

***SOCIAL TRANSFORMATIONS OF THE
NATIONAL ECONOMY IN THE CONTEXT
OF EUROPEAN INTEGRATION PROCESSES***

Monograph

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THE CONTEXT OF EUROPEAN INTEGRATION PROCESSES***

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Section II.
FINANCIAL ASPECTS OF SOCIAL GROWTH

2.1 Improvement of Methodological Approaches to the Assessment of Financial Decentralization and its Impact on the Financial Sufficiency of Local Budgets

Financial decentralization in Ukraine actually began with the adoption of amendments to the fiscal legislation since 2015, which allowed the transfer of additional budget authority and stable sources of revenue for its implementation. The above mentioned keeps current the necessity to study the impact of financial decentralization on the financial sufficiency of local budgets in order to assess the effectiveness and efficiency of these processes. It is pertinent to note that at present, Ukrainian science and practice do not have a single methodological approach to proper assessment.

Thus, the assessment of the financial sufficiency of the local budgets of the united territorial communities is carried out by: the amount of local budgets own revenues per 1 inhabitant, taking into account the real and potential amounts of community's own resources in the community budget [1; 2]; the level of budget subsidization, which characterizes the territorial community's dependence on the state budget, and therefore evaluates its economic self-sufficiency [1; 2]; share of expenditures for maintenance of the management apparatus in local budgets own revenues of territorial communities without official transfers) [1; 2] and the amount of capital expenditures of local budgets per 1 inhabitant [1].

It is worth paying attention to the approach of scientists [3] to the assessment of the degree of fiscal decentralization, which allows taking into account the significant inter-territorial disparities of regional development and the peculiarities of the formation of local budget revenues at different levels. Also interesting is the proposal [4-9] to assess the level of decentralization of financial resources by using indicators that characterize the degree of financial sustainability of local budgets. The use of this approach is quite acceptable since financial sustainability is a complex concept that provides information on the ability of local governments to accumulate sufficient financial resources for the development of territorial communities.

In order to assess the level of financial decentralization at the macro level, foreign practice uses such basic indicators as the ratio of revenues (expenditures) of local authorities to total revenues (expenditures) of state and local authorities [10]. In accordance with our native practice, the degree of financial decentralization is considered in the following aspects: as the volume of revenues (expenditures) of local budgets in the gross domestic product of the country; as the volume of revenues (expenditures) of local budgets in the revenues (expenditures) of the consolidated budget of Ukraine. In our view, it is difficult to estimate the level of financial decentralization on these macroeconomic indicators, since they do not take into account the involvement of public authorities in the formation of local budget resources. And this is quite important when implementing the

principles of decentralization in order to increase the financial sufficiency of local governments.

Therefore, based on the scientific work of Ukrainian scientists and practitioners [3-9; 11] and taking into account the current features of the formation and redistribution of budgetary resources, we propose to apply a methodological approach, including the following steps (fig. 1), to investigate the impact of financial decentralization on the financial sufficiency of local budgets.

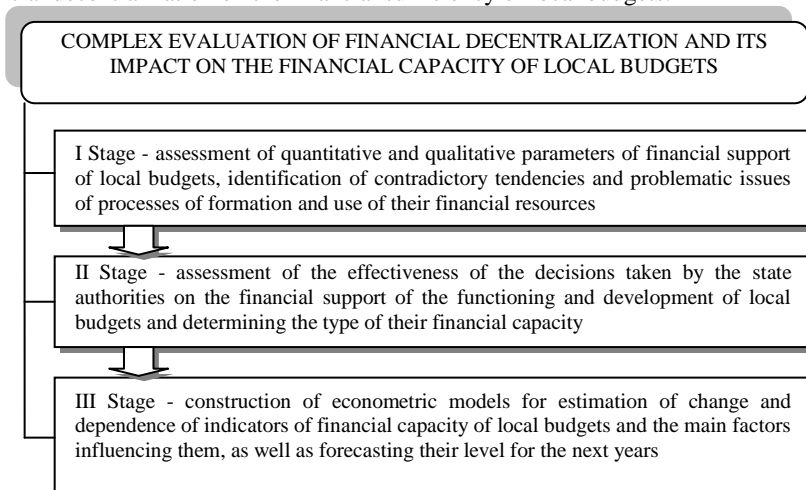


Figure 1 - Stages of integrated assessment of financial decentralization and its impact on the financial sufficiency of local budgets

