

**ADMINISTRATIVE AND FINANCIAL  
DECENTRALIZATION AS A FACTOR OF STRATEGIC  
DEVELOPMENT OF TERRITORIAL COMMUNITIES  
IN UKRAINE**

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**INTRODUCTION**

The development of Ukraine at the present stage is characterized by an emphasis shift in the field of state regulation of territorial development towards administrative and financial decentralization, which is accompanied by the formation of capable communities with the transfer of powers and resources to the local level for efficient use of their financial and economic potential. Transformation processes in the economic progress of Ukraine nowadays are being built in terms of European integration, so the key aspect of the national system development of the state formation is the chosen course for decentralization and isolation of the territorial community as a basic subject of local self-government, ensuring its formation as a self-sufficient, efficient and effective branch of government.

The importance of this problem, at the present stage of development, requires from all branches of power to resolve the issue of the need to improve the legislative fundamentals, development of scientific and practical implementation of modern state-building aimed at transforming the political system of society, conducting administrative-territorial and regional reforms, implementing a constructive social partnership between the center and the areas.

**AIMS AND METHODS**

Nowadays the investigation of the current state of formation and development of decentralization processes in Ukraine, revealing the essence of carrying out administrative – financial decentralization in the framework of reforming local self – government in

Ukraine is very important. The present research has been conducted using the following methods: the method of dialectical knowledge of the economic nature of territorial communities as subjects of managing the socio-economic development of the territory; systematic and comparative analysis in order to determine the components of development of territorial communities financial and economic potential; graphic visualization for visual presentation of calculation results and analysis; statistical methods.

## **RESULTS AND DISCUSSION**

Nowadays, European trends in economic and social development are characterized by a focus on globalization and democratization. Globalization, the social consequence of which is the destruction of stable societies and communities, may foresee the exclusion of society development democratization, since there is a gradual loss of one of the basic elements of democracy – the right of citizens to participate in the management of public affairs. Instead, there is a reverse effect – upholding the interests of civil society and the development of the state based on the involvement of local territorial communities into the territory management, and therefore the direct influence of the latter on the development of regions and the state as a whole. Accordingly, one of the main issues that need to be reviewed, is determining the place and role of territorial communities in the context of domestic realities of economic development and taking into account the orientation towards reforming the system of local self-government.

The Strategy for Sustainable Development of Ukraine until 2020, approved by Presidential Decree No. 5 of 12.01.2015, defines that in order to ensure European standards of living in Ukraine and to reach the leading positions in the world, state policy is directed to the implementation of structural reforms according to the four main movement vectors, and namely: development, security, responsibility, dignity. Within these strategic vectors of movement, 62 reforms and state development programs are planned to be implemented. One of the primary reforms and programs in public policy implementation are administrative and financial decentralization and public administration reform.

By definition, decentralization is the process of expanding and strengthening the rights and powers of administrative-territorial units or lower bodies and institutions while narrowing the rights and powers of the corresponding center in order to optimize and improve the management of socially important affairs, the fullest implementation of regional and local territories. That is, it is a system of division of functions and powers between state and local levels of government with the empowerment of the latter.

Administrative-financial decentralization is considered first and foremost as a process of transferring powers and financial resources of the public sector from the national to the local level, while assessing the amount of powers and financial resources delegated to lower administrative levels consequently to their total volume in the public sector. The state policy of Ukraine is aimed at building self-sufficient territorial communities, which should become effective branches of governance, basic subjects of local self-government. The development of society is connected with the issues of the administrative-territorial structure as an internal territorial organization of the state, and its division into corresponding parts – administrative-territorial units.

The constitution of Ukraine clearly defines the concept of “territorial structure” in the state. It is based on the principles of unity and integrity of the state territory, the combination of centralization and decentralization in the exercise of state power, balance and socio-economic development of regions, taking into account their historical, economic, environmental and geographical demographic characteristics, ethnic and cultural traditions.

