

**Olga Shevchenko**  
**Ph.D in Economics, Senior Research Associate,**  
**Head of the Sector for Regional Development Equalization,**  
**Department for Regional Policy,**  
**The National Institute for Strategic Studies,**  
**Ukraine**  
[olvalshev@mail.ru](mailto:olvalshev@mail.ru)

## **REGIONAL POLICY AND LOCAL FINANCE DURING THE DECENTRALIZATION**

Currently, Ukraine experiences decentralization of authority and enlargement of local communities. Decentralization and transfer of decisions making centre to regions and communities (there are 159 joint communities in budget process-2016) make it necessary to form and realize regional policy in a new way. Now, there is a recession after crisis and thus, the issues of regions' surviving during this period could be taking into account during the search of new format for regional policy. Providing more authority to the regions means the necessity to search bigger financial and material resources. Thus, regional policy faces new challenges during the decentralization.

Some negative and positive trends in social and economic development of regions could be observed. In 2015, and six/nine months of 2016 the development of the most part of Ukrainian regions was characterized by the next negative trends: reduction of foreign direct investments amount, the fall down of agricultural output, increase of unemployment, reinforcement of social strains, big amount of salary debt, narrowing of internal market trading.

For instance, by the data of the State Statistics Service of Ukraine, the decrease of *the FDI amount* was observed in 25 regions in June 2015 comparing with June 2014 and in 7 regions in June 2016 comparing with June 2015 which evidence the slow gradual stopping of investments outflow. In 2016 the increase was observed in Vinnitska, Volynska, Zhytomyrska, Zakarpatska, Ivano-Frankivska, Kievska, Kirovogradska, Lvivska, Mykolayivska, Odeska, Poltavska, Sumska, Ternopilska, Kharkivska, Khmelnytska, Chernivetska, Chernigivska oblasts and Kiev city.

Ambiguous trends have been observed in *agricultural sphere*. In Jan-Sept 2016 the increase was observed in 15 regions (from 100,0% in Zakarpatska oblast to 114,3% in Vinnitska), other regions demonstrated the decrease from 97,8% (Chernigivska oblast) to 89,7% (Kharkivska) with average index 100,9% in the whole Ukraine comparing with Jan-Sept 2015. In Jan-Sept 2015 the increase was observed only in 3 regions, the average index was 94,7%.

And some positive trends in social and economic development of regions were also observed in industrial output, construction sphere, capital investments, and retail trade turnover.

In Jan-Sept 2016 the number of regions where *the indices of industrial output* raised increased from 6 to 16 comparing with Jan-Sept 2015. Thereby, in Jan-Sept 2015 the maximal index was 109,1% (Vinnytska oblast) comparing with Jan-Sept 2014 and in Jan-Sept 2016 – 157,0% (Luganska oblast). At that time, minimal indices also rose: in Jan-Sept 2015 they were 23,0% (Luganska), 59,0% (Donetska), 78,5% (Kirovogradska), and in Jan-Sept 2016 minimal index was 92,4% (Ivano-Frankivska). Average indices were 83,9% in Jan-Sept 2015 and 102,0% in Jan-Sept 2016, which also means the start of stabilization period in industrial sphere.

In particular, in Jan-Sept 2016, the number of regions where *the indices of construction* raised was increased from 5 to 17 comparing with Jan-Sept 2015. Also, if in Jan-Sept 2015 the minimal indices were 27,7% (in Luganska oblast), 32,8% (Donetska) and 54,7% (Rivnenska) comparing with Jan-Sept 2014, maximal index was 139,0% (Volynska) and average rate was 79,1%, then in Jan-Sept 2016 comparing with Jan-Sept 2015 the minimal index was 81,5% (Rivnenska) and maximal – 155,0% (Luganska), and the average index was 133,2%. This situation evidences the gradual renewing of construction activity.

