace of local finance reform and causes difficulties in addressing current problems in managing the finances of the united territorial communities. On the other hand, it is possible to interrupt the hereditary shortcomings in this area, including by creating a favorable environment for eradicating corruption in the area of local finances.

Third, direct intergovernmental relations between the budget of the united territorial community and the state budget are introduced. This guarantees the integrated territorial community the amount of

intergovernmental transfers calculated for all local government budgets using the universal formula. However, the volume of such intergovernmental transfers should be sufficient to fund primarily the social sphere of the united territorial community, since it is much more difficult to obtain financial support from the united territorial community for such budgetary purposes from other types of budgets.

Fourth, there is a concentration of significant financial resources in the budget of the united territorial community. Thus, a powerful resource is emerging that is able to have a significant impact on the socio-economic development of the united territorial community. At the same time, the importance of quality planning for the development of a united community and directing resources to the priorities that are well defined in it are increasing. The increase in the financial resources available to the governing bodies of the united territorial community increases the risks of their unfair distribution or inefficient use.

Fifth, the current legislation governing the operation of the united territorial communities stipulates that the quality and accessibility of public services provided in the united territorial community may not be lower than before the unification. The implementation of the said provision presupposes the consideration of the need for proper provision of public services in the planning and implementation of the budget of the united community.

Thus, the integration of territorial communities has a number of positive consequences for managing local finances:

- increasing the ability of local governments to manage their financial resources by increasing the ability to attract highly qualified professionals to management structures (the number of which will decrease significantly);

- decrease in the number of administrative staff of local councils and the amount of expenses for its maintenance;

- increased competition of settlements within the unified territorial community, which stimulates the shadowing of the economy, reducing corruption in the sphere of formation and use of budgetary funds, distribution of land resources, management of communal property, etc.;

- management decisions to provide more public services are made by the united territorial community, not by the district council, which helps to ensure fuller priority of the population (Pelekhata).

At the same time, decentralization policy in the area of budgeting of territorial communities

is aimed at ensuring transparency of the entire budget process, which envisages several main directions.

In 2016 state fund of the regional development was created by the Ministry of Regional Development, Construction and The Housing Communal Services of Ukraine. The purposes of this fund is solving the tasks of: the education projects' implementation; the implementation of human capital development projects; the implementation of tourism development projects; the implementation of unique projects; implementation of business projects; implementation of economic projects (The State Fund for Regional Development).

The volume of the State Budget Fund is approved by the Law of Ukraine on the State Budget of Ukraine for the relevant budget period (not less than 1 percent of the general budget fund revenue)

The funds of the RDFR between the oblast and Kyiv city state administrations are distributed as follows (The State Fund for Regional Development):

– 80% – according to the population of the region;

– 20% – based on gross regional product per capita (for regions with less than 75 percent of Ukraine's average).

It is necessary to note the peculiarities of budgeting of the united territorial communities. First, UTC budgets have intergovernmental relations with the state budget. That is, the law on the state budget for the planned year, this budget approves the volumes of intergovernmental transfers. This is a basic grant, an educational subvention, a medical subvention, other subventions and grants where there are grounds for granting and receiving appropriate intergovernmental transfers

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