

Forming the Territorial Communities' Local Budgets in Ukraine Under Decentralization: Current Condition and Management Tasks

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Abstract

The budgetary capacity with the tax component as its key aspect is the basis for forming local budgets of a territorial community. The paper outlines the methods for diagnostics of the budgetary capacity of territorial communities by revenues aimed at providing a comprehensive quantitative and qualitative assessment of the status, strengths, and weaknesses of the economy of an administrative-territorial unit and determining the place and role of the local budget in ensuring the socio-economic development of the territory. The main objectives of the suggested methods are to analyze local budget revenues, identify sources and patterns of their formation, study the structure of own revenues of community budgets, justify the dependence of the characteristics of local budgets forming in territorial communities on the level of their socio-economic development and management features. As a result of the conducted research, the problems of filling local budgets were identified, and directions of budgetary capacity increase were substantiated.

Keywords: Budgetary Capacity; Tax revenues; Territorial communities; Local budgets; Efficiency of the use of budgetary capacity by revenues.

1. Introduction

Studies of the characteristics of territorial community development, in particular the efficiency of local budgeting in the context of actual indicators and reserves of growth, allow a comprehensive assessment of the community's ability to ensure sustainable development in the long term and determination of the level of this ability. This task is especially relevant in the context of decentralization since, at the legislative level, forming the capable territorial communities through consolidation is the main issue of administrative-territorial reform in Ukraine.

We have hypothesized that, based on an assessment of the budgetary capacity of a territorial community, which is based primarily on tax revenues, we can determine its functioning ability and efficiency. To confirm the hypothesis, methods for analyzing the efficiency of the use of the territorial community's budgetary capacity by revenues have been developed.

The budgetary capacity of the territorial community should be considered in the context of the interaction of financial resources and reserves of their growth and directions and possibilities of their use for ensuring the socio-economic development of the territory. S. Sember et al. (2015) consider that financial capacity is a significant determinant of community capacity because capacity itself is a phenomenon related to an opportunity and the ability of the community to allocate financial resources (including the shadow ones) to meet the needs. Hasenko

L.V. et al. (2019) in their study focus on the formation of united territorial communities (UTCs) in the context of decentralization and identify one of the main sources of replenishment of local

budgets through the payment of land taxes. Malchykova D. et al. (2019) substantiates such important measures of integrated management and planning of local budgets of coastal regions as a strategic environmental assessment of all types of economic activity; a combination of sectoral and territorial principles of coastal zone management in the form of marine complexes; zoning of coastal areas for differential planning of the use of territorial resources; implementation of a balanced integrated environmental management system with sectoral and vertical integration. O. Demianchuk (2013) determines the financial capacity considering the importance of financial capabilities to ensure the material needs; therefore, this component is the basis for the development of economic capacity of the community. U. Vatamanyuk-Zelinska, N. Sytnyk (2019) and M. Melnyk et al. (2018) consider filling local budgets and determine financial capacity in terms of financial and economic regulation of land relations by expanding decentralization reform. M.I. Stegney et al. (2020), I. Irtysheva et al. (2019; 2020), O. Hrynkevych et al. (2020) and T. Vasylytsiv et al. (2020) consider developing the local budgets based on innovative approaches. V. Yakubiv et al. (2020) and Y. Maksymiv (2016) address these issues on the basis of local bio-resources, i.e. local entrepreneurship development. A. Kuznetsova et al. (2018), H. Wozniak et al. (2019) and Pylypiv et al. (2020) study

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the financial capacity of UTCs assessing the first stage of financial decentralization in Ukraine and identifying the main mechanisms of budgetary allocation at different levels. In our opinion, the basis of the financial capacity of the administrative and territorial unit is the budget capacity with the tax component as the key element formed as a result of the use of real, potential and expanded tax base. Tax capacity is the key factor in the formation of the tax capacity of a territorial community and the capacity of the territorial community as a whole, which is the basic condition and the expected result of the decentralization reform and the change of the administrative and territorial structure at the basic level.