Source: Created by the author

Thus, the first stage involves evaluating the first results of implementing fiscal decentralization in the context of changes in fiscal legislation. So in the process of the study it was revealed:

- a positive trend in the formation of local budget revenues since 2015, which indicates that local governments receive additional opportunities to address socio-economic issues of local importance. However, the dominance of official budget revenues in local budget revenues (their ratio to own and assigned revenues in 2018 is 53,1: 46,9 [12]) and the steady increase in their share indicates an increase in the processes of centralization of budgetary resources in Ukraine, which is contrary to the rate decentralization of financial resources;

- the use of new sources of revenue generation from local budgets since 2015, including 10% tax on profits of private sector enterprises, 5% rent for the use of mineral resources for oil production, 5% excise tax on retail sales and increasing the share of environmental tax to 55% local budgets receive an additional 16 billion UAH to address them to socio-economic issues of local importance, which is 6% of local budget revenues without official transfers [12]. However, the introduction of a deduction of 25% of the basic budget-forming tax of local

budgets (personal income tax) into the State Budget of Ukraine significantly reduced the level of local budget revenues. Thus, in 2018 alone, 73 billion UAH was redistributed to the State Budget, and local budgets underperformed 27,7% of their own revenues. Therefore, the aforementioned additional revenues do not, in aggregate, compensate the aforementioned losses of local budget funds;

- a significant increase in the share of local taxes in local budget revenues (from 1,1% in 2009 to 23,1% in 2018 [12]) due to their inclusion in the land payment, introduction of transport tax and improvement of the mechanism of the administration of the real estate tax which differs from land. However, despite the strengthening of fiscal importance, local taxes and levies are only of secondary importance in shaping local budget revenues;

- an empowerment of local self-government bodies to generate funds for the socio-economic development of the territories. In particular, we note the increase in the share of development budget revenues in the overall structure of local budget revenues (from 5,7% in 2009 to 23,2% in 2018) and the double increase in the share of local capital expenditures (from 7,8 % in 2009 to 16% in 2018). On the other hand, there is an increase in state budget support for the development of integrated territorial communities and infrastructure development (from 0,5 billion UAH in 2014 to 176.9 billion UAH in 2018) [12]. However, considering that mainly local budget funds are used to finance current expenditures (in 2018, this is 84% of the total amount), the current conditions for ensuring the socio-economic development of local self-government require a significant increase in investment expenditures;

- reduction of the number of subsidized local budgets, which is a positive result of the implementation of the policy of financial decentralization. Thus, if the percentage of subsidized local budgets was 96,3% by 2014, then their number decreased by 24,2% in 2018. At the same time, the number of budgets that pay the reverse subsidy to the state budget increased from 3,7% to 16,2%, respectively. It is also worth noting that 11,5% of local budgets have become fully balanced since 2015 [12];

- a sharp decrease in the volume of treasury loans extended to local budgets to cover temporary cash gaps (from UAH 24 billion in 2011 to UAH 2 billion from 2015 up to the present moment), which shows an increase in their solvency [12];

- growth of local budget funds in deposit accounts (from UAH 4,8 billion in 2011 to UAH 26 billion in 2018), which can be viewed from the positive side as an increase in budget funds, and from the negative side, as ineffective use, since they do not actively participate in the financing of territorial socio-economic development programs.

Thus, the results obtained indicate that changes in the fiscal legislation have somewhat expanded the possibilities of financial support for local budgets, but for a deeper study it is advisable to use not so much quantitative as qualitative parameters for assessing decentralization of local self-government.

For this purpose, at the second stage of complex assessment of financial decentralization and its impact on the financial sufficiency of local budgets, we propose to use indicators that allow evaluating the effectiveness of decisions made

by public authorities on the financial support of the functioning and development of local self-government (table 1).

