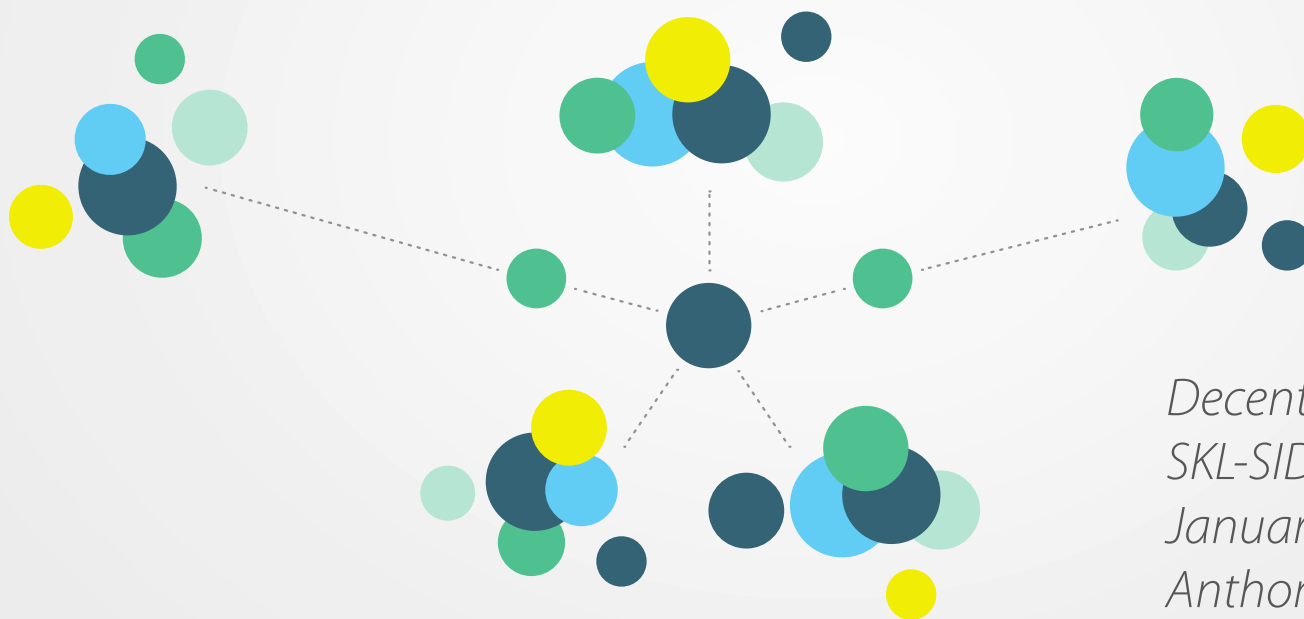


**Tony Levitas**

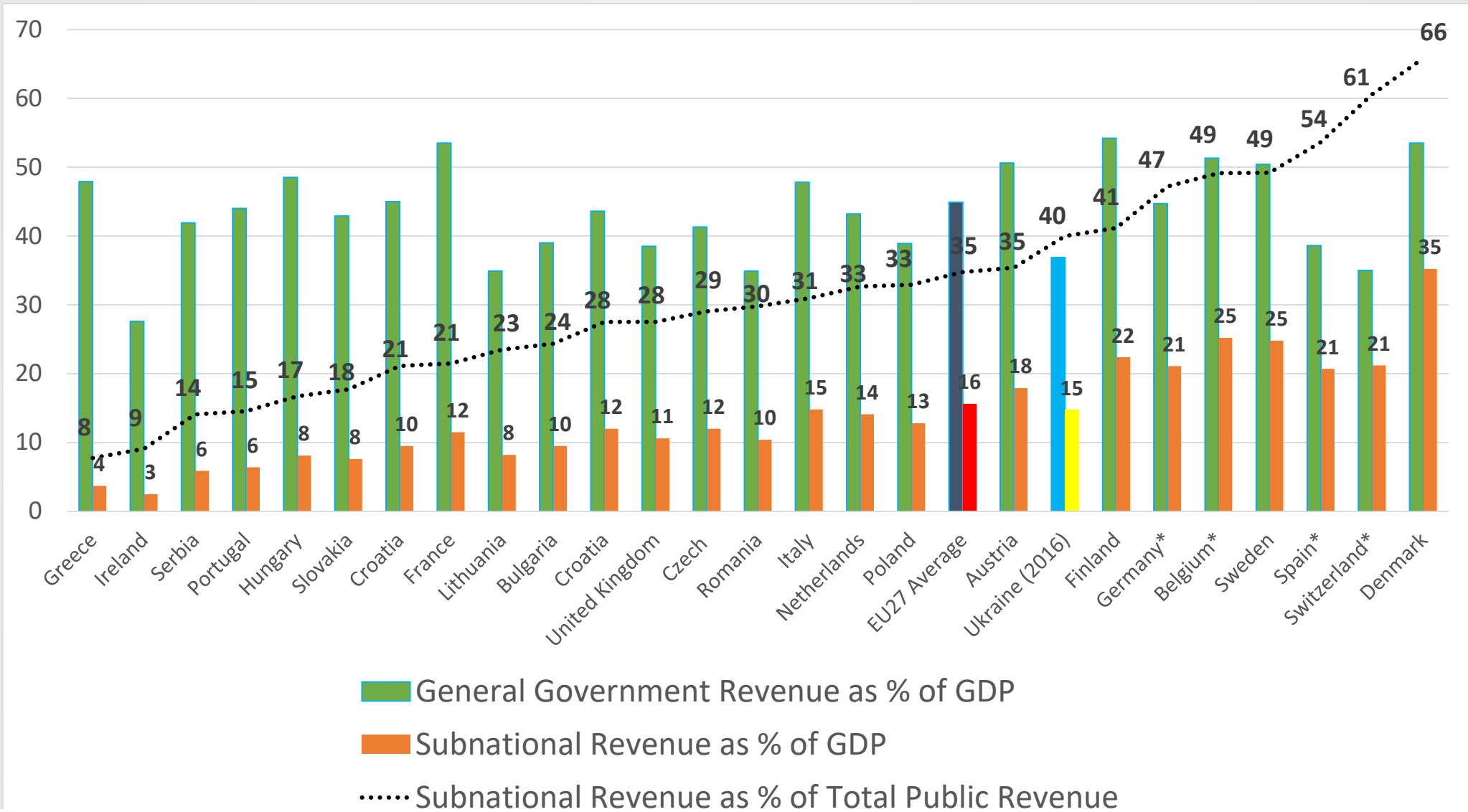
*Kyiv, January 2018*

# State Building and “Decentralization” in Ukraine: What are the Prospects?



*Decentralization Expert Group/Kyiv  
SKL-SIDA/Brown University  
January 17, 2018  
Anthony\_Levitas@brown.edu*

# Subnational Revenues as a % of GDP and Total Public Revenues in Select EU and Non-EU Countries 2015 (Ukraine 2016)



# “Decentralization” in Ukraine

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- In strictly fiscal terms, Ukraine has been one of the most “decentralized” countries in Europe for many years.
- Ukraine’s problem with “decentralization” has never been primarily financial.

## **Instead:**

- Unclear governance structure of oblasts and rayons (state appointed executives and/v.s. democratically elected councils)
- Persistence of nationally mandated expenditure norms that confuse responsibilities and undermine local independence.
- Extreme fragmentation at the gromada level, making them too small to provide basic services and dependent on higher level governments.

# “Decentralization” in Ukraine

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- Together these problems have made it extremely unclear which level of government is really responsible for what --particularly with respect to social sector functions (health & education).
- The problem of unclear responsibilities has compounded problems caused by the decline in population that has affected Europe since the late 1980s:
- **Because responsibilities are unclear, everybody has avoided taking on the extremely painful challenge of restructuring Ukraine’s school and hospital networks.**
- As a result, Ukraine now has one of the lowest teacher/pupil ratios in the world, and more doctors, nurses and hospital beds than almost any other country in Europe.

# “Decentralization” in Ukraine

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Following the Orange Revolution, reformers developed plans to:

- Amend the Constitution to allow for the democratic election of Oblast and Rayon executives.
- Amalgamate hromada in order to get them out from under rayon and oblast control and make CoS and amalgamated hromada the basic units of local government in Ukraine (Nordic/Polish model)
- Reform the finance system by creating earmarked grants for health and education functions and eliminating ministerial expenditure controls.