2. Materials and Methods

The analysis of the efficiency of use of budgetary capacity by revenues is made by estimating the revenues of the main budget-forming taxes and factors that have a direct impact on the amount of tax revenues to the budgets of territorial communities and allow to determine the level of use of budgetary capacity by certain taxes. The purpose of the analysis of budget capacity by revenues is to identify and substantiate the patterns of formation of local budgets of territorial communities, to determine the reasons for the backlog of some and the rapid development of others, to formulate recommendations for increasing the endogenous capacity of territorial communities for the future.

The efficiency of forming the budgetary capacity of the territorial community is suggested to be analyzed by evaluating the certain indicators (Figure 1), which will allow to identify problems and find out reserves for increasing the budgetary capacity of the territorial community, in particular:

- indicators for the analysis of PIT and single tax are chosen to emphasize the problem of the impact of the level of the community economic development on the tax revenues (number of taxpayers per 1000 population, average salary, number of unemployed population in the structure of persons of working age) and activity of self-government authorities towards the increasing budget revenues, which is highlighted by the indicator “Number of economic entities paying PITs to the budget at the place of registration” and rates of increase in tax revenues and the deviation of the average and the maximum rates;
- the analysis of excise tax revenues is aimed at identifying the shares of the tax of excise goods and fuel realization, which will identify the risks of possible exclusion of part of the tax (on fuel) from local budget revenues;
- the analysis of the peculiarities of land tax collection is intended to reveal the main advantages and disadvantages of the work of the territorial community governing bodies since it is the local tax and self-government bodies have significant power in establishing the rules of its management at the territory; for the achievement of this purpose, indicators for its characteristic are selected, in particular, comparison of the efficiency of the land tax, deviation of the average rate from the maximum, the ratio of the normative monetary valuation of the land to its

average market value at the territory of the community, etc.;

- study of peculiarities of taxation of non-land property as one of the key reserves of increase in local taxes and fees requires, first of all, the assessment of the use of authority’s liabilities to accumulate the tax revenues. The consideration of only tax revenues in the analysis is justified by the fact that the domestic tax system is characterized by the dominant role of tax payments in filling local budgets, in particular in 2017-2018, the tax revenues amounted to 74.5-80.5% of own local budget revenues in Ukraine (Figure 2).

The analysis is carried out across five major taxes in local budgets. Their collection and stimulation of revenues are directly impacted by local governments. PIT, excise, and local taxes - land payment, non-land property tax, and a single tax are among these taxes. Non-studied taxes are less than 10% of local budget revenues (3.7% in 2018); therefore, our research has a maximum coverage of indicators for analysis efficiency.

3. Results and Discussion

The choice of indicators to analyze the efficiency of using the budgetary capacity by revenues for each of the taxes is stipulated by their influence on the revenues from these taxes to the local budget, in particular:

1. Since the total taxable income is the base of PIT taxation, and the salaries of employees of economic entities and budget institutions located and operating at the territory of the community are the main source of PIT revenues to the budget, the main factors influencing the efficiency of the use of budget capacity by the PIT are the following: 1) the presence of economic entities in the community, the employees’ salaries of which are subject to taxation - this factor is analyzed in the context of substantiating the full utilization of existing community capacity by determining the number of economic entities in the community and the budgets to which they pay tax; 2) the amount of the wage fund of economic entities, from which the tax is deducted - this indicator allows comparing the size of average wages in the context of territorial communities, which will help to identify potential reserves of budgetary capacity increase by local governments through stimulating economic entities to increase the wages of their employees.
2. Excise tax is one of the main sources of filling local budgets. It includes an excise tax on fuel produced and imported into the customs territory of Ukraine and excise tax on sales of excisable goods by retailers. Since 2020, in accordance with the Laws of Ukraine as of November 17, 2016, №1762 (VRU Bulletin, 2017) and 1763 (VRU Bulletin, 2017a), the excise tax on fuel will be fully credited to the special fund of the State Budget as a source of formation of the State Road Fund. Thus, it is important to determine the level of dependence of territorial communities’ budgets on the excise duty on fuel and financial losses incurred by each community since 2020. On the other hand, it is important to determine the share of excise tax on sales of excisable goods by retailers since it is characterized by significant reserves of increase in tax

revenues to the budget.

