

## ASSESSMENT OF THE SYSTEM OF ALLOCATION OF SUBVENTIONS AND SUBSIDIES AND THEIR IMPACT ON THE DEVELOPMENT OF RURAL TERRITORIES

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### **Abstract**

*It was found that a rapid decrease in the population, monopolization of agricultural and other production in rural areas leads to a decrease in local budget revenues, which makes it impossible to maintain its own infrastructure at the proper level. It is proved that rational, aimed at the economic development allocation of subventions and subsidies, their distribution among rural communities, and the most important areas of funding will solve this problem. In view of this, the system of distribution of subventions and subsidies funds of the Ukrainian government for local budgets between the UTCs budgets and expenditure purposes (only UAH 1 billion or 2.8% of the total funds is spent on the development of UTCs) is analysed. It is substantiated that the system of allocation of subventions and subsidies and their distribution among rural communities have a positive impact on the change of indicators of sustainable development of rural territories. We propose a methodology for calculating the necessary level of average annual growth of the community budget in order to reach the current level of expenditures by own revenues. Taking into account the results obtained, it is found that for most communities budget revenues have to grow 6.9-10.0% annually, the financing of programs of economic development of the UTCs will require a significant increase, which will allow communities to achieve economic growth.*

**Key words:** *subventions, subsidies, rural areas, sustainable development indicators, local budgets, economic development programs, local self-government*

### **INTRODUCTION**

Nowadays the process of decentralization and associated formation of united territorial communities in rural areas is continuing in Ukraine. Undoubtedly, the priority in the implementation of decentralization of power is given to the redistribution of most powers in the management of finance and natural resources within the territories of territorial communities. Local community social and technical infrastructure management is transferred to the communities of rural areas, so they have to finance the construction and maintenance of this infrastructure in an appropriate condition. In other words: more power freedom – more financial responsibility. The goal of decentralization is

to create the right preconditions for the formation of self-sufficient communities. 876 united territorial communities were already formed (stand 10.01.2019) [9].

The overall dynamics of the formation of united territorial communities in 2015-2018 is generally stable and amounts to more than 200 UTCs per year on average. This process is set up in 2015, which resulted in the creation of 159 UTCs, and in 2016 another 207 was added. In order to more effectively assess different aspects of community development, we chose some communities, which have been formed in 2015-2016, as statistics for them is available for longer period (2016-2018).

The Government of Ukraine presents processes of decentralization of power and the

formation of united territorial communities, that is, the unification (consolidation) of existing village, settlement and city councils as a single process. There is a denial: legally it is worth dividing these processes. After all, financial and fiscal decentralization and the expansion of managerial powers, in our opinion, are crucial components of the reform and in no way depend on the process of uniting communities from the legal point of view. This is confirmed by the fact that amendments to the Budget and Land Codes of Ukraine, other laws are equally valid for both UTC and village, settlement and city councils. However, a rapid decline in the population of rural regions, monopolization of agricultural and other production leads to a decline in local budget revenues. It is a pity, but under such circumstances it is impossible to maintain its own infrastructure at the proper level. The reality of the situation has prompted the Cabinet of Ministers of Ukraine (CMU) to determine the procedure for granting subventions to the newly formed UTCs for the development of infrastructure within the territories of newly formed communities (Cabinet of Ministers of Ukraine Resolution № 200 of 16.03.2016 was adopted) [3].

This decision is intended to stimulate the process of community consolidation, since the subventions provided by the Government of Ukraine will serve as a significant replenishment of the community budget. However, subventions are distributed among communities in pre-determined amounts, but community funding can only be provided for the implementation of specific projects or can be used only with specific purpose.

**The purpose of our case study** is to provide a general analysis of the allocation system of subventions and subsidies, their distribution among rural communities, and the most important areas of financing, and then determine if they have a positive impact on the change of indicators of sustainable development of rural areas, and to calculate, according to the method proposed by us, the necessary average annual level growth of the community budget in order to reach the

current level of expenditures by own revenues.

In the process of studying the existing experience, we have **reviewed the literature** on rural development and analysed the main factors contributing to the development of the rural territories.

Hohol T. (2011) in her work is studying the multifunctional development of rural areas, which concludes the need to avoid a dominance of employment of rural areas inhabitants in the agricultural sector [5]

Malik M. and Pulim V. (2009) in their study of the development of rural areas come to the conclusion that it is necessary to build a concept of development around the development of entrepreneurship and strengthening the role of local self-government [6].