According to the main Law of Ukraine – the Constitution, the system of administrative and territorial structure of Ukraine consists of: regions, districts, cities, districts in cities, settlements, and villages. The existing administrative and territorial structure in Ukraine, which was formed during the time of the command-administrative model of management, is not effective today because it does not fully take into account the interests of local self-government, which is considered as a component of state administration vertically subordinated to higher level authorities. The question of the need to build a new model of territorial organization of power and administrative-territorial structure has been repeatedly raised in the political and expert environment. However, most of these attempts have been stopped at the stage of conceptual justifications or bills. Instead, the problems related to the imperfection of the administrative-territorial structure and management of the territories did not decrease, but increased over the years. In particular, they are exacerbated at the lowest basic level – in villages, towns and small towns, where local self-government is mostly incapable of activating economic activity and providing a favorable environment for people’s functioning.

The European Charter of Local Self-Government stipulates that “within the limits of the law, local authorities have every right to freely resolve any matter which is not within their competence and which is not entrusted to any other body. Municipal functions, as a rule, are exercised mainly by those authorities which have the closest contact with the citizen” [Beiko and Pukhtynskyi 2003]. That is, the charter declared the principle of subsidiarity as the key to local self-government and should be the guaranty of local development, especially in rural areas. The state should abandon the functions not inherent to it and delegate the right to resolve the most crucial issues at the level of territorial communities, providing adequate resources under its own responsibility.

The experience of European countries shows that effective local self-government can only be built on the principles of public authority of territorial communities, based on which the realization of the right of the community to resolve issues of local importance is ensured. The key issue in addressing certain problems is the issue of adequate resource provision for the relevant solutions, so any territorial community must consider the resource potential, both domestic and regional.

Reforming the territorial organization of power on the basis of decentralization is one of the key areas of system social transformation in Ukraine. The basic component of this reform is the optimization of the spatial basis of the authorities functioning, which is the administrative-territorial structure. The task of decentralization reform in Ukraine is to create an effective system of public authority in administrative and territorial units, capable of providing favorable living conditions for people and opportunities for sustainable socio-economic development of all regions through the rational use of their potential.

Ukraine, as a country that has outlined a European vector for development and a country that seeks to meet the requirements of a candidate country for EU membership, must

take all appropriate organizational and legal measures to build an effective, transparent public administration structure that is capable of implementing a coherent state policy aimed at sustainable social development and adequate response to internal and external challenges. The events in the East of Ukraine has become the urgent need to accelerate the processes of decentralization in Ukraine

Activation of the decentralization process in Ukraine started in 2014 with the adoption of the Concept of reforming local self-government and territorial organization of power in Ukraine, approved by the Cabinet of Ministers of Ukraine on April 1, 2014 No. 333-r [WWW 1]. The Concept has identified the main tasks that need to be addressed in the process of local government reform, namely:

- ensuring the accessibility and quality of public services;
- achieving optimal distribution of powers between local self-government bodies and executive authorities;
- defining a sound territorial basis for the activities of local self-government bodies and executive authorities in order to ensure the accessibility and proper quality of public services provided by such bodies;
- creation of corresponding material, financial and organizational conditions to ensure the implementation of local authorities' own and delegated powers.

Establishing an effective system of territorial organization of power is impossible without effective administrative-territorial reform, so the key step in this reform was the adoption of the Law of Ukraine “On Voluntary Association of Territorial Communities” of February, 5, 2015, according to which neighboring city, town or village councils can be united into one community with a single center of local self-government. The conditions for such association are:

- the absence of another territorial community with an existing representative body of local self-government within the united one;
- the continuity of the territory of the united territorial community; the boundaries of a united territorial community are determined by the external jurisdiction of the united territorial community councils;
- location of the united territorial community within one region;
- taking into account the decision to unite historical, cultural, ethnic and other factors of community evolution that have a direct impact on the socio-economic development of the united territorial community;
- improving the quality and accessibility of public services provided within a united territorial community.