3. The analysis of the efficiency of rates and privileges being set by local authorities in a certain territory in the context of statutory limits is the main issue in the study of the local community's budgetary capacity use.

Researching the peculiarities of taxation of land and property in general in the countries of the world and analyzing the achievements of scientists in this field (Patytska, 2018), four main factors that stipulate the "rules of the game" in property taxation were identified, namely: determining the tax base; assessing the tax base; setting tax rates; determining the level and features of management in taxation of property and land. As a result, indicators to analyze the efficiency of tax collection and identify the reserves for their increase have been selected. The suggested methodology is implemented on the example of assessment of the efficiency of use of the territorial communities' budgetary capacity by revenues for 2017-2018 across the groups of Ukrainian UTCs.

The level of efficiency of use of the territorial communities' budgetary capacity by revenues is established to be generally quite low; however, the results are different for each of the taxes, and different trends should be mentioned. Therefore, the obtained data should be analyzed in detail, and their preconditions should be determined for each tax separately.

PIT. The level of community subsidiarity, which depends on the amount of provided basic subsidy or transferring reverse subsidy to the State budget in the process of

horizontal alignment of budgets' fiscal capacity is one of the criteria of the UTCs grouping, according to which the calculations were made. As the alignment of the fiscal capacity of the UTCs' budgets is based on accounting and comparing PIT revenues per person to local budgets, rather high results of using the budgetary capacity in communities with lower subsidies are understandable. When comparing UTCs with the highest rates of efficiency of the territorial communities' budgetary capacity use by the PIT with the UTCs with the lowest rates, the dependence of these rates and the level of subsidization of the communities' budgets are clearly traced. Thus, the average subsidy value among the communities with the highest partial indices is 0.9%, and among the communities with the lowest indices - 25.3%. That is, the highest rates of the efficiency of the use of budgetary capacity by the PIT are peculiar to UTCs from groups of non-subsidized UTCs and with a subsidy level of up to 15%; the lowest rates belong to the UTCs groups with a subsidy level of 15-30% and 30-40%.

Given that the PIT revenues to the budget of a territorial community depend first and foremost on the level of economic development of the territory (the presence of business structures and budget institutions in the community, the number of employees, and the size of average wages), it is reasonable to emphasize the dependence of these rates on the size of the UTC (Figure 3).