Table 1 – Indicators for assessing the financial sufficiency of local budgets

Indicator	Economic content of the indicator	Weight Value	Algorithm of calculation
Coefficient of financial independence	Describes the extent to which local budgets are provided with their own revenues	0,3	$K_{\phi H} = \frac{B_{\Delta M \delta}}{\Delta M \delta + O\phi m}$
Coefficient of tax independence	Describes the extent to which local government tax revenues are generated through local taxes and fees	0,1	$K_{nc} = \frac{M\Pi}{\Pi H M \delta}$
Coefficient of tax sufficiency of own income	Describes the degree to which local budgets generate their own revenues at the expense of local taxes and fees	0,2	$K_{n3} = \frac{M\Pi}{B_{\Delta M \delta}}$
Coefficient of budget sufficiency	Describes the extent to which local budgets provide their own and assigned revenues	0,2	$K_{\delta 3} = \frac{\Delta M \delta}{\Delta M \delta + O\phi m}$
Transfer coefficient	Describes the degree of dependence of local budget revenues on official transfers	0,1	$K_{m 3} = \frac{O\phi m}{\Delta M \delta + O\phi m}$
Extraction rate	Shows what proportion of local budget revenues is withdrawn to the State budget	0,1	$K_{\theta} = \frac{\Delta \theta \Delta \delta}{\Delta M \delta}$

Note: $B_{\Delta M \delta}$ – own revenues of local budgets (sum of local taxes and fees, non-tax revenues, income from capital operations, trust funds and other charitable income); $\Delta M \delta$ – local budget revenues; $O\phi m$ – official transfers from the State Budget; $M\Pi$ – local taxes and fees; $\Pi H M \delta$ – tax revenues of local budgets; $\Delta \theta \Delta \delta$ – Local Budget Revenues Removed to the State Budget (Reverse Grant)

Source: Developed by the author

An important component of the study is the determination of the thresholds of financial sufficiency ratios, which will allow to determine the type of financial sufficiency of local budgets in the context of implementing a policy of decentralization of financial resources (table 2).

In order to summarize and identify general trends, it is necessary to calculate the integral index of the financial sufficiency of local budgets by the formula:

$$K_{\text{int}} = \sum_{i=1}^n K_i \times V_i \quad (1)$$

where K_{int} – is the integral coefficient of financial sufficiency of local budgets; K_i – coefficient of financial sufficiency of local budgets; V_i – weighted values of the coefficients of financial sufficiency of local budgets; n – the number of coefficients of financial sufficiency of local budgets.

Table 2 – Threshold values of the financial sufficiency of local budgets

Indicators	Type of the financial sufficiency			
	absolute	normal	instable	critical
Coefficient of financial independence	higher than 0,7	from 0,7 to 0,5	from 0,5 to 0,3	lower than 0,3
Coefficient of tax independence	higher than 0,6	from 0,6 to 0,5	from 0,5 to 0,2	lower than 0,2
Coefficient of tax sufficiency of own income	higher than 0,7	from 0,7 to 0,5	from 0,5 to 0,3	lower than 0,3
Coefficient of budget sufficiency	= 1	from 1 to 0,9	from 0,9 to 0,5	lower than 0,5
Transfer coefficient	lower than 0,2	from 0,2 to 0,3	from 0,3 to 0,4	higher than 0,4
Extraction rate	lower than 0,2	from 0,2 to 0,3	from 0,3 to 0,4	higher than 0,4
Integral index of financial sufficiency of local budgets	higher than 0,7	from 0,7 to 0,5	from 0,5 to 0,3	lower than 0,3

Source: compiled on the basis of [6-9; 11]

The calculation of the indicators characterizing the level of financial sufficiency of Ukraine local budgets allows us to draw the following conclusions. During the period of analysis, the coefficient of financial independence was increased by 1,5 times, which is not positive, since its low value indicates a significant financial dependence of local budgets on resources of national importance, which is unacceptable in the conditions of financial decentralization (table 3).