On April 8, 2015, the Cabinet of Ministers of Ukraine [WWW 2] approved the Methodology for Forming Capable Territorial Communities, which defines the mechanism and conditions for the formation of capable territorial communities and the procedure for developing and approving a prospective plan for the formation of such communities. This normative act introduces the notion of a capable territorial community, which is defined as territorial communities of villages (settlements, cities), and which, as a result of voluntary association, are able to ensure, on their own or through the relevant local self-government bodies, an adequate level of provision of services, in particular in the field of education, culture, health protection, social protection, housing services, taking into account the human resources, financial support and infrastructure development of the corresponding

administrative and territorial unit. Adopting these regulations and taking into account the positions of the European Charter of Local Self-Government have allowed Ukraine to begin the formation of a significant efficient and capable local government institution, which became known as United Territorial Communities (UTCs).

The process of forming a UTCs can be called dynamic: as of 2015, 159 UTC were formed in Ukraine; as of 2016 – 366; as for 2017 – 665; as of January, 1, 2019, the total number of united communities was 876, resulting from the unification of 4010 territorial communities (Fig. 1). The total area of the united communities is 37.6% of the country, with more than 8.4 million inhabitants, which is almost 24% of the total population of Ukraine.

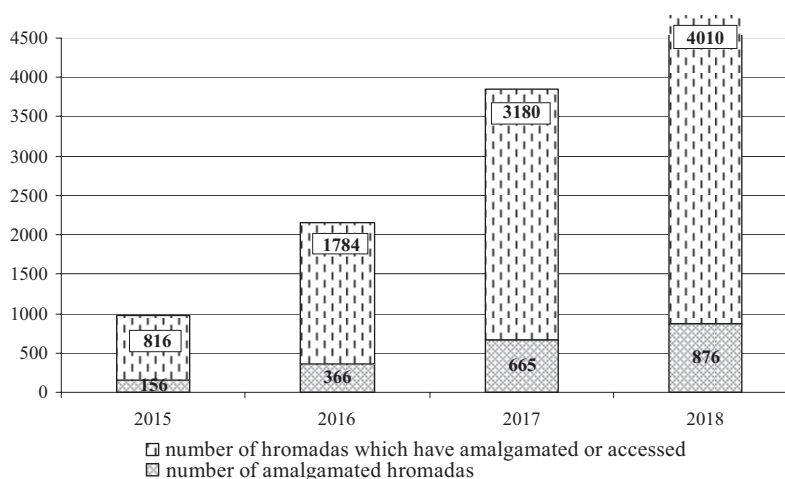


FIG. 1. Number of territorial communities that formed the united territorial communities

Source: Author's research.

Most UTCs are established in rural areas, the average number of territorial communities united into one UTC is 4.6, and the average population of one UTC is 10,289 people (Fig. 2).

Since 2014, implementing the state regional policy, the Government of Ukraine has been increasing the amount of state support for the development of regions and communities annually. The conducted analysis of the state budget showed that in 2019 the Government has been implementing 79 programs of state support for the development of territories for which 84.1 billion UAH is foreseen. In 2018, this support amounted to over UAH 66 billion. UTCs created from the state budget are provided with financial support for regional development of road and transport infrastructure, rural development, energy efficiency, environmental security, development of sports infrastructure, development in the field of education, culture, health care, infrastructure development (social security).