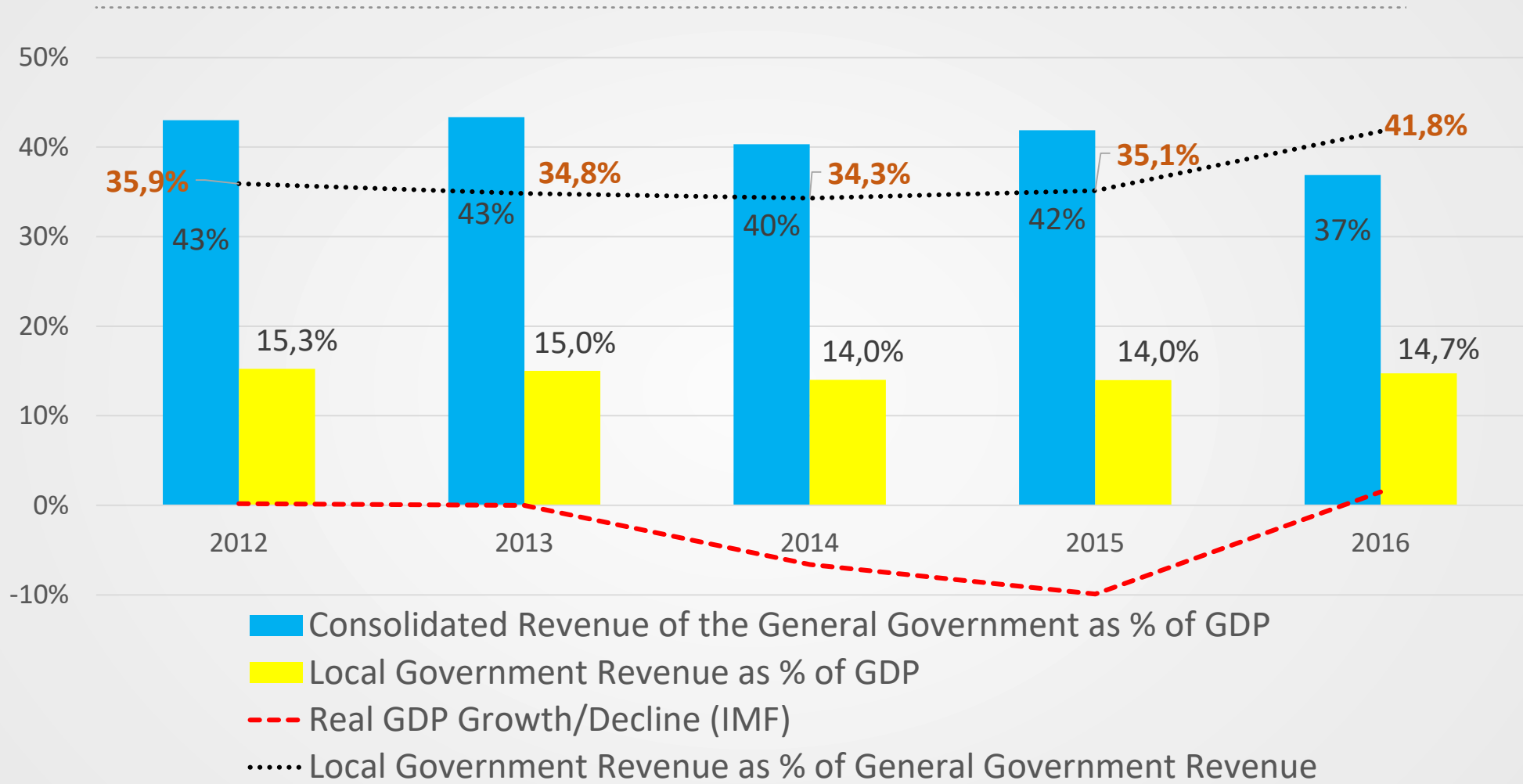
These plans however were never implemented.

# “Decentralization” in Ukraine

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- Maidan and the occupation of the Donbass revive the 2009 plans.
- Poroshenko declares “decentralization” a top priority to counter demands for “federalism”
- Old crew draft constitutional amendments and law requiring the amalgamation of all gromada.
- But can’t be passed through a very divided parliament in fall 2014
- Only thing that can be passed are major changes to the Budget and Tax codes and a law permitting **voluntary** amalgamation.
- These have major, but still ambiguous consequences