John Bryden (2011) in his work defines the main indicators of the development of rural territories used in the European Union, describes their evolution and analyses their effectiveness [2].

## MATERIALS AND METHODS

During this study, we used the data of state statistical reporting, legislative acts, materials of other scientific studies, tangent to the chosen direction of research. In particular, materials for monitoring the process of decentralization of power and local self-government reform, which is being carried out by the Ministry of Regional Development, Construction, Housing and Communal Services of Ukraine [9]. This monitoring is a unique source of statistical data, on the basis of which a large amount of information concerning the process of decentralization of power can be analysed.

We have acquainted in detail with the practice of subvention distribution system and its influence on the formation and development of the infrastructure of the united territorial communities in 2016-2017, carried out by the office of financial and economic analysis of the Verkhovna Rada of Ukraine [11]. The effectiveness of the study was influenced by the information on the assessment of financial sufficiency of 366 UTCs in 2017, carried out

with the support of the program "U-LEAD with Europe" [8].

In the worked-out materials the importance and necessity of allocating subventions for the formation of the UTC infrastructure and its economic development is indicated.

Based on this, we have analysed the system of distribution of funds between UTCs in the framework of providing subventions, the effectiveness of their use and use of other types of financial assistance to communities, which is transferred from the state budget, as well as the share of these subsidies in the community budget.

For this purpose, the following indexes are selected for our calculations: UTC area, UTC population, community budget, share of subsidized funds (including subventions), own budget revenues, expenditures per inhabitant. The goal is to calculate the necessary growth level of own budget revenues for the next 5 years in order to achieve self-sufficiency, in other words to cover the current level of expenditures by own revenues. In our analysis we paid attention to the communities that are trying to fill local budgets by themselves, so the growing ones, and depressive ones. An important aspect in the analysis is to determine whether there is a possibility of using subventions and other subsidies for development, rather than for maintenance.

In order to calculate the necessary level of growth of own budget revenues for the next 5 years in the community, we determine the share of subsidies in its budget, which are received through state funding programs of the UTCs, and accordingly are not protected by legislative requirements (such as road funds) and we calculate the rate of compound interest, as we know a value of budget revenues (with the exception of subventive and subsidized funds received under the programs of the Cabinet of Ministers of Ukraine), the current level of budget expenditures, which we want to achieve in defined period of time. This value must be achieved within 5 years. That is why the inverse formula for calculating a compound interest is used. We propose to calculate the necessary annual growth of the budget revenues using to the following formula:

$$i = \sqrt[n]{\frac{B'}{B}} - 1 \quad (1)$$

where:

$i$  – average annual growth of own budget revenues;

$B'$  – necessary amount of own budget revenues at the end of the period (current budget expenditures);

$B$  – existing level of own budget revenues;

$n$  – number of years;

The size of the subventions and other subsidies provided to each community in accordance with the Resolution of the Cabinet of Ministers of Ukraine № 200 of 16.03.2016 is determined by the following formula:

$$V' = Vx\left(\frac{X'}{X} + \frac{Y'}{Y}\right)/2 \quad (2)$$

where:

$V'$  – volume of subventions of the united territorial community;

$V$  – total amount of subventions distributed between UTCs;

$X'$  – number of inhabitants in rural united territorial community;

$X$  – number of inhabitants in all rural united territorial communities;

$Y'$  – area of territory of the united territorial community;

$Y$  – area of territory of all united territorial communities [3].

That is, subventions and other subsidies for rural areas are allocated according to the size and number of populations of the united territorial communities established in rural areas.

## RESULTS AND DISCUSSIONS

Based on the achievements of Ukrainian and European scholars, we have identified the most important indicators of local self-government development in Ukraine and their financial strength. For the formation of a list of indicators in particular the works of John Bryden were also used, as they are marked by the depth of research and informativity. We believe that the defining indicators of rural development are:

- Multifunctionality and diversification of production;
- Business activity growth;
- availability of programs to support the initiatives of the local people;
- availability of jobs;
- social and environmental safety;
- social and technical infrastructure;
- autonomy (financial, energy production, water supply...);
- tourism development in the region (community).