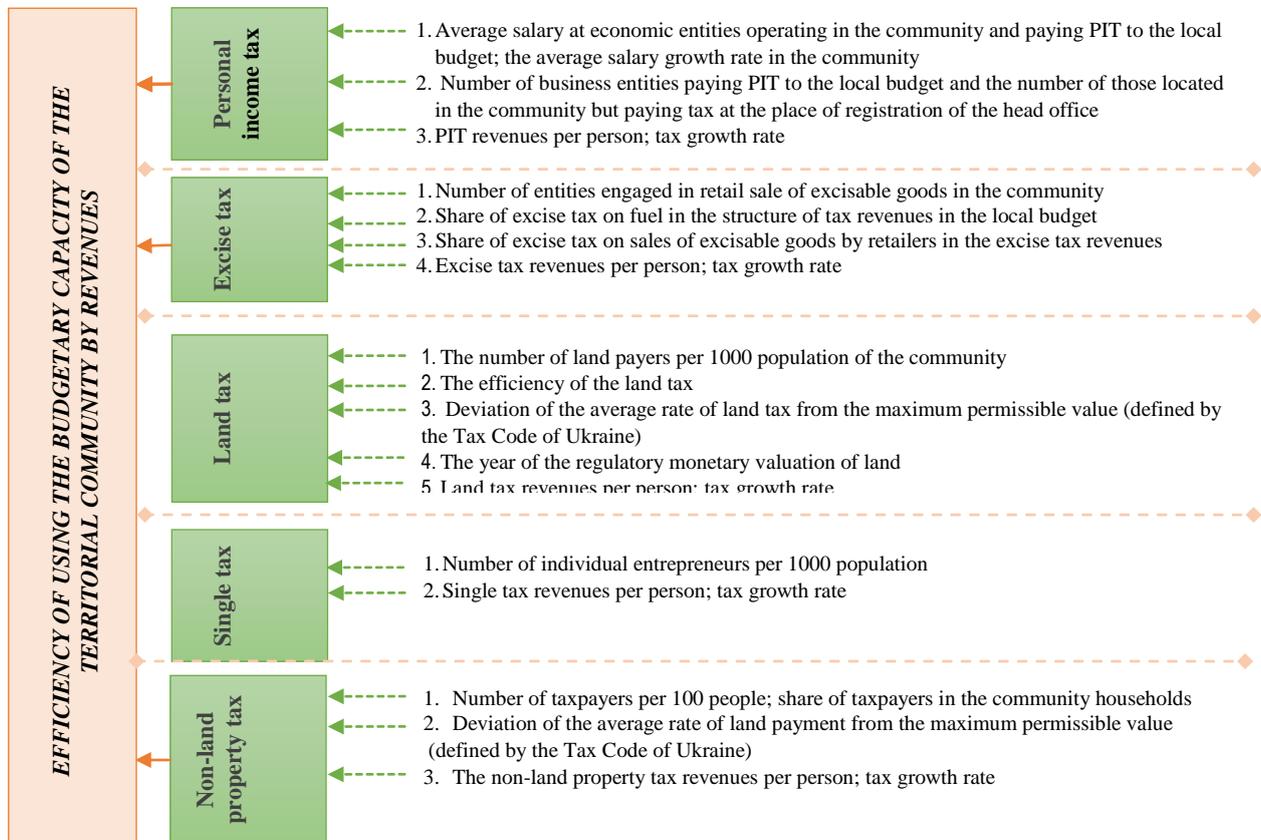


Fig. 1. Methodology of analysis of a local community's budgetary capacity in terms of determining the efficiency of the use of budget capacity by revenues



Fig. 2. Structure of local budget revenues in Ukraine, 2017-2018, %
(Source: Developed based on the data (State Treasury Service of Ukraine, 2019))