# Subnational Revenue as a % of GDP and General Government Revenue 2012-16



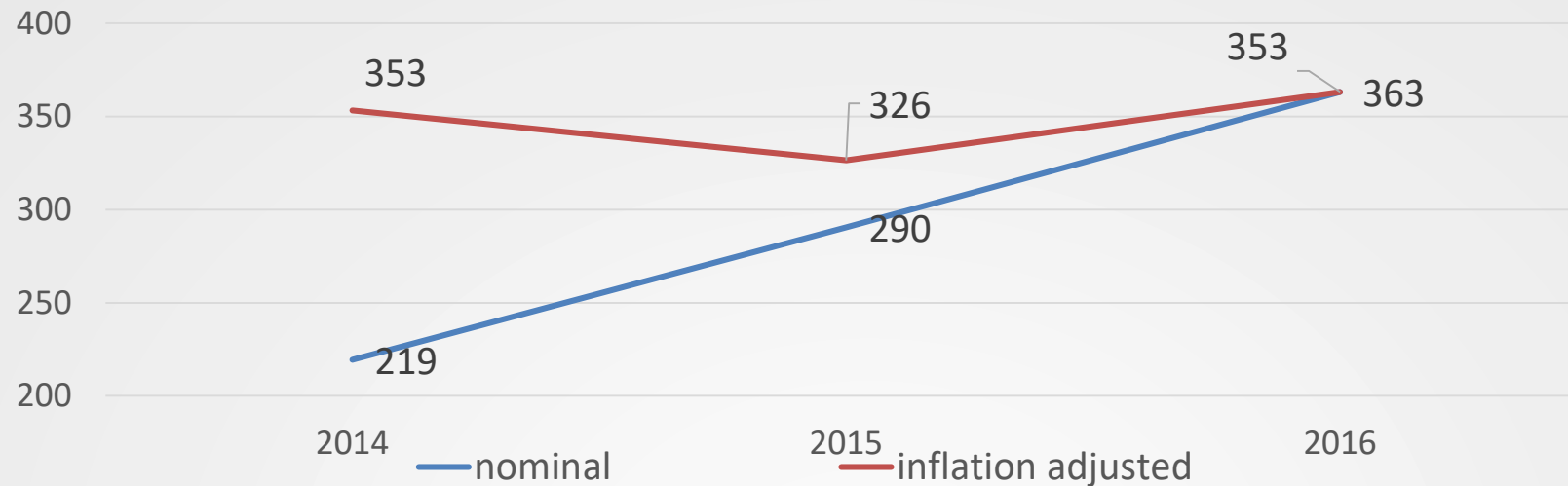
# “Decentralization” in Ukraine

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- Since 2014, General Government revenue has fallen from 43% to 37% of GDP while subnational revenue remained at 15% of GDP.
- As a result, the share of total public revenue going to subnational governments rose 34% in 2014 to 42% in 2016.
- This is remarkable because war and economic distress are typically accompanied by the recentralization of public finances.
- So the national government is clearly committed to decentralization, and making sacrifices to fund them BUT....