To improve these indicators, both local self-government bodies and the government of Ukraine should wisely use the available programs of financing the development of united territorial communities.

The Cabinet of Ministers of Ukraine, through a system of subventions and subsidies, provides funds for development of the united territorial communities. The total amount of financing planned by the Cabinet of Ministers is ₴35.45 bln (€1.10 bln) [9]. We used the exchange ratio of 32,14 ₴/€ (UAH/EUR) as an average ration in 2018 based of statistical data of National Bank of Ukraine [10]. The distribution of these funds accordingly to funding programs and, the purpose of funds is shown in Fig.1.

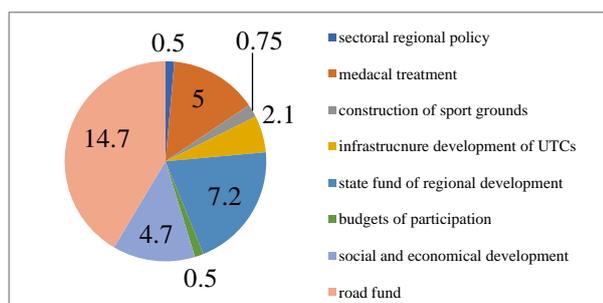


Fig.1. Distribution of funds of the state budget according to the programs of state financing (purpose), UAH bln.

Source: Ministry of Regional Development, Construction, Housing and Communal Services of Ukraine (stand 10.01.2019).

It should be noted that the funds allocated from the road fund are protected by the law of Ukraine "On sources of financing of roads of Ukraine", so they have to be transferred to the local budgets and therefore, when estimating the potential growth of the budget for a certain period, will not be considered as additional

financing, which must be compensated by an increase in communities own budget revenues [12]. The vast majority of other local budget expenditures, which are covered by government subventions and subsidies according to the goals of reform, should in the long run be covered by own revenues of local budgets.

Analysing the available statistical information, we noticed that the growth of subventions and subsidies total volume is not proportional to the growth of the number of formed united territorial communities in terms of years. For example, let's take a look at the volume dynamics of the subvention for the development of the UTCs infrastructure for 2016-2019 (Fig. 2), as well as the dynamics of the growth of the number of united territorial communities (Fig. 3). Data for 2019 is a forecast of CMU [9].

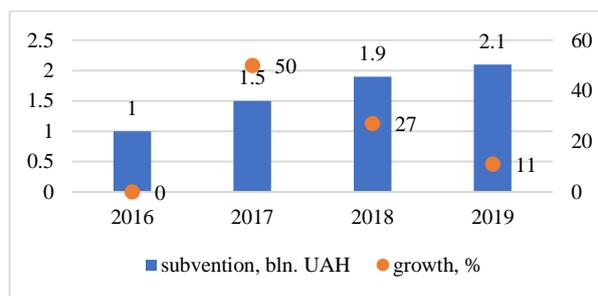


Fig.2. Volume dynamics of the subvention for the development of the UTCs infrastructure for 2016-2019  
 Source: Ministry of Regional Development, Construction, Housing and Communal Services of Ukraine (stand 10.01.2019).

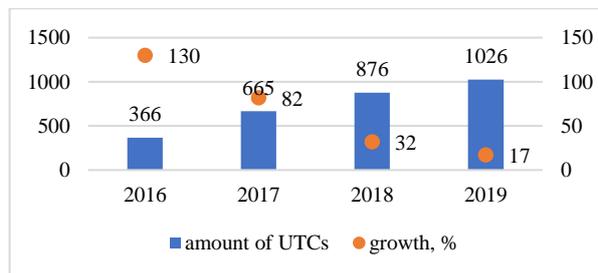


Fig.3. Dynamics of the growth of the number of united territorial communities for 2016-2019  
 Source: Ministry of Regional Development, Construction, Housing and Communal Services of Ukraine (stand 10.01.2019).

The increase in the number of UTCs exceeds the increase of the subventions volume. It means that the amount of the subventions for the development of UTCs infrastructure per community decreases each year, namely

decreasing from €2.73 mln. in 2016 to €2.05 mln. in 2019 (forecast). Taking into account the recently registered draft law of Ukraine number 8,213 we can see, that after 2019 and within the next five years the size of the state subvention for the formation of the infrastructure of the UTC will decrease annually for five years. Other subventions and subsidies from the state budget will suffer the same fate [4]. That is why we decided to calculate for the necessary annual growth of the UTCs budgets, which will allow to bring its own revenues to the level of current expenses in five years. It is important to note that budget transfers from the road fund will be taken into account as community own

revenues. The subsidy for roads construction and maintenance is about 42% of the total amount of subventions and subsidies transferred to local budgets.

