



DECENTRALISATION AND LOCAL PUBLIC ADMINISTRATION REFORM IN UKRAINE STATUS REPORT

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EXECUTIVE SUMMARY

Ukraine has laid the constitutional framework of local self-government, ratified the European Charter of Local Self-Government, and has adopted a number of basic regulatory and legal documents, which constitute the legislative and financial foundation for the daily work of local governments. In 2014, Ukraine had approximately 11,000 villages, towns and city councils at the basic community level. Almost half of them represented territorial communities with a population up to 1,500 residents. This has resulted in insufficient resources for the vast majority of local governments to exercise their own and delegated powers and to provide high quality and affordable public services.

In 2014, with the endorsement of the Concept for the Local Government Reform and Reform of Territorial Arrangement of Government Institutions" by the Cabinet of Ministers¹, Ukraine embarked on a local government reform and a reform of the territorial arrangement of government institutions (hereinafter decentralisation reform). After the Concept was endorsed in December 2014, the Parliament of Ukraine (Verkhovna Rada) introduced comprehensive amendments to the Budget and Tax Codes. As a result of these changes, local budget revenues (excluding inter-budget transfers) of all local governments in 2019 amounted to 11.4 billion Euros and almost doubled as compared with 2014 (5.3 billion Euros). In 2019, the share of local budget revenues (including transfers) constituted 43% of revenues of the consolidated National Budget, or 14% of the GDP.

The main implications of these achievements are the improvement of the intergovernmental transfer system and the expansion of local government tax powers. A new and more

stimulating system for fiscal equalisation across local governments was introduced in 2015, based on the Personal Income Tax (PIT). The equalisation system implies that the more revenue from this tax is generated and collected on the territory, the more it remains at the local level. The system of balancing local budget revenues and expenditures on the principle of horizontal equalisation has demonstrated progressive results. After this equalisation system was introduced during 2015 - 2019, local budget revenues from this tax have tripled. Local governments have become more interested in increasing their own revenue base, attracting additional revenues, and expanding their current tax base. The overall growth of the GDP, formalisation of shadow economic activity and salary increase have contributed to the growth of these tax revenues. The share of personal income tax revenues constitutes 65% of all tax revenues of local budgets. The intergovernmental transfer system has been improved also by the introduction of two separate and more transparent education and health care subsidies and a new equalisation subsidy calculated on a clearer formula. These improvements have contributed to the clarity in local government powers in the sectors of education and health care and have safeguarded local budgets from serious financial gaps².

Amendments to the Tax Code have significantly upgraded the system of local taxation by expanding the rights of local governments to set tax rates and privileges on local taxes and fees.³ In 2019, collections from local taxes and fees constituted 2.8 billion Euros⁴, while in 2014 (before the reform) they amounted only to 0.4 billion Euros. Local taxes and fees in 2019 constituted 27% of all local tax revenues (including revenues from the shared personal income tax).

1 CMU Directive "On Endorsing the Concept of the Local Government Reform and Reform of Territorial Arrangement of Government Institutions" # 333-p of April 01, 2014 <https://zakon.rada.gov.ua/laws/show/333-2014-%D1%80#Text>

2 Report. Governance reform at the sub-national level and local government finance in Ukraine: 2014 - 2018. Tony Levitas. Jasmina Djikic. SKL International/SIDA. October, 2019 <http://sklinternational.org.ua/wp-content/uploads/2019/11/PolicyBrief-UKR-FINAL.pdf>

3 Idem

4 World economic outlook database, October 2019

The decentralisation reform included also the devolution of power and responsibilities from the regional and state level to local governments. The powers of rayon councils and rayon state administrations (elementary and secondary education, primary and secondary health care, social protection, housing and municipal utilities, local transportation and territorial planning) and the corresponding financial resources were devolved to village, town and city councils elected in the consolidated territorial communities and their executive bodies.

At the first stage of the decentralisation reform in 2015, the Verkhovna Rada of Ukraine approved the Law "On Voluntary Consolidation of Territorial Communities"⁵, which outlined the procedures for consolidation of territorial communities on a voluntary basis. In 2015 - 2019, more than 4,700 communities got voluntarily consolidated creating 980 new Amalgamated Territorial Communities (ATC)⁶. In 2018, the parliament amended the law on community consolidation, whereby cities of oblast⁷ significance received an opportunity to voluntarily consolidate with the adjacent rural territorial communities. In this way, smaller territorial communities got an opportunity to become equal to cities of oblast significance in terms of their finance and scope of powers. During 2016 – 2019, the National Budget provided a subsidy to support amalgamated territorial communities develop and improve their infrastructure. Such a subsidy was distributed among the territorial communities depending on the number of rural population and the community area. In 2020, the Cabinet of Ministers has established a new territorial arrangement at the basic [community] level (1,470 territorial communities replacing 11.3 thousand former ones), while the parliament has formed up to 136 new rayons (sub-regional level) territorially embracing 490 "former" rayons and 187 cities of oblast significance.

From an institutional perspective, the decentralisation reform was enabled with the participation of the President of Ukraine

and his administration, the Verkhovna Rada of Ukraine Committee on State Building, the Regional Policy and Local Self-Governance, the Ministry of Community and Territorial Development of Ukraine, the All-Ukrainian Local Government Associations, and the international community involved in the reform.

The Association of Ukrainian Cities (AUC) takes an active part in the reform, both at the phase of drafting the legislation and in its subsequent implementation. The Concept of the local government reform, amendments to the budget and tax legislation, and the law on voluntary consolidation of territorial communities were prepared with the participation of AUC experts. In 2015, the AUC, the Ministry of Regional Development, and the Council of Europe signed a Memorandum to unite the efforts for the implementation of the local government reform and decentralisation. The AUC set up regional reform offices in each oblast for implementation of this Memorandum. These offices stimulated the process of voluntary consolidation, provided clarifications for communities and local government officials, technical and consultative assistance to communities on their way to consolidation, and to local governments of the established communities during the implementation of their powers. Now, AUC experts are actively involved in the discussion of amendments to the Constitution of Ukraine with regard to decentralisation, which will enshrine the achievements made.

The next stage of the reform implementation will include: final approval of amendments to the Constitution of Ukraine, which should enshrine the new framework of local self-government and administrative and territorial arrangement in the country; redistribution of powers between rayon and oblast councils and local government bodies in communities according to the principle of subsidiarity; formation of executive bodies of rayon and oblast councils, which will execute, respectively, rayon and oblast budgets and rayon and oblast territorial development

⁵ Law of Ukraine "On Voluntary Consolidation of Territorial Communities" # 157-VIII of February 05, 2015 <https://zakon.rada.gov.ua/laws/show/157-19#Text>

⁶ Monitoring of the decentralisation process and local government reform. MinRegion. January 10, 2020. <https://decentralisation.gov.ua/uploads/library/file/526/10.01.2020.pdf>

⁷ An oblast (Ukrainian: область), in English referred to as a region, refers to one of Ukraine's 24 primary administrative units.

plans, as well as manage infrastructure facilities at the rayon and oblast levels; raising competitiveness of local governments on the labor market of skilled labor force; and, making sure the amount of sectoral subsidies to local budgets for the implementation of

state-delegated powers matches the actual needs on the basis of social standards of services and their cost standards.

1 INTRODUCTION

Ukraine has laid the constitutional framework for local self-government, ratified the European Charter of Local Self-Government, and has adopted a number of basic regulatory and legal documents, which constitute the legislative and financial foundation for the daily operations of local governments. Administratively, Ukraine consists of 27 regions, of which 24 oblasts (provinces), the autonomous republic of Crimea and two cities with special status – Kyiv, the capital, and Sevastopol. The 24 oblasts and Crimea are subdivided into 136 Rayons (districts) and 187 cities of oblast significance.

