

ICPS newsletter

Local budgets: Independence versus expediency

During the last three years, actual revenues and expenditures of local budgets have stayed higher than targeted. As a result, the share of local budgets in the consolidated budget has increased. At the same time, the draft 2000 budget foresees a sharp reduction of local budget revenues and an increase in subsidies. Will this change become an obstacle to greater independence of local budgets? The participants of a macroeconomic seminar on "Regional Budgets in Ukraine: Turning the Pyramid Upside Down?" held at ICPS discussed problems of inter-budget relations

Year 1999: Optimising inter-budget relations

Mr. Ihor Shpak, director of Barents' Fiscal Analysis Office for the Verkhovna Rada Budget Committee, informed seminar participants about the results of local budget execution in 1999 and analysis of the draft 2000 budget. According to preliminary data, actual expenditures of local budgets exceeded targets by 16 percent, and revenues exceeded targets by 19 percent (see Figure 1).

In 1999 compared to 1998, the expenditure disproportion decreased between the best-provided and the least-provided oblasts of Ukraine (see Figure 2). This was due to the fact that in 1999 the government reallocated corporate taxes and excise on domestic goods to both the state budget and local budgets. In 1998, the mechanism of tax separation was used, i.e., 100

Figure 1. Execution of the State Budget and local budgets versus budget targets (preliminary data)

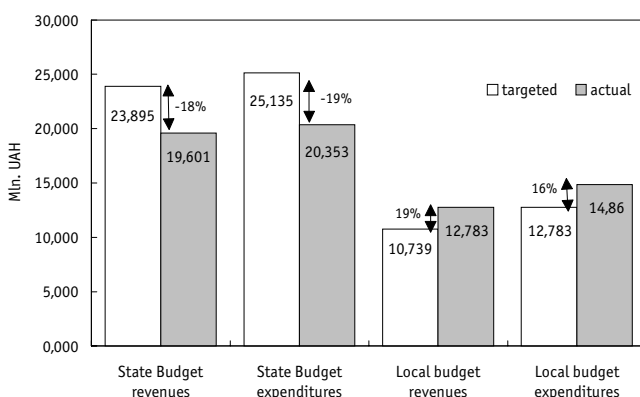
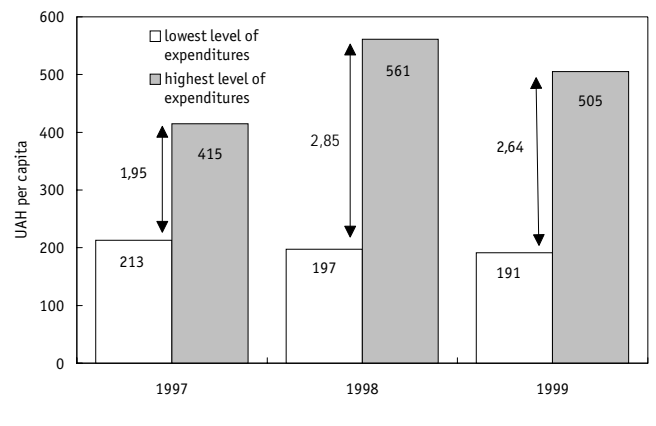


Figure 2. Disproportion in budget expenditures



percent of corporate taxes and excise was allocated to local budgets. Therefore, oblasts with the largest industrial enterprises ended up with budget surpluses.