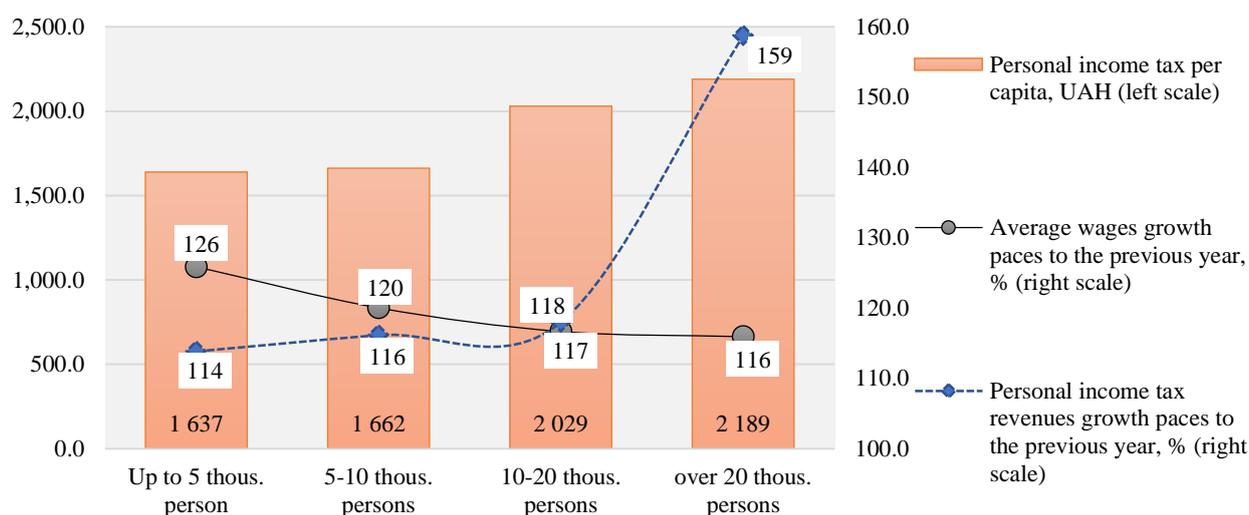


Fig. 3. Comparison of PIT revenues per capita across the groups of UTCs by population, 2018

As we can see, the growth of PIT revenues per person and the growth rate of such revenues are connected with the increase in the number of residents of communities: revenues at taxation are 1638.6 UAH per person in the UTCs with the number of residents up to 5 thousand, while they account for 2189.2 UAH in the communities with a population of 20 thousand people and more, that is 33.6% more. Faster rates of tax increase can be observed when comparing communities with different populations. However, the comparison revealed that the average wage growth at enterprises located in the communities with a population of fewer than 5 thousand people (125.9%) significantly exceeds the wage growth rate in large communities (115.9%).

In general, such results are quite predictable since communities with large populations are mainly urban UTCs, which are characterized by greater investment attractiveness and concentration of businesses within their

territory. For example, the UTCs, which are among the top ten communities with the highest levels of PIT budgetary capacity use, are mostly large communities, with a population of 10,000 persons. Of the ten, only three UTCs have a population of less than 10,000, but these are communities characterized by the advantages of geographical location or administrative structure, the presence and operation of enterprises within their territory.

When conducting an analysis of the use of the territorial communities' budgetary capacity by the PIT, to identify sources of its growth, the heads of the local councils of the UTCs were surveyed to determine the number of economic entities located and operating in the territory of the communities, but paying the PIT to the budget at the place of registration of the head office. The conducted research showed that 1/3 of the representatives of local councils do not have reliable information, which means

that the local authorities have incorrect assessment of the existing budgetary capacity and lack of interest in its increasing.

In general, it should be noted that PITs, in comparison to other taxes, make the most of their budgetary capacity, which is caused by its key role as a major budget-forming payment for most local governments.

Excise tax. In accordance with the Laws of Ukraine “On Amendments to the Law of Ukraine “On Sources of Financing of the Road Industry of Ukraine on Improvement of the Road Financing Mechanism” and “On Amendments to the Budget Code of Ukraine on Improvement of the Road Financing Mechanism”, starting since 2020, the fuel excise tax should be credited to the special fund of the State Budget. Therefore, the study of the peculiarities of the use of budget capacity in the light of charging excise tax as revenues to local budgets was carried out by combining two directions:

1) taking into account the risks emerging with the transfer of tax revenues from the fuel to the State budget;

2) analysis of the efficiency of using the capacity of excise tax on the sale of excisable goods by retailers.

The dependence of the amount of revenues from this payment on the location of the administrative-territorial unit and the presence of gas stations at its territory was revealed in the process of analysis of excise tax revenues to local budgets of territorial communities. In particular, among ten UTCs with the highest rates of excise tax per person, 100% of the communities have important motorways of international and national importance and gas stations at their territory. Therefore, such communities are characterized by a significant dependence on the excise tax on fuel; for example, the shares of this tax in the revenues of Vyshnivska and Babinska UTCs are 46.6% and 44.0% respectively, which allows emphasizing the risk of the loss of financial capacity by such communities as a result of the introduction of changes.