The system of local self-government at the basic level consists of village, town and city councils, their executive bodies and village, town and city mayors. Some of the larger cities, which are divided into city rayons, have city rayon councils. These councils also have own executive bodies. The system of local government bodies and the sectors assigned to their responsibility are provided in Box no. 1 and no. 3. Before the beginning of the decentralisation reform, there were approximately 11 thousand village, town and city councils at the basic level. Almost half of them represented territorial communities with up to 1,500 residents.

Local government bodies operating at the basic level are divided into two types according to their powers. The first type: oblast significance cities (there are 187 such cities in Ukraine). The population in these territorial communities ranges from 6.5 thousand to 1.5 million persons. These local government bodies, generally, have sufficient financial resources and powers to address issues of local importance assigned to them (primary and secondary education, primary and secondary health care, social protection, housing and municipal utilities, local transportation, spatial planning).

The second type: villages, towns and city councils (approximately 11 thousand communities), which are part of rayons. Due to their small size, they have very limited financial resources and a weak financial base. On these territories, the main issues of local importance (primary and secondary education, primary and secondary health care, social protection, housing and municipal utilities, local transportation, spatial planning) are resolved at the rayon level. As of 2020, there are 1469 villages, settlements, city councils as local government bodies operating at the basic level, including the cities of oblast significance.

Local government bodies at the regional level include the 24 oblast councils (regional level) while local government bodies at the sub-regional level include the 136 rayon councils. However, they have only representative functions: approving rayon and oblast budgets and development plans of the respective territories and representing common interests of the territorial communities. Rayon and oblast councils do not have their own executive bodies. According to the Constitution, the functions of these executive bodies are performed by rayon and oblast state administrations, which represent local state executive authorities deconcentrated at the rayon and oblast level. The heads of local state administrations are appointed and dismissed by the President of Ukraine upon the suggestion of the Cabinet of Ministers of Ukraine.

Since 2014, the country has been reforming local self-government and territorial arrangement of government institutions. In 2014, the Cabinet of Ministers endorsed the Concept of the local government reform and reform of territorial arrangement of government institutions in Ukraine⁸. This Concept envisages the establishment of new administrative and territorial units, in

⁸ CMU Directive "On Endorsing the Concept of the Local Government Reform and Reform of the Territorial Arrangement of Government Institutions in Ukraine" # 333-p of April 01, 2014 <https://zakon.rada.gov.ua/laws/show/333-2014-%D1%80#Text>

particular at the basic [community] level whose local government bodies will be in a position to provide high quality services in the sectors of education, health care, social protection, housing and municipal utilities.

The main reasons for the decentralisation reform were:

- poor quality and accessibility of public services due to the lack of resources in the overwhelming majority of local governments to exercise their own and delegated powers;
- excessive centralisation of powers of executive bodies (rayon and oblast

state administrations appointed by the President) and financial and material resources;

- complicated demographic situation in most territorial communities (population ageing, depopulation of rural areas and one-company cities);
- low professional level of local government officials, in particular due to low competitiveness of local government bodies on the labor market; and,
- lack of coordination of the national policy on social and economic development of regions with the real interests of territorial communities.

Box 1: Local government administrative system: levels of government and key actors and roles

Levels of government in Ukraine in 2014 ⁹			
National level	President of Ukraine	Cabinet of Ministers of Ukraine and central state executive authorities	Verkhovna Rada of Ukraine
Local self-governance at the regional level	24 oblasts	2 cities with the special status (cities of Kyiv and Sevastopol)	
Local self-governance at the sub-regional level	490 rayons	187 cities of oblast significance	
Local self-governance at the basic level	278 city councils 783 town councils 10,278 village councils and their executive bodies		
Levels of government in Ukraine in 2020 ¹⁰			
National level	President of Ukraine	Cabinet of Ministers of Ukraine and central state executive authorities	Verkhovna Rada of Ukraine
Local self-governance at the regional level	24 oblasts	2 cities with the special status (cities of Kyiv and Sevastopol)	
Local self-governance at the sub-regional level	136 rayons		
Local self-governance at the basic level	1,469 village, town and city territorial communities, including 187 cities of oblast significance		

9 The administrative and territorial arrangement of Ukraine is complicated. It has a number of peculiarities on certain territories: 2 rayons (those including village and town councils are subordinate to cities of oblast significance (such rayons do not have rayon councils); 58 city councils of cities of oblast significance have subordinate 184 village, town and city councils; Rayon and oblast councils do not have executive bodies; the 2014 data include city of Sevastopol and parts of Donetsk and Luhansk oblasts currently under occupation by the Russian Federation.

10 Rayon and oblast councils do not have executive bodies; Local self-governance at the local level does not include the territory of ARC and territories under occupation by the Russian Federation; ARC, city of Sevastopol and parts of the Donetsk and Luhansk oblasts under occupation by the Russian Federation; Local self-governance at the local and sub-regional levels will be formed after legislation on October 25, 2020.



2 STATUS AND DEVELOPMENT OF LOCAL PUBLIC ADMINISTRATION REFORM

On April 1, 2014, the Concept of the Local Government Reform and Reform of Territorial Organisation of Government Institutions was endorsed by the Cabinet of Ministers through Directive no. 333-p11 along with the vision of an indicative distribution of powers between different levels of local self-government and between local self-government bodies and local executive authorities.

The concept defines the following key tasks:

- 1) formation of own executive bodies of rayon and oblast councils, which will execute, respectively, rayon and oblast budgets, plans for the development of territories of rayons and oblasts, and will manage infrastructure facilities at the rayon and oblast level;
- 2) strengthening the legal, organisational and material capacity of territorial communities and local government bodies;
- 3) significant increase of the territorial basis of village, town and city councils due to the consolidation of the relevant basic administrative and territorial units (communities);
- 4) ensuring accessibility of public services and improving their quality. Local government bodies will provide stable public services in accordance with the principle of subsidiarity and taking into consideration positive international experience. The venue where administrative services are provided to citizens will migrate from the rayon level to the community level. In addition, the basic [community] level will regain the powers to resolve issues of construction on community territories, etc., which had been previously centralised;

- 5) liquidation of local state administrations to be replaced by control and oversight state authorities that will supervise the compliance, including by local government bodies, with the Constitution and laws on the respective territory; and,
- 6) creation of favorable legal conditions for citizen participation in managerial decision making to the maximum extent possible, as well as the development of various forms of direct democracy.

It was planned that the reform would be implemented during 2014 - 2017. The main central executive body responsible for the reform is the Ministry of Community and Territorial Development¹², which is responsible for the implementation of most activities within the Concept of the reform. This ministry, in particular, ensures the formation and implementation of the national regional policy, national policy in the sector of local self-government, territorial organisation of government institutions and administrative and territorial arrangement. At the same time, the support for legislative initiatives in the parliament at the level of the technical parliamentary local government committee is worth mentioning. Also, the administration of the President of Ukraine actively joined the reform process in 2020 in terms of the preparation and discussion of the corresponding amendments to the Constitution.