In addition to providing state financial support for regional development, the state has identified the sources of formation of UTCs financial resource in the Budget Code of Ukraine in order to encourage communities to unite. The main of them are: 60% tax on

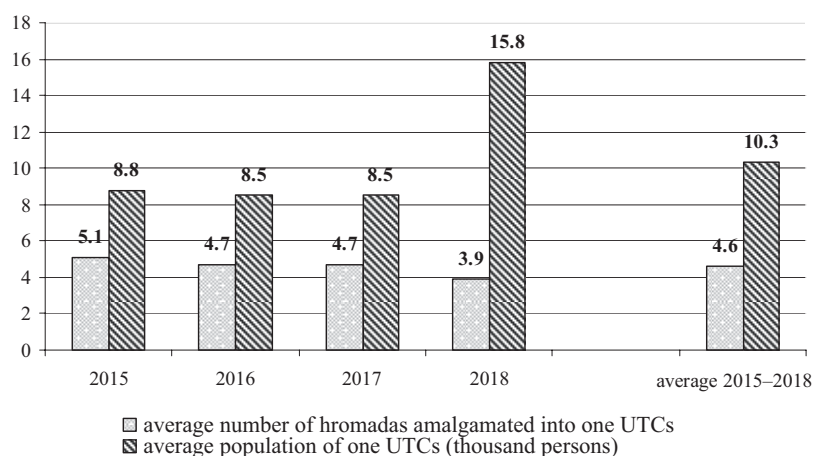


FIG. 2. Dynamics of the average number of communities and population that are combined into one community

Source: Author's research.

personal income, 25% environmental tax, 5% excise tax on sales of excisable goods (tobacco, alcohol, fuel at gas stations), 100% single tax, 100% tax on profits of enterprises and financial institutions of municipal property, 100% property tax (real estate, land, transport).

The most significant result of fiscal decentralization is the increase in the share of local taxes and levies in local budget revenues from 2.5% in 2012–2014 to 30% in 2018, mainly due to the transfer of individual taxes and levies to local budgets. The share of local budget revenues in the consolidated budget is more than 50%, compared to 42% in 2014. The standard of income ratio of the state and local budgets of most EU countries – 50 : 50 – can be considered achieved. Over 15% of GDP is redistributed through local budgets in Ukraine. The share of own revenues of local budgets (general fund) in GDP in 2018 has been 7.1% (in 2014 – 5.1%), and own revenues of local budgets increased from 68.6 billion UAH in 2015 to 189.4 billion UAH in 2018. The share of local budgets (including transfers) in the consolidated budget of Ukraine increased from 45.6% in 2015 to 51.5% in 2018. During 2016–2018, the own revenues of the general fund of local budgets per capita increased by 21.5% or from 3762.6 UAH up to 6032.9 UAH (Fig. 3).

As a result of the decentralization of management powers to the level of the united territorial communities, additional financial resources, expanded powers and direct intergovernmental budgetary relations have been provided. The exercise of these powers through the use of appropriate resources is the foundation on which the integral potential of the territory is formed and its use is ensured to achieve the development of the territory. The main component of the integral potential of a territorial community is its financial and economic potential.

The reform of the administrative and territorial structure and the introduction in Ukraine of the basics of financial decentralization imply a certain financial, organizational and administrative independence of the territorial community from the central

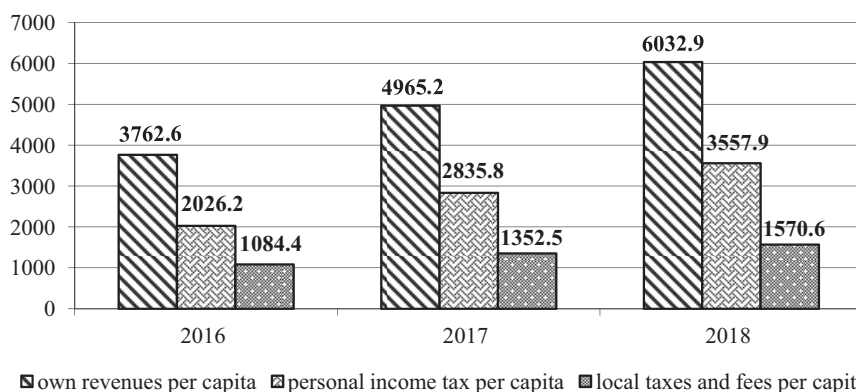


FIG. 3. Dynamics of own revenues of the general fund of local budgets per 1 resident of UTC in 2016–2018, UAH.