It should be mentioned the gradual stabilization of *the sphere of capital investment* in regions. In Jan-June 2016 the increase was observed in 22 regions from 205,9% in Mykolaivska oblast to 110,4% in Dnipropetrovska, the lowest index was observed in Kiev (79,2%) comparing with Jan-June 2015 accounting the average point of 109,6%. Thereby, in Jan-June 2015 the increase was observed only in 6 regions (indices ranged from 101,0% in Kyivska oblast to 175,1% in Volynska) comparing with Jan-June 2014 accounting the average point of 90,8%. The decrease was observed in all other regions, indices ranged from 13,2% (Luganska), 33,5% (Donetska), 57,4% (Poltavska) to 92,9% (Lvivska).

In Jan-Sept 2016 *the retail trade turnover* increased in 22 regions (comparing with the situation as in Jan-Sept 2015), indices were from 97,4% (Zhytomyrska oblast) to 107,6% (Lvivska) and 103,3% in the whole Ukraine. In the meantime, in Jan-Sept 2015 the retail trade turnover decreased in all regions comparing with Jan-Sept 2014, indices ranged from 24,4% (Luganska), 33,6% (Donetska), 78,0% (Zaporizka) to 87,6% (Ternopilska), and in Ukraine the index was 78,3%.

Unstable dynamic of regional indices makes the necessity to implement some instruments regulating regional development. There are some differentiated macroeconomic regulators influencing the renovation of economic growth in regions: taxes, credits, instruments of social policy (payments).

As a result of some actions done with these instruments it was possible to achieve some stabilization in regional development. For example, the financial resource for

support to regions was increased. In 2016, the governmental financial support for regions was supposed to reach 6 bln. UAH (~230,8 mln.USD), which consist of 3 bln. (~116,4 mln.USD) – money of the State fund for regional development, 1 bln. UAH (~38,7 mln.USD) – grant for construction of infrastructure of integrated communities, 1,94 bln. UAH (~74,8 mln.USD) – grant for social and economic development of the certain region. To compare, revenues in 2016 can reach – 625 bln in consolidated budget. UAH (24 bln.USD), 531,5 (20,4) in State Budget, 120,5 (4,6) in Local budgets, and expenditures can reach in consolidated budget 679,8 bln. UAH (26,2 bln.USD), State budget – 402,9 (15,5), Local budgets – 277,0 (10,7), by the data from the Ministry of Finance of Ukraine.

However, in 2016 regional policy is formed under the crucial circumstances. Regions feel the lack of money both from the State and local budgets. In spite of the fact that there were significant changes in local budgets' system the grant-dependence of local budgets has been increased. Mentioned changes were as follows: establishing property tax as local, raise of the portion of personal income tax in local budgets (this is the main tax in locals' budget revenues according to its amount), establishment of the grant for infrastructure of integrated communities' supporting. However, the share of intergovernmental budget grants in local budget revenues was 55,2% in Jan-Sept 2016 (comparing with Jan-Sept 2015), by the data from the Ministry of Finance of Ukraine. Those grants were allocated mostly to the social sphere (grants for the social maintenance and protection were 48,0%), medicine and education, and not to the social and economic development of the regions (these grants constituted 3,7%).

Another problem which influences the regional policy realization is that regional disproportions can vary during the decentralization and this influences the stable instruments of regional policy which means the different possibilities of these instruments' implementation.

There are three groups of regions according to the levels of social and economic development: 5 highly developed industrial regions, 13 transitive regions, and 9 less developed regions. Decentralization caused the increase of unevenness. During the last three years Kiev City traditionally has the biggest share of the index of Gross Regional Product in Gross Domestic Product of the country (appr.18%). Three regions form about 30% (Dnipropetrovska oblast– 10,1%, Kharkivska – 5,6%, Kievska – 5,6%) of GDP, by the data of the State Statistics Service of Ukraine. Correlation between max and min points in the index of GRP per capita is 3 which testifies the larger level of unevenness in regional development.