## Total Subnational Revenue in Nominal and Inflation Adjusted UAH 2014-2016 (blns)



## Subnational Expenditure by Economic Category 2014-2016 (2016 UAH, bln)

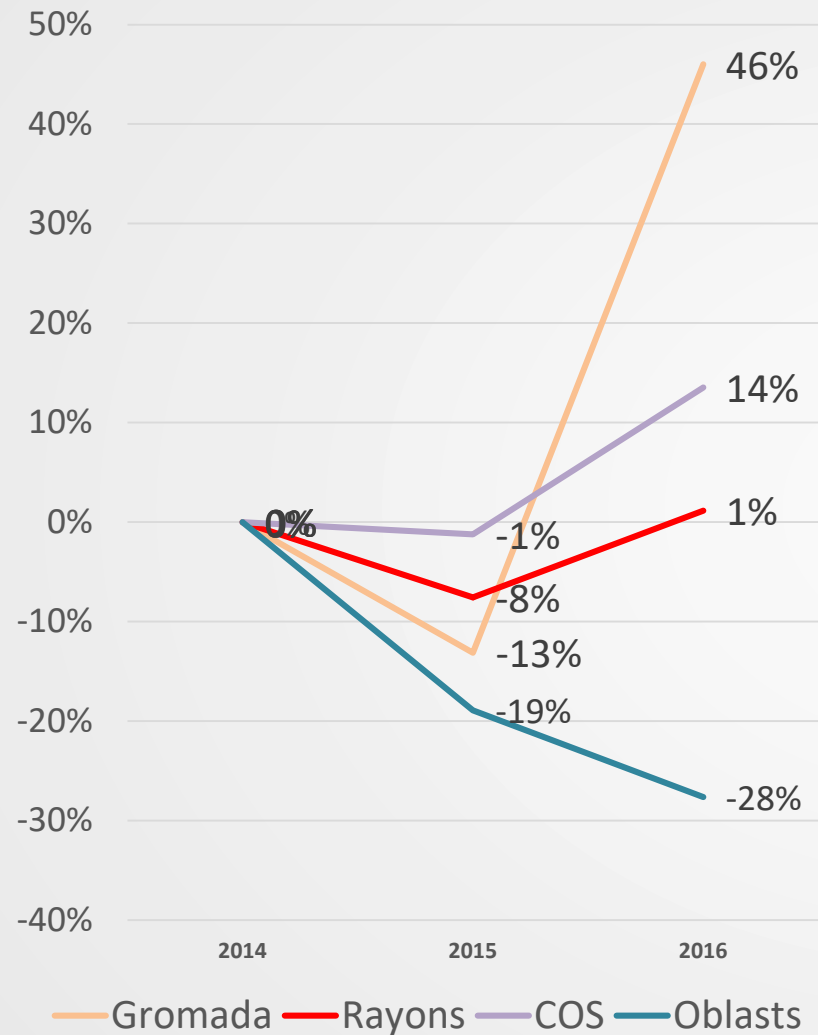
	Wages	Utilities & Energy	Other Operating Costs	Subsidies to instit's	Transfers to indiv's	Capital Expend.	Surplus	Total Expend.	Total Revenue
<b>2014</b>	<b>142.3</b>	17.4	48.1	34.0	78.8	<b>24.1</b>	<b>8.5</b>	<b>353.1</b>	<b>353.1</b>
<b>2015</b>	<b>118.8</b>	18.5	44.2	20.6	74.6	<b>38.0</b>	<b>14.2</b>	<b>328.9</b>	<b>326.5</b>
<b>2016</b>	<b>115.4</b>	17.6	44.2	19.1	99.0	<b>52.5</b>	<b>15.4</b>	<b>363.2</b>	<b>363.2</b>
<b>2015 as % of 2014</b>	<b>83%</b>	106%	92%	61%	95%	158%	167%	<b>93%</b>	<b>92%</b>
<b>2016 as % of 2014</b>	<b>81%</b>	<b>101%</b>	<b>92%</b>	<b>56%</b>	<b>126%</b>	<b>218%</b>	<b>182%</b>	<b>103%</b>	<b>103%</b>

# “Decentralization” in Ukraine

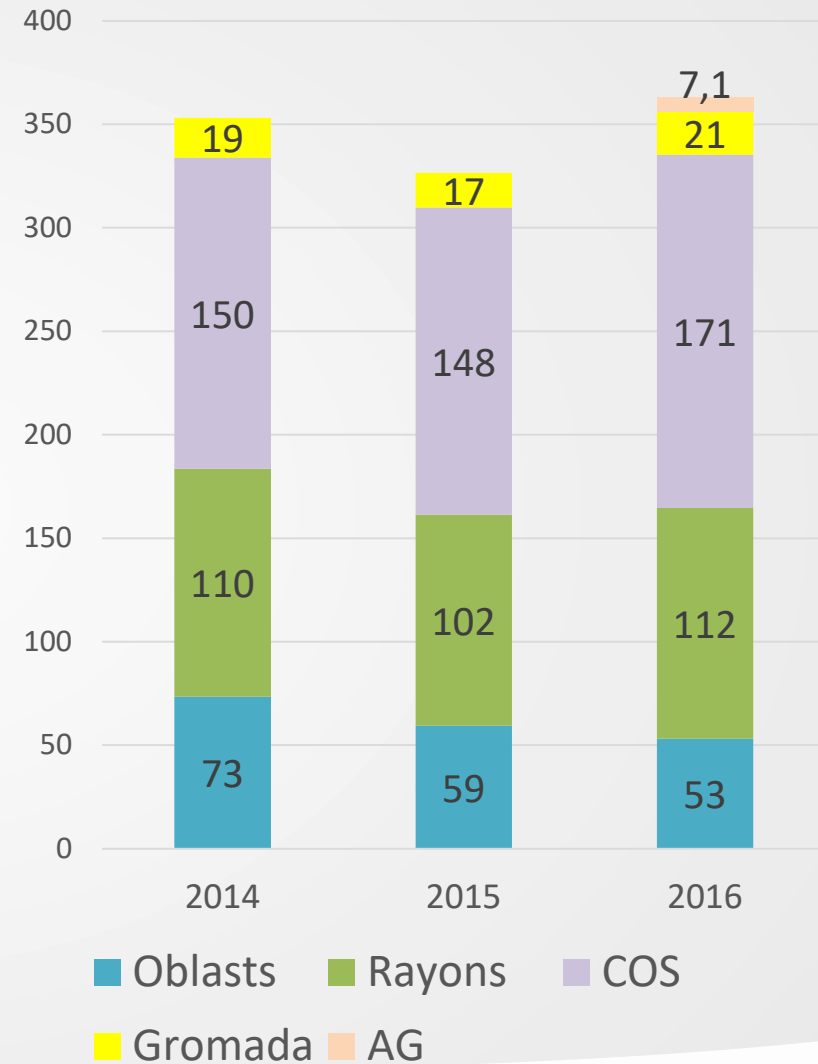
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- But this does not mean local governments are getting “getting billions of new hryvna”
- Instead, total revenues have been stable in inflation adjusted terms.
- Nonetheless subnational governments felt like their revenues increased because of the freezing of public sector wages in 2014 & 2015.
- The windfall went to investment at all levels of subnational government.
- The claim that “decentralization” is giving subnational governments lots of new money is creating dangerous expectations.
- It is also masking a profound set of changes in the relative power of different levels of government.