Source: Author's research.

authorities and their decisions. Such autonomy is only possible with the full and effective use of all the opportunities and resources available to the maximum extent possible. That is, “balanced economic, social and environmental development through sustainable use of resources” is meant.

Financial and economic potential of the territorial community is characterized by the presence of public relations, objects, connections, phenomena and resources, as well as the probable possibilities of their use, management and organization in order to ensure the complex development of the administrative and territorial unit. It is defined as the cumulative sum of the budgetary potential of a territorial community, the financial and economic potential of economic entities (located or operating in its territory), households, extra-budgetary funds and the level of their interaction. Financial and economic potential is characterized by dynamism, constant change and renewal of interconnections within the system and functional dependence of its constituents, which, due to the change of one element, leads to change of other and “shift of proportions of functional and territorial character” [Ganushhak 2013].

Most economists argue for the existence of the financial potential of the territory as a component of economic potential. However, taking into account the importance of financial capacity to meet material needs allows us to argue the existence of financial potential as a basis for the development of economic capacity of the territory, i.e. its economic potential. On the other hand, it is as a result of production activity and management that the consequences of such activities gain value and provide value creation. Accordingly, the components of economic capacity are the basis for the formation of financial potential. And each element-component of financial and economic capacity is a reflection of the system within which financial resources are formed (Fig. 4).

Analyzing the structure and sources of formation of financial and economic capacity of a territorial community, it is possible to distinguish the presence of its two components – real and potential. Taking into account the potential component makes the indicators of formation of financial and economic capacity of the territorial community much higher



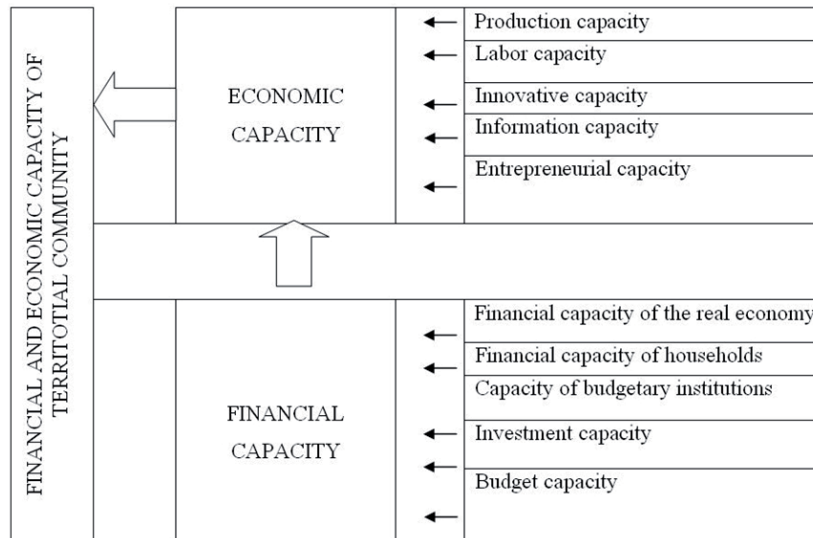


FIG. 4. Structure of financial and economic capacity of the territorial community

Source: Author's development.

than in determining only the real component, which can be analyzed by means of estimation statistical indicators. The main reason for such situation is the consideration of the level and capabilities of the economy in determining the potential component.

The main quantitative indicators of decentralization are the revenue part, which is at the disposal of local authorities, as well as the share of expenditures made at subregional and local levels of government in the consolidated budget of the state. However, only these quantitative parameters do not reflect the real state of decentralization of government in the state, since the redistribution of resources between levels of management is accompanied by a redistribution and “areas of responsibility”, i.e. management functions. Along with financial decentralization, the state transfers directly the implementation of the public function to the regions, the provision of relevant public services to the population at their own expense or through higher-level transfers, regulatory adjustment of the corresponding function in ensuring the quality and accessibility of public services, natural and financial regulations, level and cost structure.