The implementation of these tasks, as well as the establishment of executive bodies of rayon and oblast councils, and liquidation of local state administrations to be replaced by state control and oversight authorities, requires amendments to the Constitution of Ukraine. However, during the last five years of reform implementation, such amendments to the Constitution were not adopted. In 2015, President of Ukraine P. Poroshenko initiated

¹¹ <https://zakon.rada.gov.ua/laws/show/333-2014-%D1%80#Text>

¹² Ministry of Community and Territorial Development of Ukraine since 2019, and prior to this – Ministry of Regional Development, Construction, Housing and Municipal Utilities

such amendments to the Constitution (# 2217a of July 15, 2015)¹³, which received the preliminary approval from the Parliament, as well as a positive opinion of the Constitutional Court of Ukraine. However, there were not enough votes in parliament for the final vote. After the regular presidential elections and the early parliamentary elections in 2019, President of Ukraine V. Zelenskyi introduced the draft Law “On Amendments to the Constitution of Ukraine (with regard to decentralisation)”¹⁴ as a priority piece of legislation (Registration #2598 of December 27, 2019). However, the proposed amendments were not in line with the title and contained signs of centralisation and curtailment on local self-government. Given

the strong criticism from local governments, the Association of Ukrainian Cities (AUC)¹⁵, the parliamentary opposition factions, experts and other stakeholders, the President of Ukraine withdrew this draft law on January 17, 2020. During February-March 2020, upon the initiative of the Office of the President of Ukraine and the parliamentary faction of the Servant of the People Party, discussions of amendments to the Constitution of Ukraine on decentralisation took place in regions with the participation of academics, members of parliament, representatives of central state executive authorities, oblast state administrations, local governments and AUC experts.

13 Draft Law on Introducing Amendments to the Constitution of Ukraine (with regard to decentralisation) (Registration # 2217a of July 15, 2015) http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=55812

14 Draft Law on Introducing Amendments to the Constitution of Ukraine (with regard to decentralisation) https://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=67644

15 All-Ukrainian Association of Local Governments “Association of Ukrainian Cities”

BOX 2: Timeline of recent decentralisation process

Key phases	Events/activities	Main changes for local governments
Initial	The Cabinet of Ministers approved the Concept of the local government reform and reform of territorial arrangement of government institutions in Ukraine (April 01, 2014).	The Concept provides for the establishment of new administrative and territorial units, in particular at the basic [community] level whose local governments will be in the position to provide high quality services in the sectors of education, health care, social protection, and housing and municipal utilities.
Fiscal decentralisation	Amendments to the Budget Code of Ukraine (2014)	A new model of incentives for fiscal equalisation of tax capacity of territories.
	Amendments to the Tax Code of Ukraine (2014)	Local governments received more rights to set tax rates and privileges on local taxes and fees the list of local taxes finally includes land fees (sub-type of the property tax).
Phase of the voluntary consolidation of communities (2015-2019)	Law "On Voluntary Consolidation of Territorial Communities" (2015)	The mechanisms for consolidation of territorial communities on a voluntary basis were defined.
	Amendments to the Budget Code of Ukraine (2015)	Village, town and city councils elected in consolidated territorial communities and their executive committees received from rayon councils and rayon state administrations powers (primary and secondary education, primary and secondary health care, social protection, housing and municipal utilities, urban public transportation, territorial planning) and the relevant financial resources.
	Process of voluntary community consolidation	Over 2015-2019, more than 4.7 thousand communities got consolidated in a voluntary manner and 980 new territorial communities were established.
Administrative community consolidation at the basic and sub-regional levels	Decision of the Cabinet of Ministers on the formation of territorial communities (June 12, 2020) Decision of VRU on formation of rayons (July 17, 2020)	In 2020, the Cabinet of Ministers introduced the new territorial arrangement at the basic level [community] (1,470 territorial communities instead of former 11.3 thousand ones) and the parliament formed 136 new rayons (sub-regional level) comprising the territories of 490 "former" rayons and 187 cities of oblast significance.
Changes in the election legislation	Amendments to the Election Code (July 17, 2020)	Party system in territorial communities with the number of voters of 10 thousand and more; "imperative" representative mandate for local council members.
Local elections	October 25, 2020	Formation of local governments on a new territorial basis.

Box 3 Main powers of local governments at the basic level

OWN

Formation of the structure of executive bodies of councils, determining the total number of employees of executive bodies

Approval of programs for social, economic and cultural development, targeted programs on other local government issues;

Approval and implementation of the local budget

Approving decisions on local borrowings

Setting rates for local taxes and fees and granting privileges on their payment;

Communally-owned property management;

Setting up and managing communally-owned companies, in particular in the sectors of district heating, water supply, passenger transportation, solid waste management, street lighting, green plantations, maintenance of streets and roads

Resolving land relations issues

Endorsing, in due manner, local urban development programs, development master plans of the relevant populated areas, other urban development documents

Granting permits for special use of natural resources of local significance

Approving territorial community charters;

Setting tariffs for municipal utility services and urban public transportation services;

Parking management

Approving passenger transportation routes and vehicle schedules, rules for using urban public transportation system

Maintenance of cemeteries, other burial places and their protection

Granting permits for placements of advertising in the manner specified by the legislation

Management of educational establishments (pre-school, extra-curricular, secondary), health care (primary and secondary care), culture, physical culture and sport, health improvement facilities owned by territorial communities

Ensuring privileged travel for schoolchildren, pupils, students and teachers to schools and homes

Management of health care services and catering in educational establishments, cultural, physical culture, sport and health improving facilities owned by territorial communities

Provision of social services

Provision of free primary legal assistance

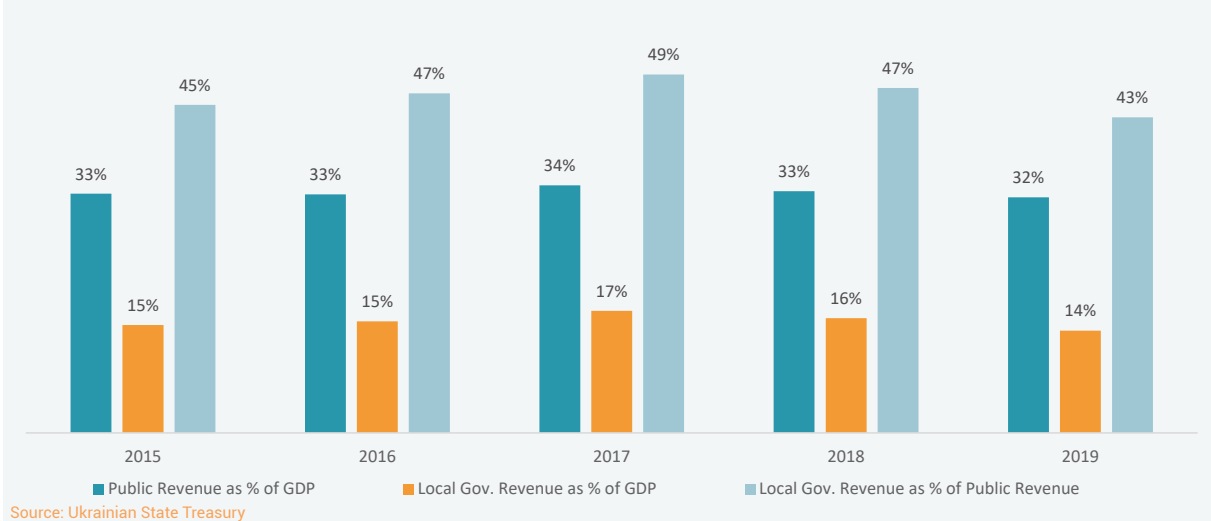
	<p>Keeping statistical records of citizens</p> <p>Provision of administrative services of executive authorities through Centers for Administrative Services</p> <p>Provision of data from the State Land Cadastre</p> <p>State registration of legal persons and private entrepreneurs;</p> <p>State registration of property rights for communally-owned property and their limitations</p> <p>Providing citizens entitled to social protection free housing or housing at affordable prices according to the law</p>
DELEGATED	<p>Performing activities to maintain in due manner the unified state register of citizens who require improvements of their housing conditions</p> <p>Exercising state architectural and construction control and commissioning finished construction facilities</p> <p>Performing works to set up and maintain the urban development cadastre of populated areas</p> <p>Within the scope of delegated powers, ensuring accessible and free education and health care on the relevant territory and possibility to obtain education in the state language</p> <p>Providing, in line with the legislation, medicine and medical goods to privileged categories of the population</p> <p>Keeping records of pre-school and school age children</p> <p>Organisational aspects of the work to prevent homelessness of under-age children</p> <p>Ensuring protection of historical and architectural monuments, preservation and use of the cultural heritage</p> <p>Improving housing, material and household conditions of socially vulnerable groups of population</p> <p>Guardianship and care</p> <p>Exercising control of labor protection</p> <p>Providing subsidies and privileges to socially vulnerable groups of population</p> <p>Facilitation to drafting citizens to military service</p> <p>Organisation and participation in activities related to military mobilisation training and civil defence</p> <p>Formation and maintenance of the territorial community register</p> <p>Consideration of issues on administrative offences rendered by law to the local competence; setting up administrative commissions</p>