## Percent Change in Total Revenue by Level of Government since 2014

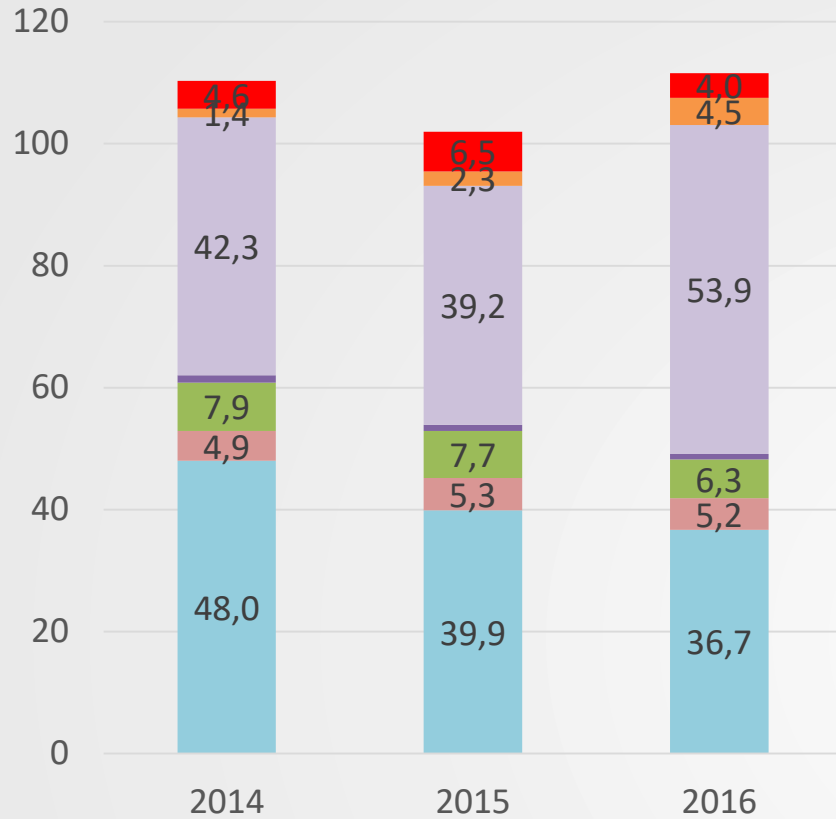


## LG Revenue by Level of Government in 2016 UAH (blns)

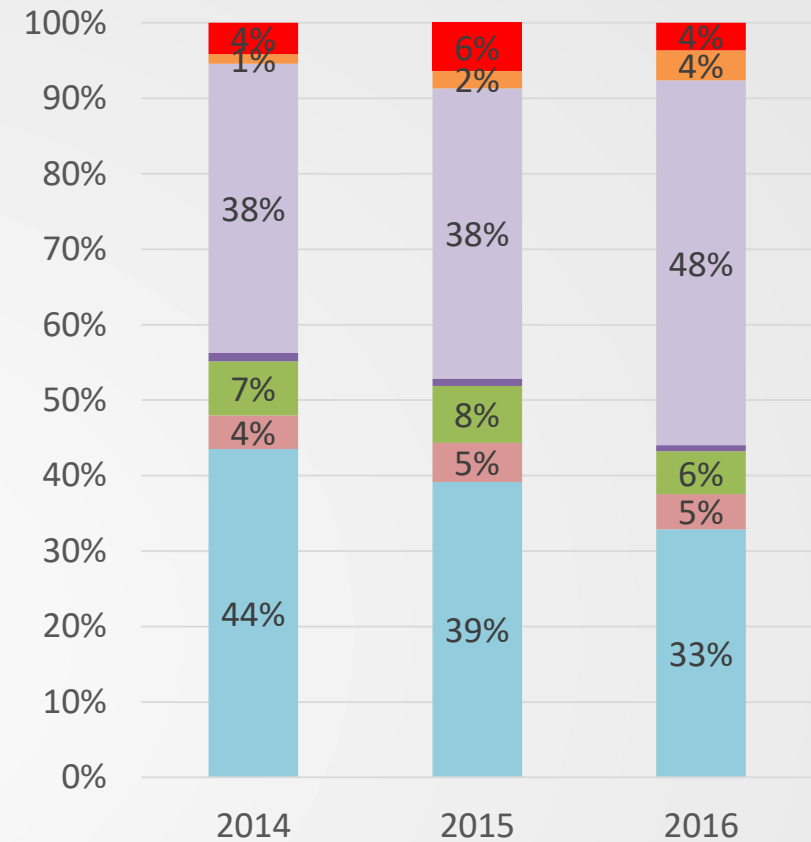


# Rayon Expenditure by Economic Classification 2014-16

(2016 UAH, bln)