Table 3 – Indicators characterizing the level of financial sufficiency of Ukraine local budgets for 2008-2018

Indicators	Years											SE (+,-)
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	
Coefficient of financial independence	0,112	0,095	0,086	0,088	0,090	0,097	0,095	0,167	0,180	0,163	0,164	0,052
Coefficient of tax independence	0,014	0,014	0,012	0,034	0,063	0,081	0,093	0,275	0,288	0,262	0,262	0,248
Coefficient of financial sufficiency of own income	0,053	0,064	0,060	0,156	0,266	0,346	0,370	0,548	0,641	0,648	0,663	0,610
Coefficient of financial sufficiency	0,537	0,537	0,505	0,477	0,447	0,476	0,436	0,409	0,466	0,457	0,469	-0,068
Transfer coefficient	0,463	0,463	0,495	0,523	0,553	0,524	0,564	0,591	0,534	0,543	0,531	0,068
Extraction rate	0,104	0,110	0,082	0,031	0,014	0,015	0,019	0,026	0,018	0,017	0,021	-0,083
Integral index	0,210	0,207	0,198	0,206	0,233	0,256	0,257	0,331	0,359	0,352	0,357	0,147

Source: compiled on the basis of [12]

According to the requirements of the European Charter of Local Self-Government, most of their own budget resources should be accumulated at the expense of local taxes and fees. At present, the value of this ratio for the local budgets of Ukraine is 66,3%, which is a significant increase compared to 2008, when the share of budget own resources at the expense of local tax revenues was formed by only 5,3%. Therefore, it is positive to estimate the change in the coefficients of tax autonomy and tax security of their own income, the value of which increased by 18,7 and 12,5 times, respectively, in 2008-2018.

Budget ratio characterizes the degree of relative financial autonomy of local governments in the formation of budget resources to finance local expenditures. In this case, the coefficient of transfer dependence reflects the degree of dependence of local self-government bodies on the financial assistance of public authorities. Considering the direction of the budget policy on strengthening the processes of decentralization of financial resources, the share of official transfers in the overall structure of local budget revenues should decrease. However, the results of the study show an increase in the transfer dependency of local budgets while reducing the value of the budget security ratio.

The extraction rate also reflects the extent of influence of the state power on the formation of local budget revenues, so reducing its value by 6,1 times indicates reforming the system of intergovernmental equalization and ensuring decentralization of financial resources at the level of local budgets.

A graphical interpretation of the development of the level of financial sufficiency of Ukraine's local budgets is presented in fig. 2.

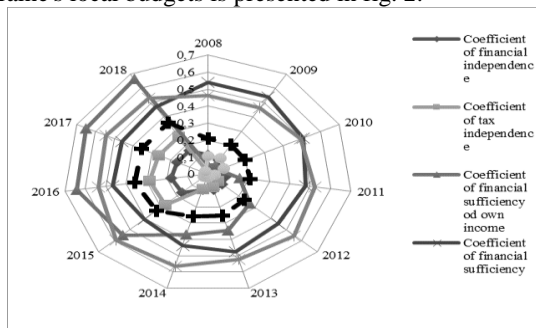


Figure 2 - Development of indicators of financial sufficiency of local budgets of Ukraine for 2008-2018

Source: compiled on the basis of tables 2-3

The results obtained and the thresholds for the financial sufficiency of local budgets allow us to distinguish the following periods for assessing the level of financial decentralization:

- 2008-2010 - a period characterized by a high level of centralization of budget resources and low financial sufficiency of local budgets for territory development;

- 2011-2014 - the period of updating the Budget and introduction of the Tax Codes of Ukraine, which allowed increasing the level of financial sufficiency of local budgets somewhat, but the level of centralization of budget resources remains high. As a result, the value of the integral indicator during the years 2008-2014 is within the crisis type of financial sufficiency, even despite the changes in the 2011 fiscal legislation;

- 2015-2018 - a period characterized by a focus on budget decentralization through an increase in the share of budget resources that remain at the disposal of local governments to fulfil their own and delegated powers. During this period, the integral indicator has significantly improved its position, but its value is still consistent with the unstable type of financial sufficiency of local budgets.

