

July 4, 2024

Fiscal Decentralization Reform in Ukraine

Strategic Directions and Support for Strengthening Local Financial Management

Urška Zrinski
Senior Public Sector Specialist

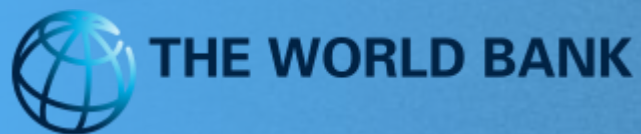


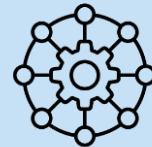
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Fiscal Decentralization Reform Directions

Ukraine Decentralization Reforms



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Ambitious Reforms: Political, Administrative, and Fiscal Decentralization

- Adheres to the European Charter of Local Self-Government
- Principle of subsidiarity in delegation



Revenue Needs

- Substantial revenues required for local governments
- Central-level funds shared with local governments
- Enhanced efforts to improve local tax base



Additional Responsibilities

- Support to displaced persons
- Removal of rubble and de-mining
- Social assistance to veterans



Alignment between Local Government Expenditure and Revenue Assignments

Figure 1. Local Budget Expenditure, Local Tax Revenue and Total Local Budget Revenue (Share of GDP)

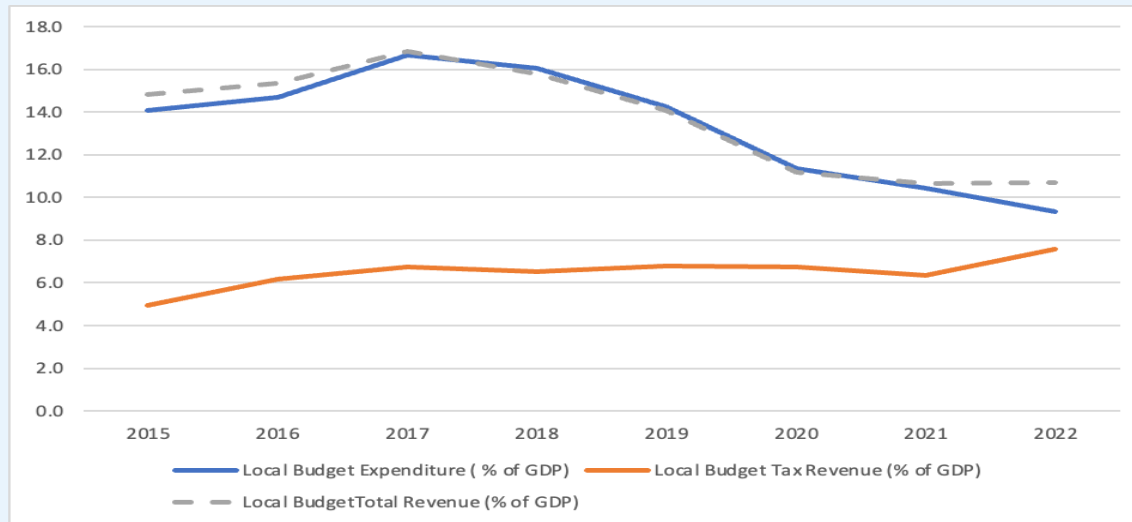
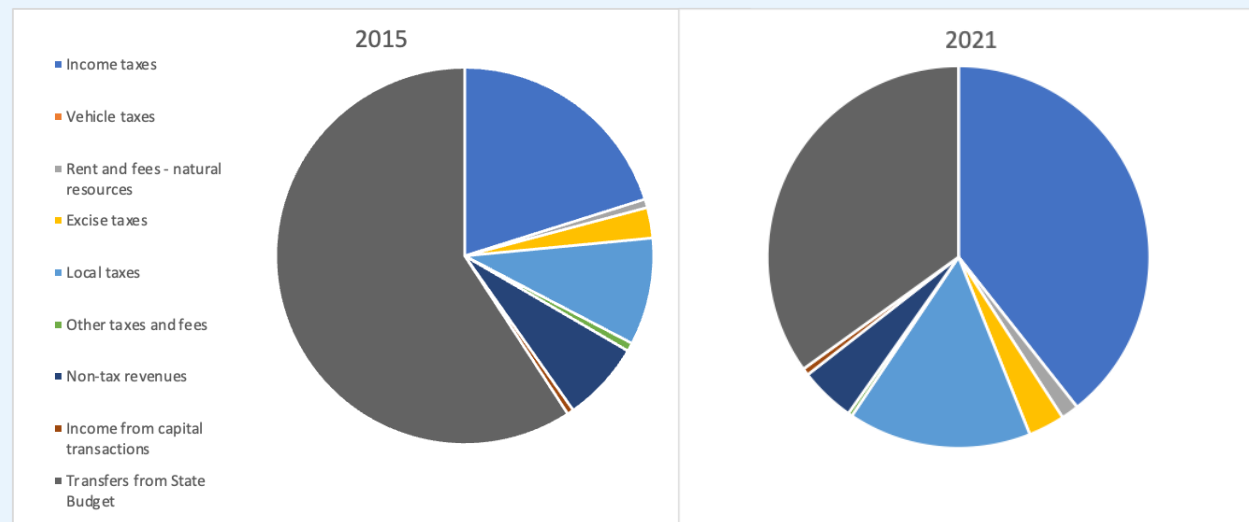