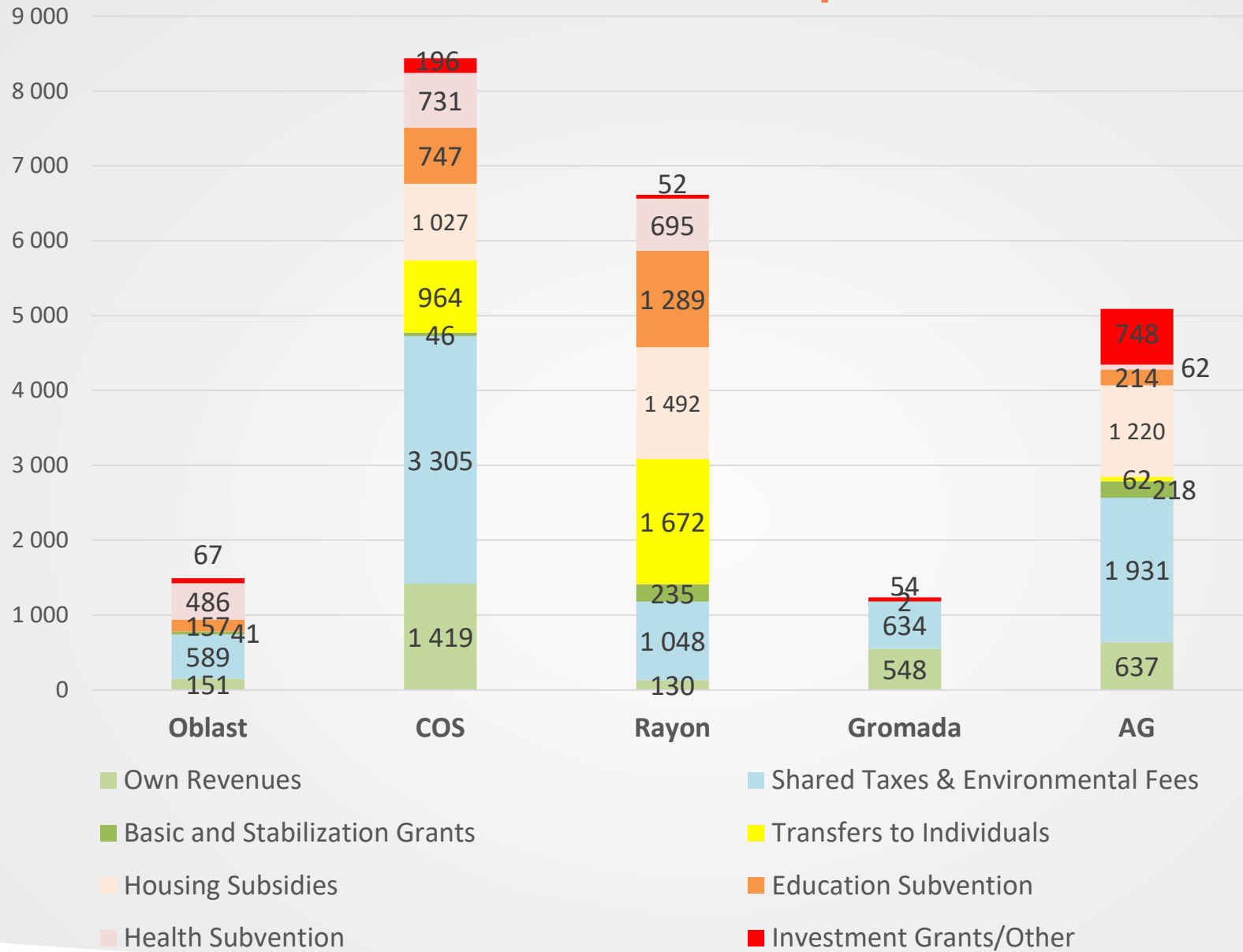


- Surplus
- Capital Expenditure
- Transfers to individuals
- Subsidies to institutions
- Other operating costs
- Utilities & Energy
- Wages



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# Local Government Revenue Per Capita (2016 UAH)



# “Decentralization” in Ukraine

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- Oblasts are the big losers, and functions and finances have been shifted from them to CoS.
- Rayons are also losing finances and functions, but primarily to AGs. They are increasingly windows for social transfer payments.
- AG finances now structurally resemble those of CoS.
- What we are seeing is the “further municipalization of oblast power”, and the “beginnings of the gromadization of rayon power” (which together signal progress towards a Polish/Nordic model of local governance)
- But with no clear vision of final division of functions between layers of subnational government. In this sense, **finance is leading functions, instead of following them.**

# Conclusions & Recommendations

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- Current discourse on “decentralization” as more money is misleading and dangerous.
- Masks what is really happening (going “Polish/Nordic”).
- Also on a collision course with recently passed legislation to create a single-payer health care system which will require taking money away from Oblasts, CoS and Rayons.
- Increasing public sector wages will also end current “fiscal illusion.”
- Without legislation requiring amalgamation the process may stall, not least because the costs of voluntary amalgamation (incentives to form AGs and subsidies to failing gromada) may become prohibitively high.

# Conclusions & Recommendations

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There are major legal and functional issues that require immediate attention:

- Division of education functions between levels of government:
  - Should Vocational Education be an oblast or CoS/AG function?
  - Should secondary education be an AG function everywhere?
  - Who should monitor school performance?
- Division of responsibilities in health sector:
  - Who owns hospitals?