At the third stage of complex assessment of financial decentralization and its impact on the financial sufficiency of local budgets, we will form econometric models of estimation of indicators of financial sufficiency of local budgets and make the forecast of their levels for the next years. To do this, we define the analytical form of the econometric model based on the factors studied (table 3).

Taking into consideration the specification of the model, we have the following econometric models that best describe the integral indicator of the financial sufficiency of local budgets: 1) linear: $y = 0,0171x - 34,197$, $R^2 = 0,8366$;

2) polynomial: $y = 0,0017x^2 - 6,7617x + 6787$, $R^2 = 0,9122$.

Based on the relation “the minimum value of the mean square error of modelling and the minimum value of the maximum difference between the factual and the minimum value”, we consider the best model to be a polynomial function of the second degree.

The most influential factors on the change of the integral indicator of the level of financial sufficiency of local budgets were determined by tools of correlation-regression analysis (table 4). As a result indicator (Y) the integral coefficient of financial sufficiency of local budgets was chosen, as the factor values we consider the following indicators: X_1 – the coefficient of financial independence; X_2 - the coefficient of tax independence; X_3 - the ratio of tax provision of own income; X_4 - the coefficient of budget security; X_5 – the transfer coefficient; X_6 - the extraction ratio.

Table 4 – Correlation matrix of factors studied

Indicators	Y	X_1	X_2	X_3	X_4	X_5	X_6
Y	1	0,856	0,986	0,988	-0,811	0,811	0,048
X_1	0,856	1	0,898	0,769	-0,716	0,716	0,332
X_2	0,986	0,898	1	0,962	-0,867	0,867	0,067
X_3	0,988	0,769	0,962	1	-0,809	0,809	-0,059
X_4	-0,811	-0,716	-0,867	-0,809	1	-1	-0,046
X_5	0,811	0,716	0,867	0,809	-1	1	0,046
X_6	0,048	0,332	0,067	-0,059	-0,046	0,046	1

Source: Created by the author

According to the correlation matrix, financial independence (0,856), tax independence (0,986), own income tax ratio (0,988) and transfer coefficient (0,8) have the greatest influence on the change of the integral index of financial

sufficiency of local budgets. All other indicators have no significant effect on the financial value of the local budgets.

$$Y_p = 0,604 + 2,692 X_1 - 9,328 X_1^2 - 1,369 X_2 + 3,615 X_2^2 + 0,494 X_3 - 0,138 X_3^2 - 2,463 X_5 + 2,559 X_5^2, \quad (2)$$

This means that if the coefficient of financial independence increases by 1 unit, then the coefficient of tax independence decreases by 1,37 p. and the coefficient of transfer dependence - by 2,46 p., and the ratio of tax security of own income increases by 0,49 p.; if the coefficient of taxation of own income increases by 1 unit, then the coefficient of financial independence increases by 2,69 p, and the coefficient of tax independence decreases by 1,37 p and the coefficient of transfer dependence - by 2,46 p tax independence is reduced by 1 unit, the coefficient of financial independence is increased by 2,69 p and the ratio of tax security of own income - by 0,49 p, and the coefficient of transfer dependence is reduced by 2,46 p; if the coefficient of transfer dependency decreases by 1 unit, the coefficient of financial independence increases by 2,69 p. and the ratio of tax security of own income - by 0,49 p.; , and the tax independence ratio decreases by 1,37 p and the transfer dependency ratio by 2,46 p..

Next, we will perform a regression analysis between the performance indicator and factor values X_1 , X_2 , X_3 and X_5 using the “Regression” in the “Data Analysis” package in MS Excel. Therefore, according to the results of the analysis, the economic and mathematical model (2) was constructed and the multiple regression coefficient, determination coefficient, standard error, Student's t-test were calculated.

The multiple regression coefficient $R = 0,999$ indicates a very close relationship between the performance index and the factor values. Regarding the value of the coefficient of determination R^2 of the obtained correlation-regression model $R^2 = 0,9998$, the dependence of the volume of realized innovative products is 99,98% due to the selected factor values. The other 0,02% are due to other factors affecting the productive value of the level of financial sufficiency of local budgets, but are not included in the regression model.