2.1 Status and development of fiscal decentralisation

Ukraine has a relatively small public sector – public revenue in 2019 constitutes up to 32% of GDP. On the other hand, in Ukraine, local and regional governments have responsibilities. Local government revenues constitute 43% of total public revenue and 14% of the GDP. From this fiscal perspective, Ukraine results to be one of the most fiscally decentralised countries in Europe. Figure 1 shows the evolution of local government revenue and total public revenue in Ukraine over the past five years.

In December 2014, the Verkhovna Rada of Ukraine introduced comprehensive amendments to the Budget and Tax Codes. As a result of these amendments, local budget revenues have almost doubled in 2019 compared with 2014. Figure 2 below shows the evolution of local government revenues during the decentralisation reform 2014-2019, in billion euro. Between 2014 and 2019, local government revenue (excluding inter-budget transfers) grew from 5.3 billion Euro to 11.4 billion Euro. Nevertheless, local government revenues as a percent of GDP in 2019 are lower than in 2015, indicating that

Figure 1 The evolution of general and local government finance indicators in Georgia, 2014-2018



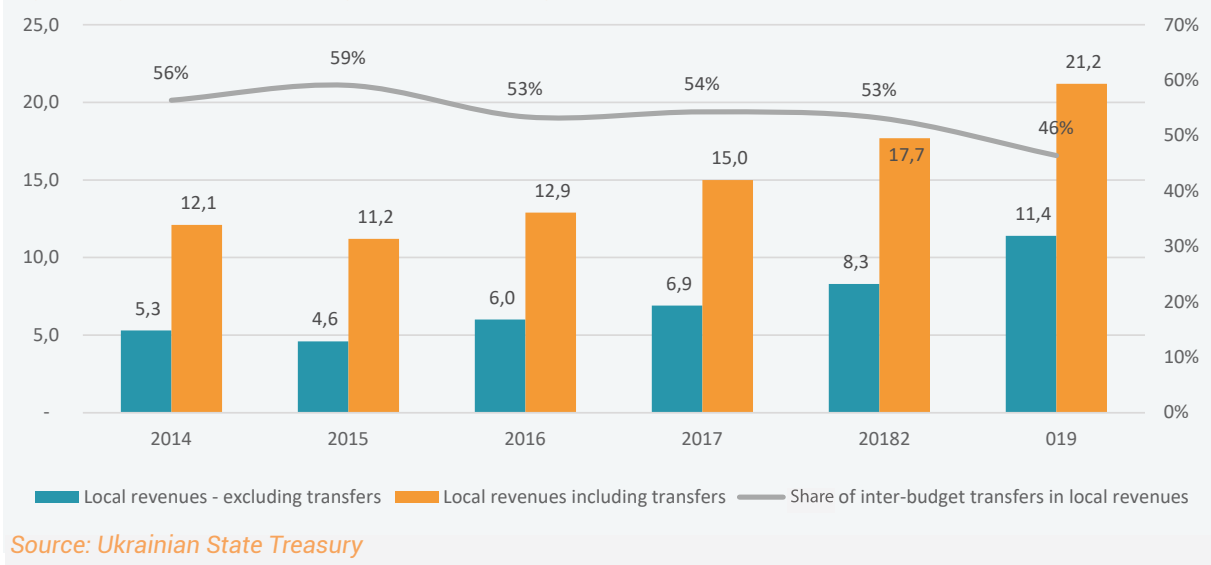
GDP has increased at a higher rate than local government revenues.

While Ukraine appears to be highly fiscally decentralised, it is important to clarify that 82% of local government revenues come from intergovernmental transfers, including revenues from the shared Personal Income Tax, the General (Equalisation) Grant and the Sectoral Earmarked Grants. Local governments exercise discretion over the utilisation of about

equalisation grant.

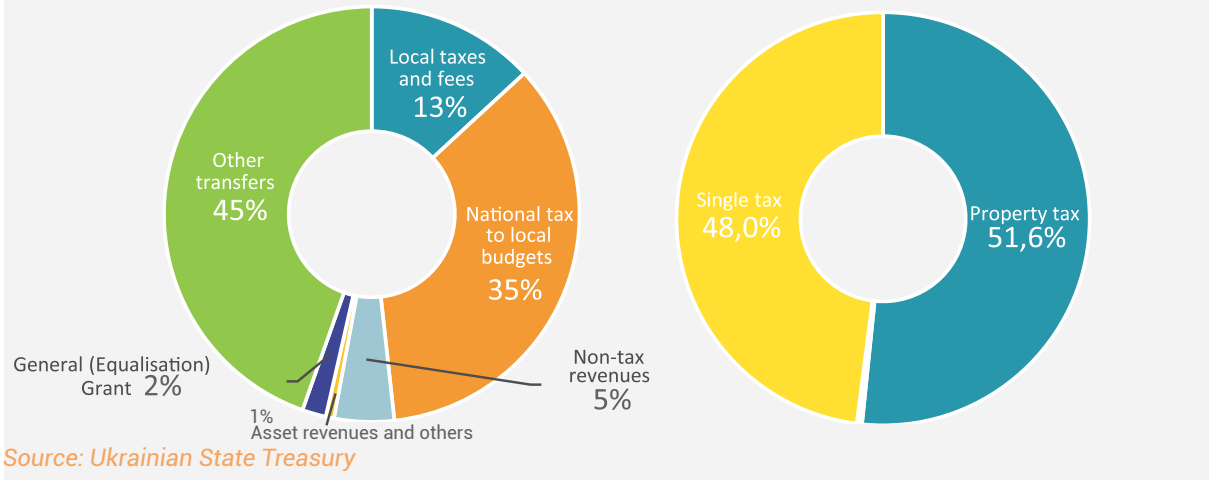
Figure 3 shows that Ukrainian local governments raise on their own through local taxes, fees and charges, assets etc., only 19% of their total revenues in 2019. However, including PIT revenues, local tax revenues make up to 48% of total local revenues. The two most important sources of local own tax revenue include the local property tax and the

Figure 2 Dynamics of local budget revenues during the decentralisation reform in 2014 – 2019