Figure 2. Composition of Local Budget Revenue (percent of total)



Source: Ministry of Finance and Treasury of Ukraine data.



System of Transfers in Ukraine



Basic subsidy

- Purpose: Horizontal equalization
- Untied grants
- Calculation: Based on population, PIT and CIT receipts, and tax capacity indices



Reverse subsidy

- Purpose: Horizontal equalization
- Funds transferred from local governments to the state budget
- Untied grants
- Calculation: Similar to basic subsidy, based on population, PIT and CIT receipts, and tax capacity indices



Subventions

- Specific purposes like education, road maintenance, and support for special needs
- Educational subvention: Salaries for teachers in various educational establishments
- Road maintenance subvention: Construction, repair, and maintenance of public roads funded from the Special Fund
- Investment program subventions: Aligned with the State Strategy for Regional Development



Additional subsidies

- Provided for specific needs and projects
- Focus on development and support initiatives beyond regular budget allocations

Local Government and Revenue Challenges



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Strengthening Local Government Accountability and Revenue Mobilization for Economic Activity and Housing Services



Incentives for Increasing Local Revenues

- Rebuilding and advancing economic sectors
- Key sectors: Economic trade, agriculture, energy, industry, construction, ICT, and applied research
- Importance for reconstruction and post-war recovery
- Motivating force for local governments to raise revenue



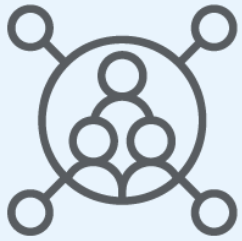
Accountability and Revenue Trends

- Amalgamation process completed in 2020, raising accountability concerns
- Local revenues under local government control increased from 10% in 2015 to slightly above 15% in 2021
- Majority of local funds still come from the central budget
- Long-term need for efficient revenue mobilization and stronger accountability



Future Directions

- Enhance local government discretion over revenue instruments
- Increase the share of own revenues to support decentralization
- Align revenue mobilization efforts with local accountability and service provision needs



Possible Solutions

Strengthening Local Government Revenues and Accountability

Short Term

Personal Income Tax (PIT):
Shift allocation of PIT from an origin to a destination basis

Property Tax: Develop a strategic plan to register properties within three years, streamline process, and centralize databases

Medium Term

Service User Charges
Consider introducing a local business tax to support service delivery and post-war recovery.

Long Term

Strengthening Local Government Accountability:

Provide local self-governments with a 'legal personality.'

Develop an open database with demographic, fiscal, and sectoral information for amalgamated communities.

Define clear responsibilities for infrastructure service delivery across different government tiers.