The analysis and research of the features of the territorial community development, in particular the efficiency of using its financial and economic capacity in the context of allocating actual indicators and reserves of growth, allow to evaluate comprehensively the ability of the community to ensure sustainable development in the long term and to determine its level of capability. This task is especially urgent in the current context, since at the legislative level the main issue of administrative-territorial reform is the formation of capable territorial communities through unification. Therefore, capacity should be seen as the ability to provide extended self-improvement to meet the needs of the territorial community, its socio-economic development and maintain an appropriate level of



competitiveness. Capability includes internal and external components or manifestation forms. The internal components include:

- level of use of the territorial community financial and economic capacity;
- the level of availability of financial resources to satisfy the provision of public services;
- the tax capacity of the territorial community and the level of use of its tax capacity.

An external form of the territorial community capacity manifestation is the level of its involvement into regional or country-wide distribution relations and indicators of community competitiveness.

On April 8, 2015, the Cabinet of Ministers of Ukraine [WWW 2] approved the Methodology of formation of capable territorial communities in which the term “capable territorial community” is defined. They are territorial communities of villages (settlements, cities) which, as a result of voluntary association, are able to provide independently or through the relevant local self-government bodies level of provision of services, in particular in the field of education, culture, health care, social protection, housing services, taking into account human resources, financial support and infrastructure development of the relevant administrative unit.

The main goal of local self-government reforming in Ukraine is to stimulate economic growth in the country on a bottom-up basis through the effective use of its own socio-economic resources by newly created united territorial communities. The main directions of intensification of the territorial community financial and economic capacity formation in the conditions of implementation of the decentralization reform are shown in Figure 5.

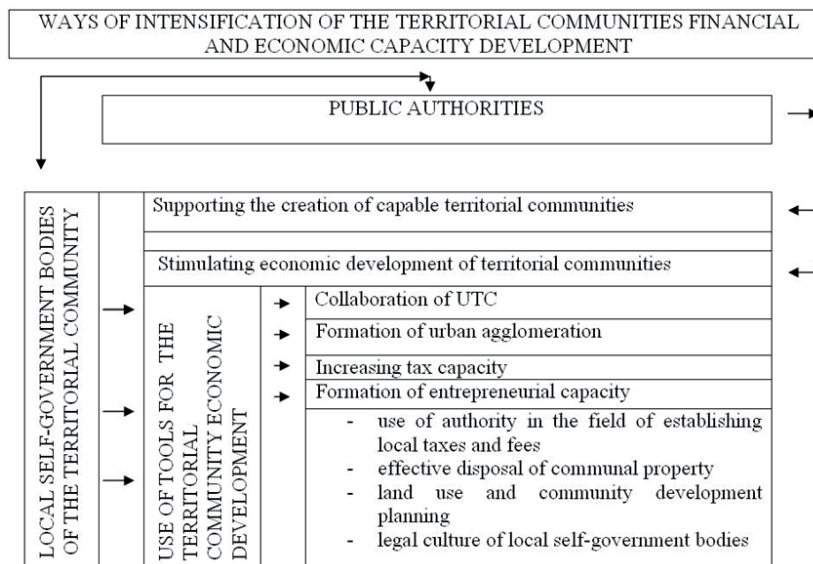


FIG. 5. Ways of intensification of the united territorial community financial and economic capacity development

Source: Author's development.

Nowadays, there are many unresolved issues that affect the formation and development of UTCs in Ukraine, the main of which are:

- development of communities that do not meet the criteria of capacity (according to the population size, financial and economic capacity, etc.), although some of them currently have a high level of taxability;
- leaving cities of regional importance, as well as subsidized rural communities, outside the process of unification;
- low level of support to the process of UTCs creation by district administrations and local elites, who are not interested in changing the leadership of settlement councils and principles of their functioning.