Taking into consideration the high values of multiple regression and determination coefficients, this dependence is quite regular. The index of dispersion, significance of F , and F -statistics indicate that the assessment results are sufficiently reliable. According to the calculation results: t_r for the Y -cross-cup and the regression coefficients of the factor values X_1 , X_2 , X_3 and X_5 reflect equal values. The critical value of $t_{\text{КРИТ}}$ at the set value of significance $p=0,05$, determined using the T.INV.RT() function of the MS Excel software package. The result of the calculation of the critical value is $t_{\text{КРИТ}} = 2,262$. Since the condition $t_K > t_{\text{КРИТ}}$ is fulfilled only for the regression coefficient of X_5 (transfer dependence coefficient), which, accordingly, it is statistically significant for this model. The analysis shows that the constructed model (2) is reliable, whose coefficients are statistically different from zero, which allows determining the pointwise estimated value of the financial sufficiency of local budgets (Y_p). It is worth noting that the factual and estimated values of the integral indicator of the financial sufficiency of

local budgets are almost indistinguishable from each other, which indicates the quality of the models built.

Because the built model is nonlinear, the built-in GROWTH () MS Excel function was used to determine the estimated value of the integral financial sufficiency factor of the local budgets. The results of the calculation are presented in Fig. 3. According to the results of correlation-regression analysis, the dynamics of the integral index of financial sufficiency of the local budgets of Ukraine (fig. 3) has an unstable tendency, which corresponds to the introduced changes in the fiscal legislation and its growth in 2017-2018 - to reforming the budget system based on the principles of financial decentralization. According to the results of predicting the integral indicator, we can speak about a noticeable tendency to further increase the financial sufficiency of the local budgets of Ukraine. However, dependence of the local budgets on financial support from the state budget against the background of improving the financial sufficiency of local budgets remains high.

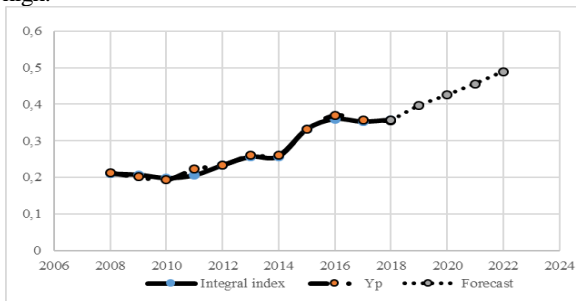


Figure 3 – Dynamics of factual, estimated and forecast data of the integral indicator of financial sufficiency of local budgets

Source: Created by the author

Thus, validation of the proposed methodology for assessing financial decentralization and its impact on the financial sufficiency of the local budgets confirmed the possibility of using it to analyse the financial sufficiency of the budgets of individual territories. It allows you to:

- to compare and evaluate the quantitative and qualitative parameters of their financial support;
- identify conflicting trends and vulnerabilities of the process of formation and the use of their financial resources;
- to determine the integral indicator of the level of the financial sufficiency of local budgets, as well as the type of their financial sufficiency;
- on the basis of econometric models construction, to evaluate the change and dependence of the indicators of financial sufficiency of local budgets on the main factors affecting them, as well as to forecast their level for the next three years.

Thus, changes in the fiscal legislation, despite the deepening of the level of centralization of budget resources, have increased the capacity of local budgets of the region and the country as a whole to financially ensure the implementation of their own and delegated powers of local governments. However, taking into consideration

the peculiarities of implementing the policy of decentralization of financial resources in Ukraine, the economic realities and state system of the country to achieve the absolute level of financial sufficiency of local budgets today is impossible, despite the positive results of the conducted forecast. Obtained by the results of correlation-regression analysis, the positive tendency of increase of the transfer dependency ratio is the evidence of their further dependence on the state budget. For this purpose, it is necessary to intensify the work of local self-government bodies in expanding tax and non-tax sources of the formation of the revenue by identifying reserves and using alternative sources of the formation of the financial resources of local authorities.

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