Having analyzed the peculiarities of the use of the

budgetary capacity of territorial communities by excise tax across the groups of UTCs by the population (Table 1), we can draw the following conclusions.

1. The share of excise tax revenues from sales of excisable products by the retailers in the total excise tax revenues declines with the decrease of the population in the territorial community; this figure is 56.8% in the group of UTCs with a population of up to 5 thousand people, while it is 27.4% in the communities with a population of more than 20 thousand, that is twice less. Therefore, fuel excise tax revenues are comparatively lower in small communities, and there are fewer gas stations at the territory of such communities compared to larger communities.

2. There is a significantly higher number of business entities engaged in retailing excise goods in the communities with a population of more than 20,000, which are mostly urban ones. 64.5 of these entities account for one such community, while the figure is 13.3 entities in communities with a population of up to 5,000 people, which is almost five times less. Such results are related to the higher level of economic development of urban territorial communities and urban settlements and the concentration of economic entities at their territories. However, such an advantage does not impact the share of excise tax revenues from sales of excise goods by retailers in the total amount of excise tax revenues, as it decreases with the increase in the number of residents. This again confirms that more gas stations are located in relatively large communities.

3. In spite of this, the small UTCs are characterized by the maximum dependence on the excise tax on fuel as a part of their own budget revenues (6.0-6.2%) compared to the large UTCs (5.1%). This is due to the smaller number of small businesses in the communities and their lower socio-economic development level, and thus the dependence on the functioning of the entities located at the territory.

Table 1
Peculiarities of Excise Tax Collection across the UTCs Groups by Population, 2018

UTCs Group	Number of entities conducting the retail trade in excise goods at the territory of the community, units.	The share of excise tax on fuel in the structure of tax revenues of the local budget, %	Revenues of excise tax per person, UAH	Growth rate of the excise tax revenues to the previous year, %	Share of excise tax revenues from sales of excisable products by retailers in the structure of excise tax revenues, %
up to 5 thousand people	13.3	6.0	198.9	97.6	56.8
5-10 thousand people	18.4	6.2	237.6	107.0	47.2
10-20 thousand people	46.2	5.9	259.0	132.8	28.4
over 20 thousand people	64.5	5.1	231.9	111.0	27.4
Average for UTCs	35.6	5.8	231.8	112.1	39.9

Property taxes (land and non-land property taxes) are a significant part of local budget revenues of territorial communities in Ukraine. However, the low share of revenues from property taxes collection remains the main problem of their functioning, which is a result of the inefficient existing system of these taxes collection and

inefficient use of the territories’ capacity since these are local taxes.

The analysis established that the collection of property taxes, which are attributed to local taxes and fees and are established by local governments, is characterized by the following problematic aspects:

- inefficient determination of tax rates and tax-exempt

persons;
 - differences in the application of tax in different territories;
 - failure to take into account the financial position of property owners at taxing.

At the same time, it is worth considering the following facts: when comparing the results of the analysis for 2018 and 2017 (Figure 4), there is a rapid improvement in the

efficiency of use of the territorial communities' budgetary capacity by property taxes. The growth rate of the partial index for the payment for land in 2018 compared to the previous year is 125.6%, for the non-land property tax - 11.9%. It shows an understanding of the benefits of using these taxes by local governments to enhance the financial capacity of territorial communities.