The problems related to the socio-economic differentiation of the development of individual territories of Ukraine are largely caused by the model of relations between the center and the regions, which was based on the exclusive role of the center in solving the issues of regional development and the redistribution of resources, as well as the total lack of authority and finances in the regions for implementation of regulatory influence at the internal regional level. This situation did not lead to effective management of the internal socio-economic capacity, since the additional financial resources obtained as a result of economic activity could not be used by the authorities and local self-government at their own discretion and to meet the immediate needs of the development of local territories. Therefore, the implementation of reforms in the field of local self-government and administrative-territorial structure of the state, is meant to shift the weight of responsibility and the resource base of development to the regional and local level, which can be a catalyst for leveling excessive disproportions of socio-economic development of territories by launching mechanisms local self-government bodies promoting to endogenous capacity creation.

The Concept of reforming local self-government and territorial organization of government in Ukraine has identified two stages of the reform realization and timeframes for their implementation: preparatory stage (2014) and the second stage (2015–2017). Analyzing the peculiarities of the UTCs development in Ukraine, it should be emphasized that a large number of communities with a population of less than 5,000 people, the vast majority of whom are rural inhabitants, have been created. At the same time, while in 2015 their share was 31.4% of the formed UTCs, in 2016 it was 35.8%, and in 2017 it comprised 35.0%. A significant increase in the number of UTCs created in 2018, along with the decrease in the number of communities that were included into UTCs, was caused by the increased involvement of regional cities and even regional centers into the integration process. Taking into account the larger size and population of urban UTCs, as well as the much higher economic capacity (including tax capacity), we might foresee further differentiation of opportunities and levels of urban and rural UTCs in the future.

Therefore, the Government has introduced a new timetable for reform implementation nowadays. The development of capable territorial communities should be formed by the middle 2020, which would correspond the already adopted law on the administrative and

territorial structure in Ukraine. The principle of voluntariness, however, remains fundamental. Along with this, the reorganization of districts and the formation of administrative districts as a temporary territorial basis for the organizational construction of territorial units of central executive bodies, taking into account the configuration of hospital districts, as well as the reformation of the network of territorial bodies of central executive bodies and state administrations, begins.

## CONCLUSIONS

Ukraine is only making the first steps on the way to decentralization and economic growth, however there are tangible shifts in the direction of decentralization. Continuation of the policy of decentralization of governance should become an effective factor in stabilizing the socio-economic situation, overcoming contradictions between different levels of government, and contributing to improving the efficiency of budgetary funds use at all levels. The main tasks of decentralization for the medium term perspective are completing the formation of capable territorial communities throughout the country, strengthening the communities institutional and resource capacity, introducing strategic planning for the UTCs development, building community infrastructures, improving the quality of provision of the entire range of public services to the population.

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**Summary.** The current state of decentralization reform implementation in Ukraine has been highlighted. The necessary assurance of the decentralization process based on the principles of administrative and financial decentralization has been identified. The key aspects of the reform are the creation of conditions for socioeconomic development of the administrative-territorial structure of the state. The main ways of development of territorial communities, their economic and financial status strengthening have been determined on the basis of the conducted research. The complex of tasks which are dependent on territorial community capacity functioning has been analyzed. It has been established that the efficiency of forming and utilizing the financial and economic potential of a territorial community is a prerequisite for ensuring its capacity. Conclusions have been made on the necessity of further implementation of decentralization in Ukraine in order to ensure the strengthening of the institutional and resource capacity of territorial communities, and to introduce strategic planning for their development.

**Key words:** decentralization, administrative-territorial structure, capable territorial community, financial decentralization, resources

**JEL:** H73, O18, R11

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