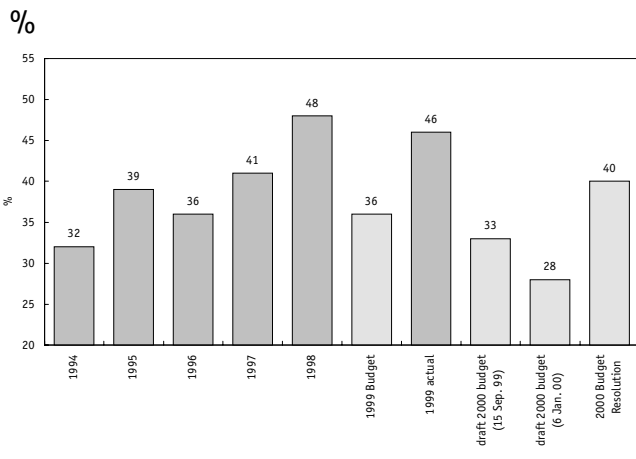
The new transfer allocation mechanism was the main event in 1999 with regard to local budget execution. This mechanism introduced a daily norm for deducting taxes collected in the oblast to the state budget. Firstly, local authorities became interested in the implicit enforcing of tax payments, particularly VAT, to the central budget in their regions. Secondly, local authorities improved budget expenditures planning, because they had complete control regarding the level of subsidy deductions.

Year 2000: Concentrating resources

The draft Law of Ukraine "On the State Budget of Ukraine for 2000" as of January 6, 2000 provides for reducing local budget revenues and increasing subsidies (see Figure 3). Such reorientation shows that financial resources are being concentrated at the level of the state budget. For example, the draft budget stipulates the 100-percent allocation of corporate taxes and excise on domestic goods to the state budget.

This government decision is sound, as corporate taxes and excise are paid from profit which is not always received from the local communities where the enterprises are situated. Moreover, experience in 1998 demonstrated that full assignment of corporate taxes to local budgets significantly aggravated inter-oblast disproportions. At the same time, however, the centralisation of corporate taxes and excise to the

Figure 3. Local budget expenditures as a share of consolidated budget expenditures,



state budget cuts down the share of local budget revenues in the consolidated budget to 20 percent, and the share of expenditures to 28 percent. The principle of local community equity is also infringed: corporate taxes and excise received in Kyiv and Crimea are still allocated to their respective budgets. Instead, the government offers local budgets an additional revenue source amounting to 406 million hryvnias: 70 kopeks per each collected hryvnia of arrears will be allocated to local budgets. But whether arrears to the budget can be interpreted as a revenue source is an arguable point, both practically and methodologically.

According to the draft 2000 budget, 100 percent of personal income taxes will be allocated to local budgets. Revenues from personal income taxes should become a stable source of cash for local communities. However, there is a risk that authorities will concentrate the tax revenues at the oblast budget level, while local community budgets will receive less stable revenues, particularly including state budget subsidies.

The draft 2000 budget does determine subsidy increases, but

abolishes the automatic transfer mechanism used in 1999. So there is a risk of instability in allocating state budget subsidies to local budgets. This will result in uncertainty in planning local community expenditures, leading to accumulation of budget arrears.

According to Mr. Pavlo Kachur, deputy executive director of the Association of Ukrainian Cities, the increase in subsidies to local budgets is not a negative fact in itself. But the allocation of subsidies from the state budget should be accompanied by a clear division of proper and delegated authorities of local budgets. For example, proper authorities of local communities include providing housing and communal services, while delegated authorities include financing education and healthcare institutions.

Local budgets can become independent only under the condition that local communities have their own revenue sources for fulfilling their proper authorities. In 1999, the share of local taxes and levies was 3 percent of total payments to local budgets. Real estate tax could become a source of own revenues for local budgets, but seminar participants believed that it was still too early to introduce this tax in Ukraine.

Delegation of state responsibilities to local authorities respectively demands delegation of state budget revenues to local budgets. However, the amounts should be calculated very accurately. Seminar participants proposed to use formula methods for determining transfer amounts, based on fixing per capita budget norms for fulfilling delegated authorities.

Finally, introduction of treasury execution of local budgets will be important in the reform of local budgets. Treasury execution of local budgets will ensure the transparency of revenue formation and control over local budget expenditures. It will lead to improving quality of funds allocation for fulfilling proper and delegated authorities of local communities. ■

The macroeconomic seminar on "Regional Budgets in Ukraine: Turning the Pyramid Upside Down?" was held at ICPS on January 18, 2000.

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Hlib Vyshlinsky, director of the Publications Group

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