  - What does ownership entail in practice if hospitals are supposed to pay for their basic operating through service contracts with the single-payer system.
- Should Rayon's be eliminated entirely or consolidated? If consolidated, should their role be limited to owning hospitals?



# Conclusions & Recommendations

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- Who should oversee the legality of local government decisions and who should monitor their performance, particularly with respect to their social sector responsibilities?
- Traditional struggle over constitutional reform may be unnecessary and harmful (particularly in light of the discord over the Minsk accords:
  - May be no need to democratize executive authority at oblast and rayon level.
  - Leave them as territorial arms of the national government with limited functions.
  - Assign responsibility for monitoring the legality of CoS and AG functions to oblasts as territorial arms of the national government.

# Additional Slides on Voluntary Amalgamation

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- Government is making significant “side payments” to encourage amalgamation.
- In 2016, 159 AGs were created and in 2017 another 254 (413 total)
- Together they serve 3.68 citizens or 22% of the non-urban population.
- Range in size from 1,600 to 44,000 inhabitants: Of the original 159, 60% have no town settlements.
- Evidence of dysfunctional self-sorting into AGs with no town center, and AGs that attempt to restrict the number of rural gromada they contain.
- Employment-based system of sharing Personal Income Tax encouraging this dysfunctional self sorting

# AG Revenue Per Capita (in Quartiles ranked by Shared Taxes)

Quartile	Population	Shared Taxes	Land & Property Taxes	Rent	Other Own	Equaliz.	Other Subs. & Invest. grants	Educational Grant	Health Grant	Total	Total as % of 4th
Q1	260,213	593	84	113	61	456	739	1,453	249	3,748	0.53
Q2	375,250	1,163	94	221	107	308	739	1,340	191	4,164	0.59
Q3	377,947	1,723	145	308	122	139	804	1,081	189	4,511	0.64
Q4	372,637	3,848	186	490	502	42	706	1,079	237	7,091	1.00
<b>Total</b>	<b>1,386,047</b>	<b>1,931</b>	<b>131</b>	<b>297</b>	<b>209</b>	<b>218</b>	<b>748</b>	<b>1,220</b>	<b>214</b>	<b>4,967</b>	<b>0.70</b>

# Unconsolidated Gromada Expenditure by Economic Classification 2014-16 (2016 UAH, bln)