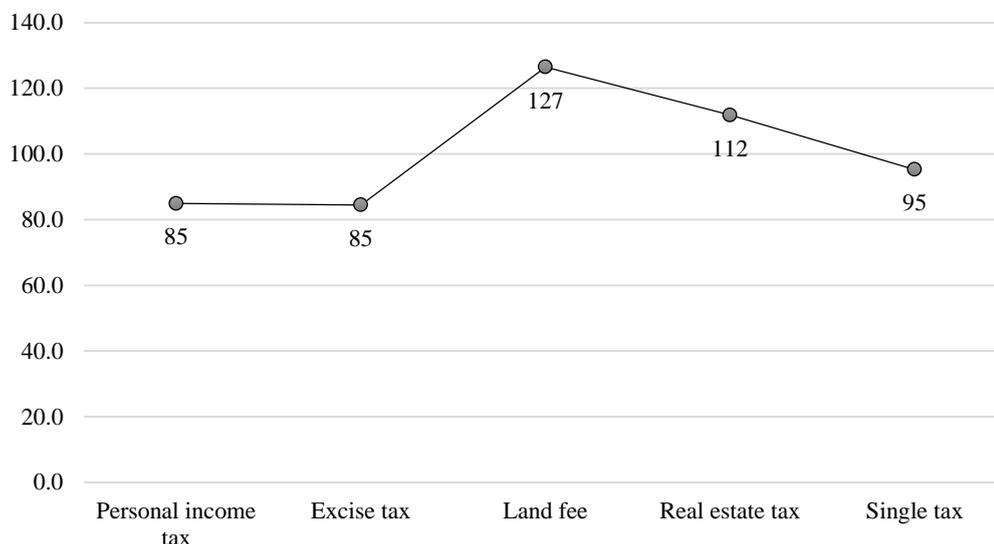


Fig. 4. Growth rate of partial indices for certain taxes revenues to the budgets of the UTCs of Ukraine, 2018, %

Single tax. The analysis of the efficiency of using the budgetary capacity of territorial communities by a single tax, as in the case of PIT, showed the dependence of the partial efficiency index on the level of economic development of the community and its financial capacity. Thus, UTCs with income per capita within 4000-7000 UAH are characterized by an average index value of 0.2607, while the value for the communities with incomes

up to 4000 UAH is 0.1366, i.e. twice lower (Figure 5). Similar trends can be observed in the case of per capita taxation: the difference between the group of non-subsidized UTCs with an income of 4000-7000 UAH per person (820.7 UAH) and UTCs with subsidy level of 15-40% and income per person of 1000-4000 UAH (381,8 UAH) makes 2.15 times.