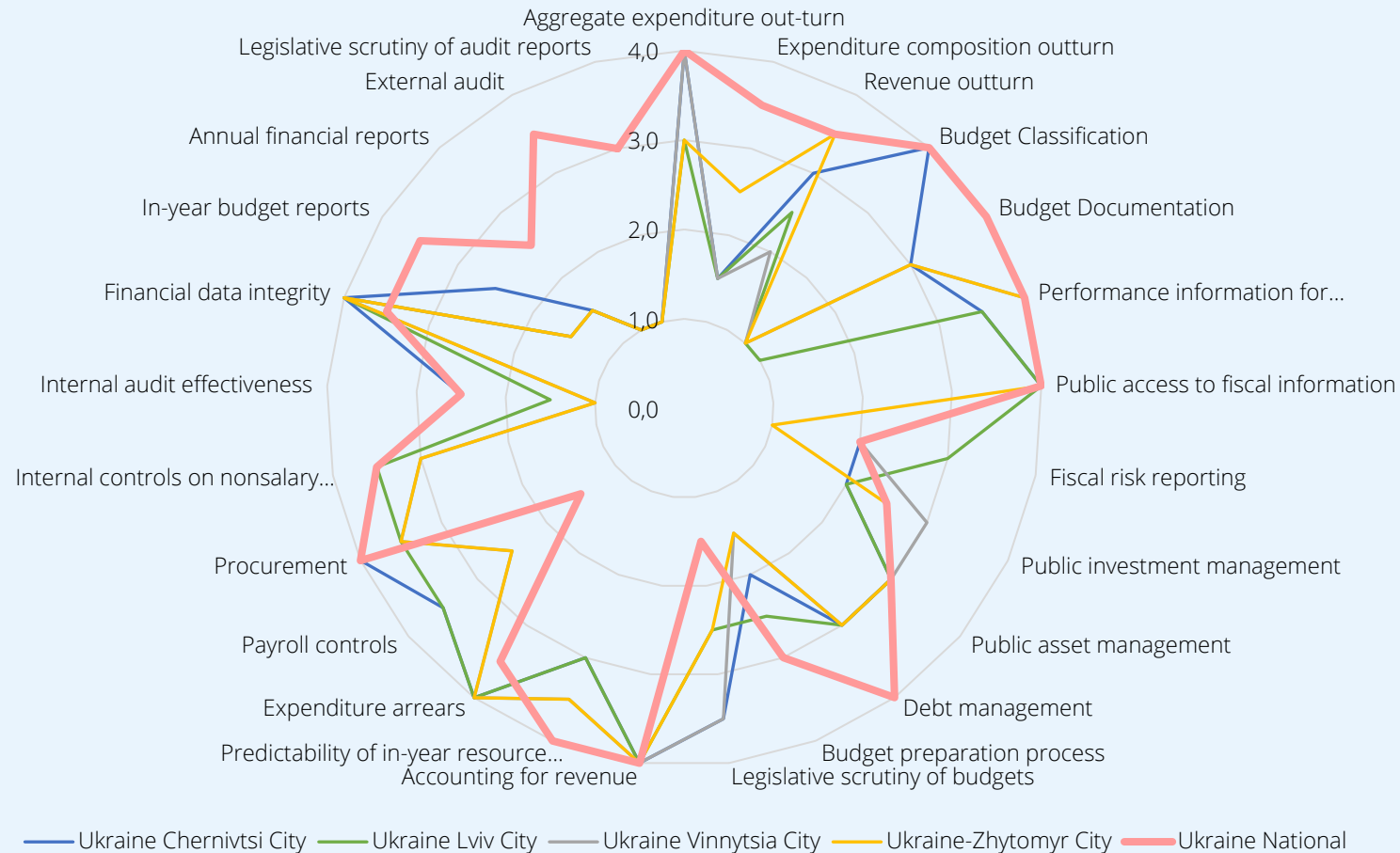
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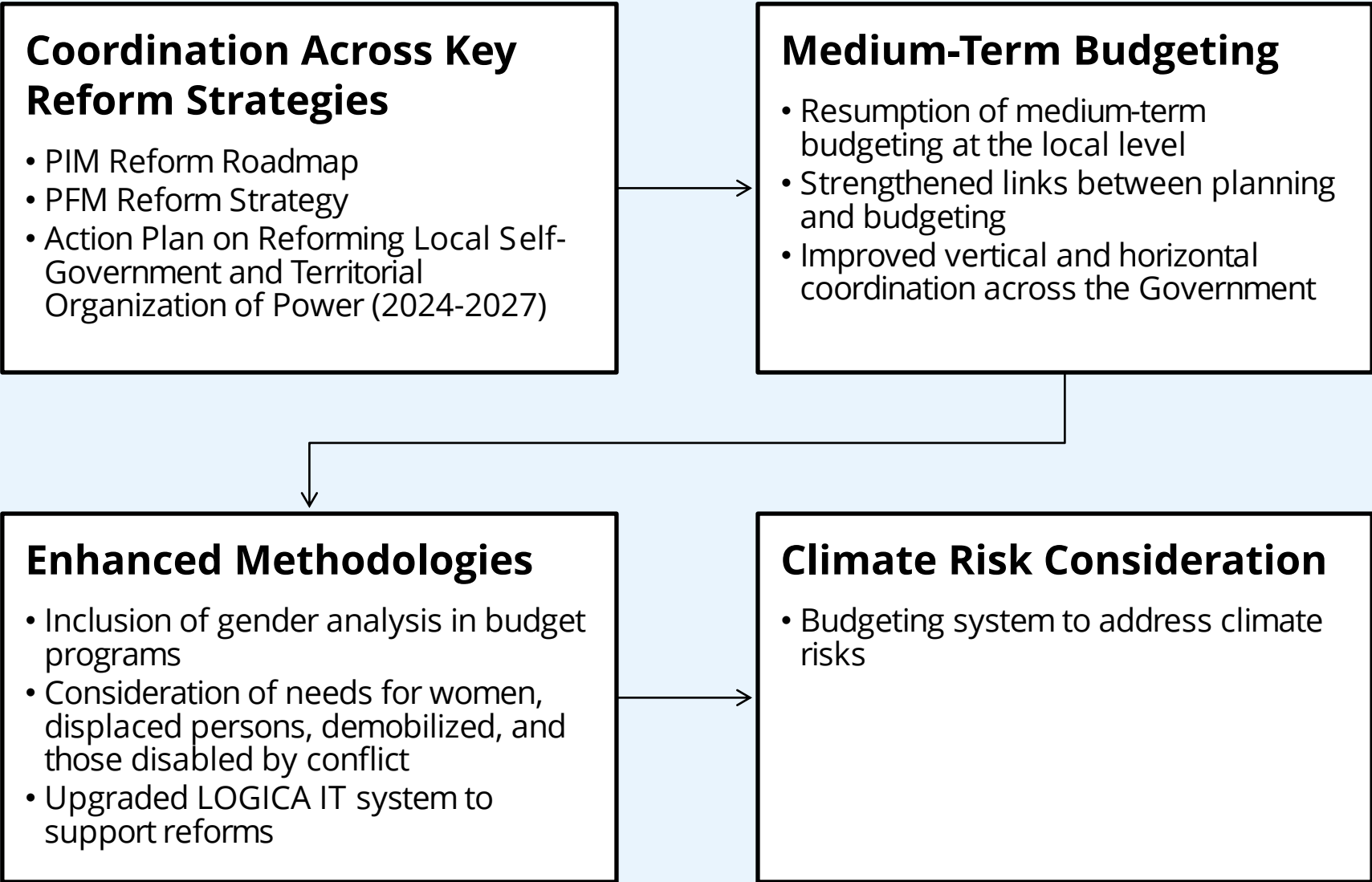
Public Financial Management (PFM) at the Local Level