As decentralization caused the increase of unevenness, this unevenness of regional indices forms the base for different implementation of macroeconomic regulators (taxes, credits, instruments of social policy (payments)) for the compensation of bad factors and encouraging the good ones. Stimulation of highly developed regions and improvement of macroeconomic indices will lead to the transformation of these regions into the locomotives which can pull up other regions to higher paces of

development, and the postponing of production units to the less developed regions and the pulling up the less developed regions.

During the decentralization such a system is more attractive especially for highly developed regions because they have possibility to use resources as previously. Other regions will be on the second positions with the possibility to receive resources only from the State. Hence, the disproportion of regional development will grow again. Then the government while providing highly developed regions with more authorities must give the aid to the less developed regions too.

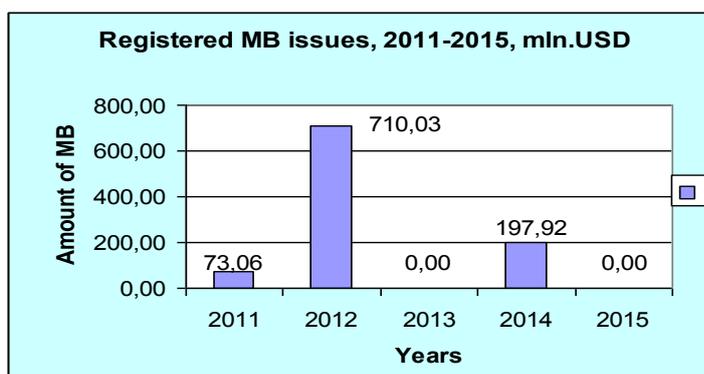
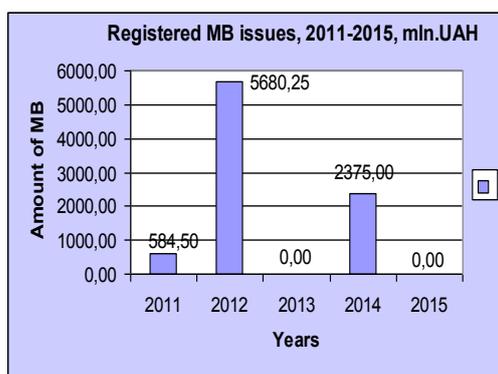
By giving more authority to the community, the State can make less developed regions even weaker. In highly developed regions, more authority in regions may encourage the creation of some developed centers except the capital of region. These centers can prevent the outflow of resources. In this context, encouraging stimulus for weak regions is the support of city-forming enterprises development at the expense of public-private partnership, state contracts, and clusters. The alignment policy can be directed to the stimulation of regional growth-poles, small and medium enterprises, structural rebuilding, regulation of innovations, and providing cluster policy in regions.

Thus, during crisis and growing disproportions between regional indices, decentralization must be provided and new instruments of regional policy must be found out. There are some differences in decentralization process for regions and communities. Decentralization of powers is accompanied by budget and fiscal decentralization. Joint communities have more responsibilities (in practice) and more finance resources (in theory) this year. On one hand, fiscal decentralization leads to the increase of financial efficiency of local communities. But the later is true only for stable and strong communities. On the other hand, poor communities do not become richer in terms of finance and resources after their integration.

During the process of decentralization, not regions but local communities have to find out the resources for their development. Decentralization of authority significantly widen the abilities of communities to regulate the development of subordinated territory, and the issue of the maintenance of casual needs and responsibilities for the social and economic development of regions were transferred to the community level. However, huge financial resources are needed for the effective implementation of the reforms, because new local taxes and duties as well as new grants can only partly encourage the enforcement of financial ability of local communities. The main financial resource is hidden in the effective use of the results of reclamation of internal productive and source potential of regions and communities. Also, municipal bonds market remains promising but underdeveloped segment of the Ukrainian stock market.

Municipal loans in Ukraine are not widespread now. In 2015, municipal bonds were not issued, and in 2014, municipal bonds constitute 197.92 mln.USD (chart 1).