16 <https://www.treasury.gov.ua/ua/file-storage/vikonannya-derzhavnogo-byudzhetu>

Figure 3 The composition of local government total and own revenues, as a percent of the total

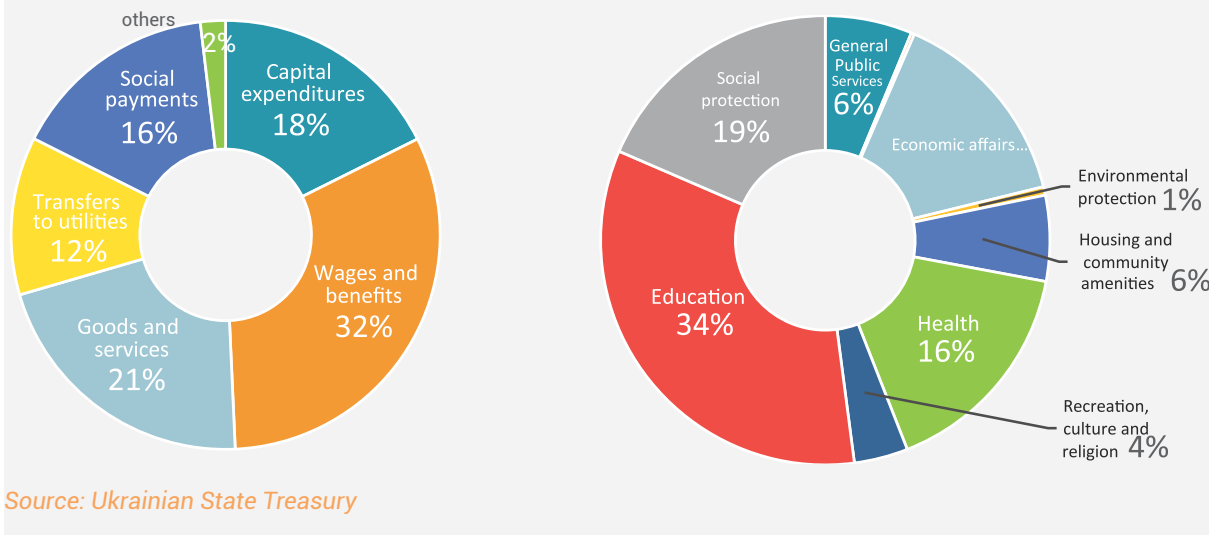


makes up to half of total local own revenues.

Figure 4 below shows the composition of local government expenditures. As Ukrainian local governments have extensive social service responsibilities in education, healthcare and social protection, these three functions alone make up to 70% of total local government spending. Consequently, spending for salaries, including salaries of school teachers for

category (32%), followed by spending for purchasing goods and services necessary for the operation of local government responsibilities and regular maintenance of local public infrastructure (such as school buildings for example) (21%). Spending for capital investments accounts for 18% of local governments.

Figure 4 The composition of local government expenditures (by economic and functional classification), as a % of total, 2019



2.2 Intergovernmental fiscal relations

Intergovernmental transfers make up about half of local government revenues in Ukraine. If we include also shared tax revenues, transfers constitute over 80% of local government revenues in Ukraine. From this perspective, financial equalisation across local governments is very important.

In 2014, Ukraine introduced a new model for financial equalisation of tax capacity of territories and a number of new types of intergovernmental transfers (equalisation subsidy, education subsidy and healthcare subsidy). Before 2014, equalisation was performed based on local government expenditures. With the 2014 changes, equalisation is now performed on the basis of revenues, namely, on the personal income tax collected in a certain territory. The personal income tax is a national tax. It should be noted that cities of oblast significance, rayons and amalgamated territorial communities receive 60% of the personal income tax collected in their respective territories. Non-amalgamated small villages, settlements and town territorial communities do not receive any share of the personal income tax. The possibility to receive such income contributed to the process of amalgamation of territorial communities.

The new equalisation system is stimulating in its nature. The system implies that the more revenue from this tax is collected on the relevant territory, the more it remains at the local level. Equalisation of local budgets is performed by comparing the per capita PIT indicators for a given local government with the average indicator for the whole country. If such ratio (budget capacity index) is less than 0.9, the local government receives a basic subsidy (this local government budget is subsidised). If the ratio is within the interval 0.9-1.0, the local government does not receive any subsidy because it is considered 'balanced' and therefore does not need to be equalised. If the ratio (index) is more than 1.1, it means that the local governments PIT revenues are above the national average and

therefore some part of the PIT revenues in 'excess' are withdrawn from the budget of this local government. The actual amount to be withdrawn is 50 percent of the amount exceeding the 1.1 value of this index (this local government is considered a donor budget; as it will be donating a portion of its funds for local governments with lower-than-average fiscal capacity). The withdrawn funds are directed to subsidised budgets, meaning to local governments with lower-than-average fiscal capacity. Changes in the equalisation system have reduced the number of subsidised budgets.

In addition to the new financial equalisation system, the 2014 changes brought significant improvements also as regards intergovernmental transfers. These changes have replaced the complicated and non-transparent equalisation subsidy with a system with three main components: separate education and health care subsidies and an equalisation subsidy calculated based on a clear formula. These new subsidies have contributed to clarity in local government powers in the sectors of education and health care, while the new, more effective and transparent equalisation subsidies have safeguarded local budgets from serious financial gaps¹⁷.

In general, the share of inter-budget transfers in local budgets decreased from 56% in 2014 to 46% in 2019. The downward tendency of local budget transfers is associated, in particular, with the introduction of a new model of health care funding. This model provides for the transition from maintenance of health care establishments (medical subsidies) to payments for medical services received (direct contracts between health care establishments and the National Health Service of Ukraine).

Figure 5 shows the composition of inter-budget transfers in 2019. The largest transfers in terms of volume are the payments of state social benefits to the population (28% of total transfers), education subvention (25%), and health care subvention (20%). Since 2017, the Cabinet of Ministers decided to reduce the amount of inter-budget transfers by shifting