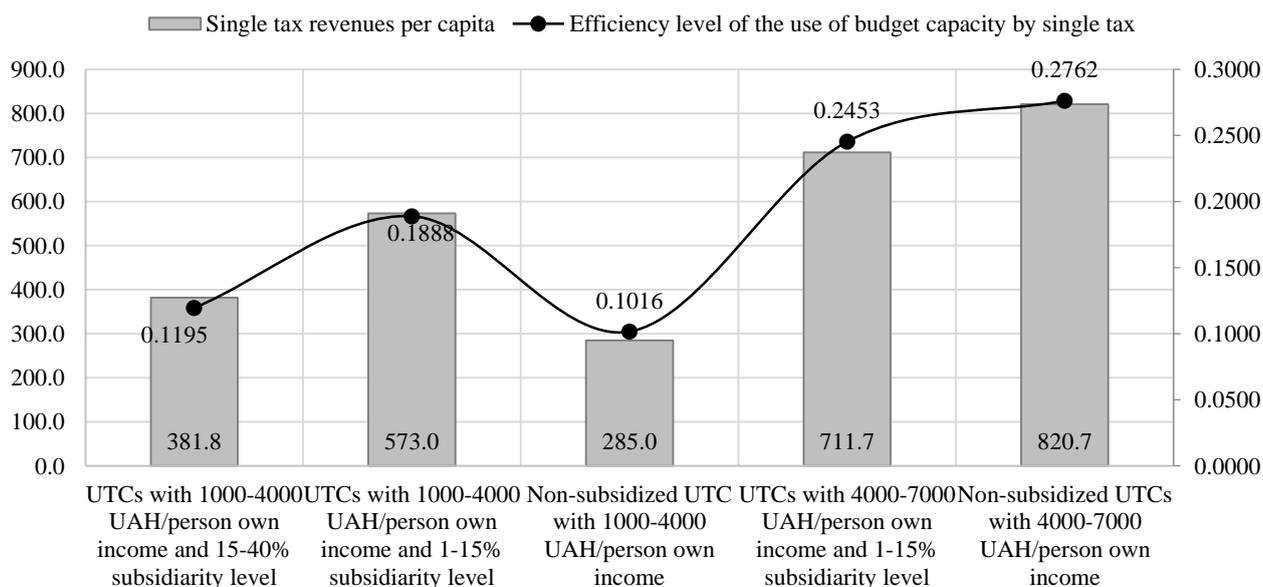


Fig. 5. Dynamics of the index of the budgetary capacity use efficiency by a single tax and the amount of tax revenues per person across the groups of UTCs of Ukraine, 2018.

The research revealed trends of relatively high revenues from the collection of taxes in UTCs with a high partial index and a significantly higher number of individual entrepreneurs per 1000 of the population.

However, as in the case of other analyzed local taxes (payment for land and non-land property tax), the state has transferred the right to independently establish the rules of tax within the legally defined limits to the level of local governments.

For example, currently, the proposal of forming a "tax haven" for individual entrepreneurs is being considered at the level of the Mlynivska UTC of the Rivne region (Suspilne media, 2019). The single tax rates for two categories of payers - the first and the second - are planned to be changed starting since 2020. Currently, payers of the first category pay 10% of the subsistence minimum to the local budget, the second category pays 15% of the minimum wage. If a new "regime" is put into effect, the rate for both categories will be 1%.

Due to the introduction of such innovations, local authorities expect the tax revenues growth due to registration and re-registration of numerous taxpayers at the community's territory despite the loss of tax revenues because of the reduced rates. In addition, getting out of persons who worked without proper registration (in particular, taxi drivers and individual employees of the trade industry) from the "shadow sector" should be the expected effect.

Thus, it can be emphasized that setting tax rates at a low level should not always be interpreted from the viewpoint of the inefficient use of tax capacity. It is important to define the goals that are envisaged by local governments in the context of setting certain taxes, as in the case of Mlynivska UTC.

4. Conclusion

Thus, the analysis of the efficiency the use of territorial communities' budgetary capacity by revenues allowed us to draw the following conclusions:

- the level of efficiency of the use of budgetary capacity by revenues is not sufficient for all analyzed UTCs. The share of unused budgetary capacity for revenues was 69.1% in 2018. The analysis established the following: 1) the highest share of unused budget capacity by revenues is peculiar to the UTCs group with 1000-4000 UAH / person of own income and subsidy level of 15-40; 2) the budgetary capacity by revenues is most efficiently used in the UTCs groups with own income of 4000-7000 UAH / person and subsidy level up to 15%; 3) non-subsidized UTCs groups are characterized by relatively lower indicators of the use of budget capacity by revenues (the reserve of unused budget capacity is more than 69.0%); being financially viable as a result of significant local PIT revenues to local budgets, such communities have no incentive to increase budget revenues from other taxes;
- the highest level of efficiency of the use of budgetary capacity by revenues is peculiar to PIT (42.2%); the rate for excise tax is 37.3%; local taxes and fees have the lowest efficiency level. While the land payment as one of the key budget-forming taxes has a 34.2% capacity use

rate, such local taxes as non-land property tax and single tax account for 22.2% and 18.0%, respectively. It indicates a significant reserve of the unused budget capacity of communities.

The testing of the methodology of the analysis of territorial communities' budget capacity with regard to calculating the efficiency of the use of budget capacity by revenues has contributed to determining the level of the use of territorial communities' budget capacity by certain taxes and revealing the factors that directly impact the volumes of tax revenues to territorial communities' budgets. Finding the unused reserves to increase budget capacity in conditions of decentralization and securing territorial communities' capacity will help efficient execution of competences by local governments and directing endeavors to achieve the communities' self-sufficiency.

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