At the end of 2015, 68 municipal bonds were traded on the stock market, 5.88% of which were admitted to the trade on stock exchanges. In 2015, 93.5 mln.USD of municipal bonds were traded, which is for 40.88% less than in 2014. In 2014, the number of municipal bonds, traded on stock exchanges, was the lowest during 5-year period. The shares of MB amount trading were 0.08% in 2011, 0.30% in 2012, 0.21% in 2013, 0.18% in 2014, 0.11% in 2015 in the overall structure of trading on the stock market. In 2014, the MB amount of trading on the stock market was 0.82%. In 2015, the MB were amounted 0.76 mln.USD in the trade on the stock market.



**Chart 1.** Amount of MB issues, 2011-2015, mln.UAH and mln.USD

**Source:** Annual Report-2015 of National Securities and Stock Market Commission of Ukraine.

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There are top-5 MB' issuers who were in demand on the stock market and the number of exchange market' contracts: Kremenchug City council of Poltava region (2 contracts), Kyiv City Council (40, 41, 35 contracts (on different exchange markets)), Cherkassy City council (6 contracts). There are top-5 MB' issuers who were in demand in the OTC (over-the-counter) market (according to the amount of executed contracts) and the amount of the executed agreement on the informal (not organized) market: Kyiv City Council (89.56 mln USD), Donetsk City council (2.72), Kremenchug City council of Poltava region (0.34), by the data of National Securities and Stock Market Commission of Ukraine.

The necessity of MB market expansion in Ukraine is based on the following: municipal bonds are instruments for loaning and they are important for cities as a source of "long" funds, allowing to attract resources for financing of various long-term projects for urban development and infrastructure.

As underdeveloped market, municipal bonds' market in Ukraine has some problems: lack of interest of potential investors in MB caused by low yield of these papers, non-transparency of financial transactions on the community level, reduction of paper liquidity, additional loading on local budgets, limited investors' access to information about MB-issuers activity, the lack of well-developed stock market infrastructure (lack of widespread net for financial associations, unions, or branches of credit institutions

and common investment institutions, which does not allow all stakeholders to create demands for MB through various funds, low level of municipal financial management, difficulty in estimation of risks in local investment projects.

Municipal bonds' market has some peculiarities in its regulation. The central government has no responsibilities as to the local debts, and this constitutes problem for local authority and citizens (community) which have no possibilities to find resources to cover debts. The local authority can act in some ways to prevent increase of local debts and to stabilize the local finance system. Firstly, it can use the outsourcing system for some services execution (in road construction, waste handling, and water supplying – big capital projects). Secondly, it can provide particular guarantees for investors of local communities, i.e. reduced amortization rate, lower tax rates, some privileges during the distribution of land for construction. And thirdly, it can optimize expenditures of local budgets according to the responsibilities and real financial resources. More attention should be paid to external borrowings.

Thus, during the decentralization regions have fewer authorities but the same amount of financial resources and even more, communities have the same amount of financial resources (sometimes more) and more authorities. More authority means more obligations and thus, the ability of local bodies to operate with finances influences the effectiveness of decentralization.

There are three key roles for contemporary regional policy: surviving during the crisis, more authorities for communities, not for regions, and searching for bigger financial and material resources. Regional and local policy can be realized by parallel processes: encouraging growth poles in regional economics, motivation of regions' self-development, structural diversification of economy, using hidden internal economic potential in regions. Regional policy during the decentralization encompasses six main directions: idea of regional consolidation – creation of open society and renewal of economic growth, saving common economic space and strengthening the cooperative links “source of resources – production – sale” among internal enterprises, saving operating investment projects, establishing common interregional infrastructural renovation projects. It is expected that these directions will promote the increase of regional competitiveness and effective use of natural resources as well as the focusing of regional economy on innovative research and their implementation. The spheres which can play the role of accelerators of regional economy growth are agricultural sphere, construction, chemical industry, mining industry, transport sphere (cargo transportation and passenger traffic), and tourism.