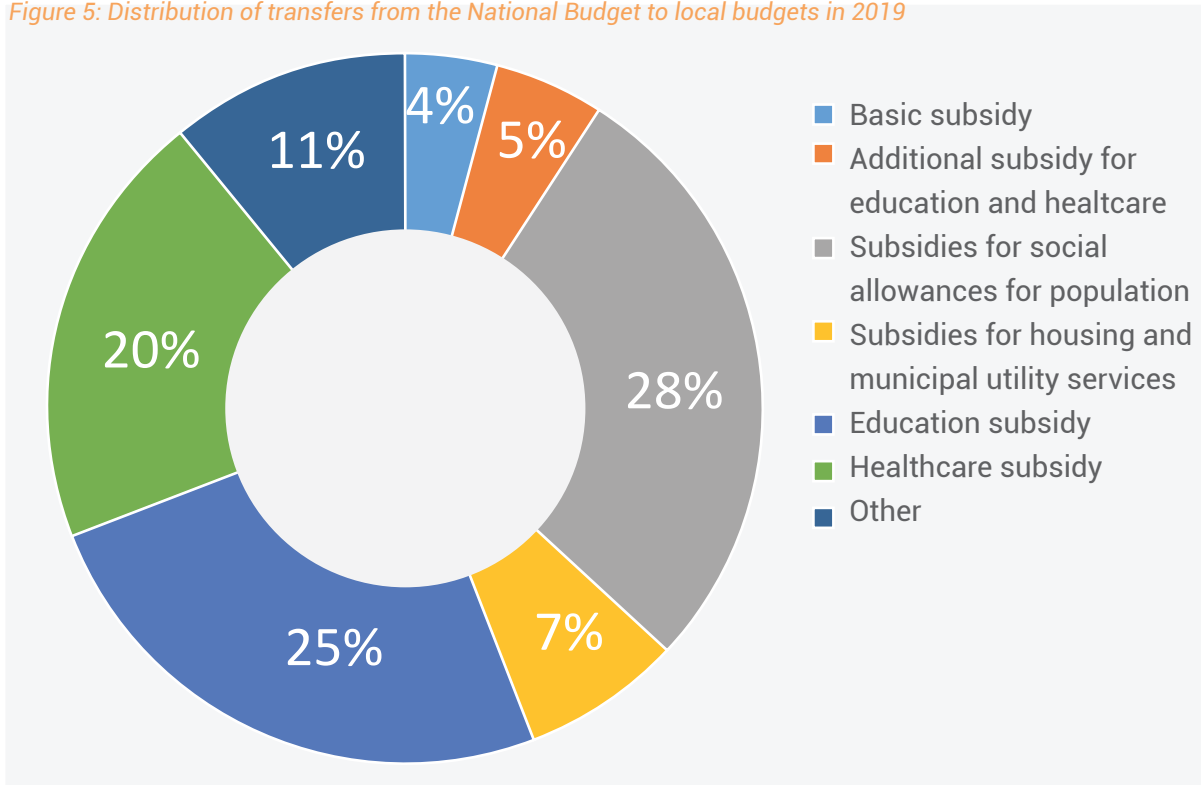
¹⁷ Report. Local government reform at the sub-national level and local government finance in Ukraine: 2014 - 2018. Tony Levitas. Jasmina Djikic. SKL International/SIDA. October 2019 <http://sklinternational.org.ua/wp-content/uploads/2019/11/PolicyBrief-UKR-FINAL.pdf>

the responsibility to local governments. In particular, the education subvention now includes only salaries of teachers, while all other expenditures of educational establishments have been shifted to local budgets. Also, expenditures on utilities and energy were excluded from the health care subvention, while the subvention for compensation of privileges for citizen for public transport travel was abolished at all. Starting from 2017, these expenditure categories are made from own local budget revenues, in particular, at the expense of

amounted to 0.4 billion Euros, while in 2019 they constituted 2.8 billion Euros. The amount of local taxes and fees in 2019 already reached 27% of all local government tax revenues (which include also PIT revenues).

As regards the right to issue debt, only city councils have the right to issue internal and external debts. In accordance with the fiscal legislation, local debts can be issued only under certain conditions: the overall amount of borrowed funds may not exceed the deficit of the development budget of the local budget

Figure 5: Distribution of transfers from the National Budget to local budgets in 2019



Source: Source: Ukrainian State Treasury

increased revenues from PIT.

Significant changes have also taken place in the local taxation system. First, the rights of local governments to set tax rates and privileges on local taxes and fees have increased.¹⁸ Second, the property tax now includes tax on commercial and non-residential property. In addition to this, the Tax Code has actually introduced a new type of the local tax: 5% excise tax on the value of tobacco products, alcoholic beverages and petroleum products sold on the local government territory. In 2014, (prior to the reform), revenues from local taxes and fees

for the relevant year; funds from local debt may go only to fund the development budget of the relevant local budget; debt service expenditures may not exceed 10% of the local budget during any period when the service of the debt is planned; the overall amount of the local debt and the debt guaranteed by the city territorial community may not exceed 200% (for the city of Kyiv – 400%) of the average annual indicative projected development budget revenues. In 2019, city councils issued 41 local debts of the amount of 61.6 million Euros.

¹⁸ Report. Local government reform at the sub-national level and local government finance in Ukraine: 2014 - 2018. Tony Levitas, Jasmina Djikic. SKL International/SIDA. October 2019 <http://sklinternational.org.ua/wp-content/uploads/2019/11/PolicyBrief-UKR-FINAL.pdf>

2.3 Political, administrative and territorial decentralisation reform

During the first phase of the decentralisation reform in 2015, the Verkhovna Rada of Ukraine approved the Law "On Voluntary Consolidation of Territorial Communities"¹⁹, which outlined the procedures for consolidation of territorial communities on a voluntary basis. At the same time, the parliament approved amendments to the budget legislation. According to these amendments, the powers of rayon councils and rayon state administrations (elementary and secondary education, primary and secondary health care, social protection, housing and municipal utilities, local transportation and territorial planning) and the corresponding financial resources were devolved to village, town and city councils elected in the consolidated territorial communities and their executive bodies.

In 2015 - 2019, a total of more than 4,700 communities got voluntarily consolidated creating 980 new territorial communities.²⁰

In 2018, the parliament amended the law on community consolidation, whereby cities of oblast significance received an opportunity to voluntarily consolidate with the adjacent rural territorial communities. In this way, smaller territorial communities got an opportunity to become equal to cities of oblast significance in terms of their finance and scope of powers. Aiming at supporting consolidated territorial communities, the National Budget provided a subsidy in 2016 - 2019 for the development of their infrastructure. This subsidy was distributed among territorial communities depending on the number of rural population and the total area of the community. However, the increase in the amount of this subvention from UAH 1 billion (35 million Euros) in 2016 to UAH 2.1 billion (79 million Euros) in 2019 was not proportional to the growth in the number of consolidated territorial communities (159 in 2015 and 806 in 2018).²¹

During 2014 - 2019, state support for local and

regional development (capital expenditures) significantly increased due to the increase of the amount of the subsidy for social and economic development, the National Regional Development Fund, introduction of a new subvention for construction, and maintenance and repairs of local roads. However, the distribution of these funds between regions took place on a case by case basis and was focused primarily on the rayon and oblast level.

In 2020, a new phase of decentralisation reform started. On April 16, 2020, the Verkhovna Rada of Ukraine approved Law of Ukraine # 562-IX, which vested the Cabinet of Ministers with the powers to approve territories of territorial communities and designate their administrative centers. These territories will represent the basis for election of local government bodies at the basic level, such as: village, town and city councils and the relevant village, town and city mayors during the local elections on October 25, 2020. And already on June 12, 2020, the Cabinet of Ministers issued a directive to approve the territories of 1,470 territorial communities and their administrative centers including those on the occupied territories of the Donetsk and Luhansk oblasts, but not in the Autonomous Republic of Crimea. Prior to the reform, there were 11,250 territorial communities on these territories.

On July 17, 2020, the Verkhovna Rada of Ukraine approved the Resolution on the formation of 136 new rayons embracing the territories of the "former" 490 rayons and 187 cities of oblast significance. The decision of the formation of the new rayons covers also the occupied territories of the Autonomous Republic of Crimea and the Donetsk and Luhansk oblasts.

On July 16, 2020, the Verkhovna Rada of Ukraine significantly changed the election legislation, according to which local elections will take place on October 25, 2020 (Law of Ukraine "On Amendments to Certain Laws of Ukraine on Improving the Election Legislation" (# 3485). In particular, the law has introduced the following:

- party system of elections in territorial

19 Law of Ukraine "On the Voluntary Consolidation of Territorial Communities" # 157-VIII of February 05, 2015

20 Monitoring of the decentralisation process and local government reform. MinRegion. January 10, 2020, Link.

21 Idem, According to the data of the State Treasury

communities with a number of more than 10 thousand voters (used to be 90 thousand and more). Such a system will cover the area with 80% of the population;

- "imperative" representative mandate for local councils members (local council member can be recalled by a decision of the party if his/her activity is not in line with the party program or its local offices, or he/she has failed to join the party faction or was expelled from it);

- the upfront cash deposit for participation in elections of local council members and mayors in the populated areas with the

number of voters of 10 thousand and more has been reduced 9 times in comparison with the current system. However, such deposit remains too high for cities of oblast significance. For example, the cash deposit for the position of the Kyiv city mayor or for the party that has nominated its list of candidates to the Kyiv City Council is 445 thousand UAH or 15 thousand Euros; before the amendments this amount constituted 4 million UAH or 133 thousand Euros; and,

- a new system for determining the winners among candidates for the local council from the party list.