PFM Performance at the Subnational Level



Key Reforms and Strategies to Strengthen Local Government PFM Capacity





Enhancing Fiscal Resilience of Local Governments Amid Crisis

Local governments' fiscal capacity strained by infrastructure destruction and population displacement.

Estimated US\$3.2 billion in revenue losses for subnational governments (SNGs).

Introduction of a new grant to address short-term needs and compensate for lost revenues.

Grant formula includes revenue losses and key local revenue dynamics.

Targets affected communities through a dynamic list.

Alignment of intergovernmental transfers with service delivery needs.





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How We Support Fiscal Governance and PFM at the Local Level in Ukraine

Enhancing institutional capacity and ensuring effective, transparent, and accountable use of public funds.



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Public Investment Management
Objective: Streamline and strengthen the management of public investments to ensure effective use of resources.

Subnational Fiscal Governance
Objective: Improve fiscal governance and resource allocation to support effective local service delivery.

Subnational Public Financial Management
Objective: Enhance financial transparency and accountability at the local government level.

Revenue Administration
Objective: Modernize tax administration to improve efficiency, compliance, and integrity.

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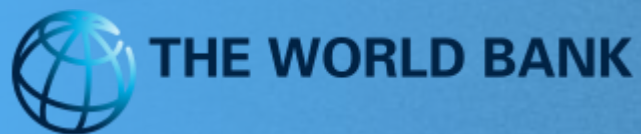


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