LOCAL GOVERNMENT BODIES AND THEIR KEY AREAS OF RESPONSIBILITY

<ul style="list-style-type: none"> • Health care (tertiary level – highly specialised and emergency medical care) • Education (specialised pre-higher, vocational, specialised schools) • Culture (theatres, cultural oblast level facilities) • Sport (specialised sport schools, oblast level facilities) • Social protection (boarding schools) • Regional development 	<p>24 oblast councils representing common interests of territorial communities of the oblast</p>	<p>24 oblast councils representing common interests of territorial communities of the oblast</p>
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136 rayon councils*

<ul style="list-style-type: none"> • Health care (secondary level – specialised hospitals, primary level – out-patient facilities and polyclinics) • Education (pre-school, secondary, extra-curricular) • Culture (clubs, houses of culture, libraries) • Sport (stadiums, sport schools) • Social protection (social protection, social services) • Local economic development • Housing and municipal utilities, urban beautifications 	<p>488 rayon councils representing common interests of territorial communities of oblasts</p> <p>187 city councils of cities of oblast significance and their executive bodies</p>	<p>Additionally, 980 village, town and city councils of territorial communities, which got consolidated in a voluntary manner</p>	<p>1,470 village, town and city councils** whose local elections will take place on October 25, 2020</p>
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<ul style="list-style-type: none"> • Housing and municipal utilities • Urban beautifications 	<p>278 city councils</p> <p>783 town councils</p> <p>10.278 thousand village councils and their executive bodies</p>	<p>4.7 thousand territorial communities got consolidated in a voluntary manner into 980 territorial communities</p>
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Functional responsibilities

2014

Phase of voluntary community consolidation 2014-2019

Administrative and territorial reform, 2020

Notes:

- 1.The administrative and territorial arrangement of Ukraine is complicated and not streamlined. It has a number of peculiarities on certain territories: 2 rayons comprising village and town councils are subordinated to cities of oblast significance (such rayons do not have rayon councils); 58 city councils of cities of oblast significance have 184 village, town and city councils subordinate to them
- 2.Rayon and oblast councils do not have executive bodies.
- 3.The 2014 data include ARC, city of Sevastopol and parts of the Donetsk and Luhansk oblasts under the occupation of the Russian Federation
- 4.This chart does not include local government bodies of the city of Kyiv and Sevastopol with their special status.

* rayon councils will continue to perform powers in case the latter are transferred from the basic level upon the decision of village, town and city councils
** including the 187 cities of oblast significance

2.4 Intergovernmental dialogue and coordination

The Law “On Associations of Local Self-Government Bodies”, which entered in force in 2009, outlines the following mechanisms for interaction between state bodies and local government bodies and their associations: conducting consultations and providing expert opinions on draft regulatory and legal documents. Once a year, all-Ukrainian local government associations participate in budget consultations with the Ministry of Finance. These consultations are conducted in order to prepare the National Budget for the coming year. In addition to this, one should mention the DIALOGUE Day with central government authorities taking place within the framework of the municipal forum, which takes place on an annual basis and is conducted by the AUC²². The framework of this event includes meetings with the Cabinet of Ministers, leadership of the central state executive authorities, National Deputies of the Verkhovna Rada of Ukraine and local government bodies. Also, the AUC participates in meetings of the Cabinet of Ministers and its Government Committees with the right to advisory vote. Central state executive authorities send draft regulatory and legal documents to all-Ukrainian local

government associations for concurrence, if these acts deal with issues of local importance.

The AUC takes an active part in the reform, both during the phase of legislation drafting and in its subsequent implementation. The Concept of the local government reform, amendments to the budget and tax legislation, and the law on voluntary consolidation of territorial communities were prepared with the participation of AUC experts. In 2015, the AUC, Ministry of Regional Development and the Council of Europe signed a Memorandum to unite the efforts for implementation of the local government reform and decentralisation. The AUC set up regional reform offices in each oblast for implementation of this Memorandum. These offices stimulated the process of voluntary consolidation, provided clarifications for communities and local government officials, technical and consultative assistance to communities on their way to consolidation, and to local governments of the established communities during the implementation of their powers. Now, AUC experts are actively involved in discussion of amendments to the Constitution of Ukraine with regard to decentralisation, which will enshrine the achievements made.

²² <http://auc.org.ua/novyna/xv-ukrayinsky-municipalny-forum-v-odesi-sogodni-den-dialogu-z-vladoyu>

3 MAIN ACHIEVEMENTS, CHALLENGES AND OPPORTUNITIES

The main achievements and opportunities are:

- a new administrative and territorial arrangement has been formed at the community and rayon levels, which should serve as the basis for the formation of local governments capable of providing high quality services;
- the phase of voluntary consolidation of territorial communities in 2015 - 2019 helped the Cabinet of Ministers to endorse a decision on the administrative consolidation of all territorial communities;
- territorial communities, which voluntarily united in 2015 - 2019, have received the powers and financial resources cities of oblast significance have;
- during the period of 2014 - 2019 local budgets (excluding transfers) increased from 5.3 billion Euros to 11.4 billion Euros;
- territorial communities have received a new incentive model of financial equalisation of tax capacity of territories and local governments have become more interested in increasing their own revenue base, attracting additional revenues and expanding the existing tax base. After the introduction of this equalisation system, local budget revenues from this tax in 2015 - 2019 tripled (from 2.1 billion Euros to 6.3 billion Euros);
- the amount of local taxes and fees in 2019 already reached 27% of all local government tax revenues; and,
- opinion polls show the improvement of public attitudes to reforms, including fiscal decentralisation. The 2015 survey demonstrated that 19 percent of respondents said that fiscal decentralisation brought positive changes in their localities. In 2018, this share increased to 39.5 percent. That same year, 22% of respondents said they had heard about positive changes in other localities and expected similar improvements where they lived²³.

Challenges:

- threats of curtailment of local democracy, centralisation (for example, promotion of amendments to the Constitution to strengthen central executive bodies);
- centralised regulation of local government matters; all key issues are regulated by law, while the community charter plays a purely decorative role;
- excessive dependence on parties during the formation of local councils;
- newly elected local council members and chairmen lack managerial experience (in 2020, the composition of councils and their chairmen will be renewed, the basic level of local self-government will be enlarged and will receive new powers);
- lack of a well-coordinated management system of the new territories (necessity of establishing a new local government executive including sectoral ones);
- insufficient professional level of many employees; lack of an effective system for their training and competence development, also because of lack of experience and resources;
- lack of possibility to plan local budgets (constant change in the local government financial and tax base);
- lack of an established legislative framework for exercising new powers of local government bodies at the basic [community] and rayon levels;
- lack of division of powers between the new community, rayon, and oblast levels (given their consolidation);
- low professional level of the preparation of laws and government regulations. The pace of decision-making in the Verkhovna Rada and Cabinet of Ministers provokes legal conflicts.

²³ Council of Europe (2019), 'Reports: annual national opinion polls on decentralisation and local self-government reform', 4 March 2019, <http://www.slg-coe.org.ua/p16423/?lang=en> (accessed 5 Aug. 2019).

4 INTERNATIONAL COOPERATION FRAMEWORK

4.1 International cooperation and assistance at the local level

The international community has been continuously supporting decentralisation reform and has allocated significant resources for its implementation throughout the country. Such international technical assistance will be most effective and efficient in the context of a clear coordination between the Ministry of Community and Territorial Development of Ukraine and the donor and international development partners of Ukraine that support local government reforms in Ukraine. The Decentralisation Donor Board established at the Ministry of Regional Development in 2017 has become one of the tools for such coordination. This is a coordination platform where the Ministry and representatives of donor agencies, international diplomatic missions in Ukraine and international organisations discuss and coordinate their activities to implement the reform trying to have best synergies in achieving the relevant results. The Board of Donors also operates in the format of the relevant Working Groups set up in accordance with the main technical areas of the reform. The organisational support for the work of the Donor Board and its Working Groups is provided by the Donor Board Secretariat.

The Results Framework of Decentralisation in Ukraine prepared in December 2016 - April 2017 by the Ministry and the entire donor community serves as a roadmap for joint activities to support the reform and its specific results. It helps the Government and international partners to jointly monitor and evaluate the results of the reform, as well as to effectively coordinate the implementation of international projects and programs. Since late 2018, this Matrix has entered the automatic mode, which provides opportunities for international technical assistance projects and programs to fill it independently, track the relevant changes

in the reform, and make steps to ensure its effectiveness.

The biggest international donor programs and projects in Ukraine supporting the decentralisation reform include: "Support to Decentralisation Reform in Ukraine/U-LEAD with Europe (supported by GIZ); Ukraine: Local Empowerment, Accountability and Development" (funded by the European Union and its member states, such as: Denmark, Estonia, Germany, Poland and Sweden); Decentralisation Offering Better Results and Efficiency (DOBRE) (funded by USAID); Council of Europe Program "Decentralisation and Local Government Reform in Ukraine"; "Policy for Ukraine's Local Self-Governance" -PULSE (funded by USAID) and many others.

4.2 Review of the framework for international cooperation

The national legislation does not define the framework of international cooperation for local governments.

Cross-border cooperation and the formation of the Eurozones and Euroregions

Ukraine shares borders with seven countries and 19 of its 27 administrative and territorial units are border regions. Nine Euroregions have been established on the territory of such border regions as Vinnytsya, Volyn, Zakarpattia, Ivano-Frankivsk, Lviv, Luhansk, Odessa, Sumy, Kharkiv, Chernivtsi, Chernihiv, and Donetsk, namely: Buh, Verkhniy Prut, Dnister, Dnipro, Karpatskyi, Lower Danube, Slobozhanshchyna, Donbas and Yaroslavna including five Euroregions with EU member states (Poland, Slovakia, Romania, and Hungary). Currently, cross-border cooperation in Ukraine is considered in two senses: as a tool for the development of border areas and as a factor for the implementation of European integration aspirations.

In Ukraine, the cross-border cooperation as a tool for increasing competitiveness of border

areas and a factor for accelerating integration processes has been reflected in the National Regional Development Strategy for the period till 2020 and the National Program for Cross-Border Cooperation for 2016 - 2020. The Cabinet of Ministers has approved the National Program for the Development of Cross-Border Cooperation for 2016 - 2020. This program outlines: priority areas and main tasks for the development of cross-border cooperation for 2016 - 2020; the mechanism for its implementation; scope and sources of funding. The Program will be implemented through a set of cross-border cooperation activities and projects, which are likely to receive the financial support from the state. The program envisages the implementation of 25 cross-border cooperation projects aimed at infrastructure development in border regions of Ukraine and environmental protection. For example, the Ukrainian city of Lutsk together with the municipality of the Polish city of Chelm is implementing the project under the title: "Improving the safety of cross-border road infrastructure of Chelm and Lutsk", which is implemented under the 2014 - 2020 Poland-Belarus-Ukraine Cross-Border Cooperation Program of the European Neighborhood Instrument.

Sister cities

The cooperation between cities of Ukraine and other countries takes place through exchanges of delegations, artistic and sport groups, exhibitions, as well as through literature, movies, and photos about life in cities. Exchanging experience in municipal management is also of equally importance. For example, the city of Odessa has 34 partner cities and, Dnipro has 8 sister cities,

and Kyiv has ties with more than 54 cities abroad. For example, the city of Vinnytsya has received more than one hundred trams within the framework of the Zurich Trams for Vinnytsya Project. Since 2019, Uzhgorod and the Romanian sister city of Satu Mare have been implementing the project under the title: "Ensuring public safety through cooperation of law enforcement agencies and using advanced video surveillance systems in Uzhgorod and Satu Mare".

International cooperation of municipal associations

The Association of Ukrainian Cities and the Ukrainian Association of Rayon and Oblast Councils represent the interests of Ukrainian communities through their membership in the Council of European Municipalities and Regions (CEMR). AUC is also a member of PLATFORMA which continues to support local government reform in Ukraine promoting an open and inclusive intergovernmental dialogue and consultation on decentralisation reform in Ukraine and by supporting AUC to strengthen advocacy efforts and capacities.

International technical assistance

In 2019, more than 60 international technical assistance projects were implemented in Ukraine whose recipients are local governments or municipal associations. For example, thanks to the financial support from the EU, the largest investment project in Luhansk Oblast for reconstruction of the main water supply system was implemented. The title of the Project was: "Improving access to water in the conflict-affected community of Kreminna".

5 NEXT STEPS FOR REFORM

The key next steps for local government reform over the period 2020-2025 include:

- Final approval of amendments to the Constitution of Ukraine, which should enshrine the new principles of local self-government and administrative and territorial arrangement of the state;
- Preparation and approval of the laws of Ukraine "On Local Self-Government" and "On the Administrative and Territorial Arrangement of Ukraine" on the new constitutional basis;
- Redistribution of powers between rayons and oblast councils and local government bodies according to the principle of subsidiarity;
- Setting up own executive bodies of rayon and oblast councils, which will execute, respectively, rayon and oblast budgets, plans of territorial development of rayons and oblasts, and will manage infrastructure facilities at the rayon and oblast levels;
- Matching the number of sectoral subsidies for local budgets for implementation of powers delegated by the state according to actual needs based on social standards of services and their cost standards; preparation and implementation of such standards and regulations by line ministries;
- Ensuring ubiquity of local self-government by transferring state-owned lands to the ownership of capable territorial communities, extending the jurisdiction of councils of capable communities to all lands within their administrative boundaries (currently, the powers of local governments to manage land are limited by the boundaries of populated areas);
- Approval and implementation of the new Law of Ukraine "On Service in Local Government Bodies"; ensuring competitiveness of local government bodies on the labor market of skilled workforce;
- Full coverage of territorial communities with administrative services through Centers for Administrative Services (Tsnaps), development of electronic services, SMART-CITY;
- Consultative support to newly established local governments; training of their employees in proper performance of the new tasks including the preparation of local development projects;
- Development and introduction of an effective system for continuous competence development of employees of all local government bodies; and, ensuring strategic development and planning in territorial communities including their budgets.

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The aim of this Status Report, carried out by AUC, is to provide an overview of the status and development of decentralisation and local public administration reform in Ukraine and support informing an open and inclusive intergovernmental dialogue and next steps for the decentralisation and local government reform in Ukraine.



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