The results of our calculations are given in Table 1. Communities are given and this study was selected on the following criteria:

- not more than one community from each oblast;
- formed in 2015 or 2016;
- rural communities with an administrative centre in one of the villages of the community;
- population from 3 to 15 thousand people (to increase representativeness and to avoid extreme values).

Table 1. Assessment of Necessary budget revenues annual growth of selected communities

United territorial community name and oblast name	Area of UTC, km <sup>2</sup>	Population, thousand	Density, people/ km <sup>2</sup>	Community budget, mln. UAH	Community budget per citizen, ths. UAH	Subventions and subsidies		Road fund (~42%), mln. UAH	Community budget without subventions and subsidies (excluding road fund)		Budget without subventions and subsidies per citizen, ths. UAH	Necessary budget revenues annual growth, %
						mln. UAH	%		mln. UAH	%		
						Sokolivska UTC Kirovohradska obl.	214.4		6.2	29		
Bilokorovytska UTC Zhytomyrska obl.	110.1	6.0	54	37.0	6.2	20.1	54.3	8.4	25.3	68.5	4.2	7.9
Ozernianska UTC Ternopil'ska obl.	126.8	6.3	50	38.2	6.1	24	62.8	10.1	24.3	63.6	3.9	9.5
Rozsoshanska UTC Khmelnytska obl.	147.9	5.0	34	53.0	10.6	10.5	19.8	4.4	46.9	88.5	9.4	2.5
Velykokopaniivska UTC Kherson'ska obl.	112.9	7.1	63	60.0	8.5	37.0	61.5	15.5	38.5	64.2	5.4	9.3
Zymnivska UTC Volyn'ska obl.	175.0	5.4	31	44.8	8.3	24.4	54.4	10.2	30.6	68.4	5.7	7.9
Krasnosil'ska UTC Odeska obl.	246.6	11.0	45	123.3	11.2	41.5	33.7	17.4	99.2	80.5	9.0	4.4
Velykokuchuriv'ska UTC Chernivetska obl.	103.1	13.8	134	80.7	5.8	52.8	65.4	22.2	50.1	62.1	3.6	10.0
Shakhiv'ska UTC Donetsk obl.	231.8	3.0	13	62.4	20.8	9.8	15.7	4.1	56.7	90.9	18.9	1.9
Prybuzhaniv'ska UTC Mykolaiiv'ska obl.	363.6	8.1	22	56.7	7.0	27.7	48.9	11.6	40.6	71.7	5.0	6.9

Source: Ministry of Regional Development, Construction, Housing and Communal Services of Ukraine (Stand 01.02.2018), Ministry of Finance of Ukraine, state budget portal (Stand 03.02.2018) and calculations of authors.

In most of the communities selected for analysis, the budget for a single local resident is at a low level and amounts 6 to 11 thousand UAH. The level of subsidization of

communities varies considerably and ranges from 15 to 65%. This discrepancy is explained by the fact that on the territory of Shakhiv'ska and Rozsoshanska communities there are

enterprises that have been operating since the Soviet era and, accordingly, the subsidization of the budgets of these communities is 15 and 20%. The budgets of eight other communities are subsidized by 1/3-2/3, or an average of 51%, that is, they are able to cover only about a half of their expenditures on their own.

But the main goal of our calculations is to determine the necessary annual increase in budget revenues in order to reach a self-sufficient level in five years. Of the total number of communities, Shakhivska, Rozsoshanska, Sokolivska and Krasnosilka require an average annual growth of budget revenues of 1.9-4.4%, which in Ukrainian

realities is rather stagnant than rapid development, therefore, this situation is not a big economic challenge for them. As for other communities, the average annual growth expected for them is 6,9-10,0%, so they need a truly stable high growth of the domestic economy.

The next step was to analyse budget expenditures of the selected UTCs in order to assess how they use their available resources and whether they are aimed at improving the rural development indicators identified in this article. Average expenditures of budgets of selected 10 UTCs in percent are shown on Fig. 4.

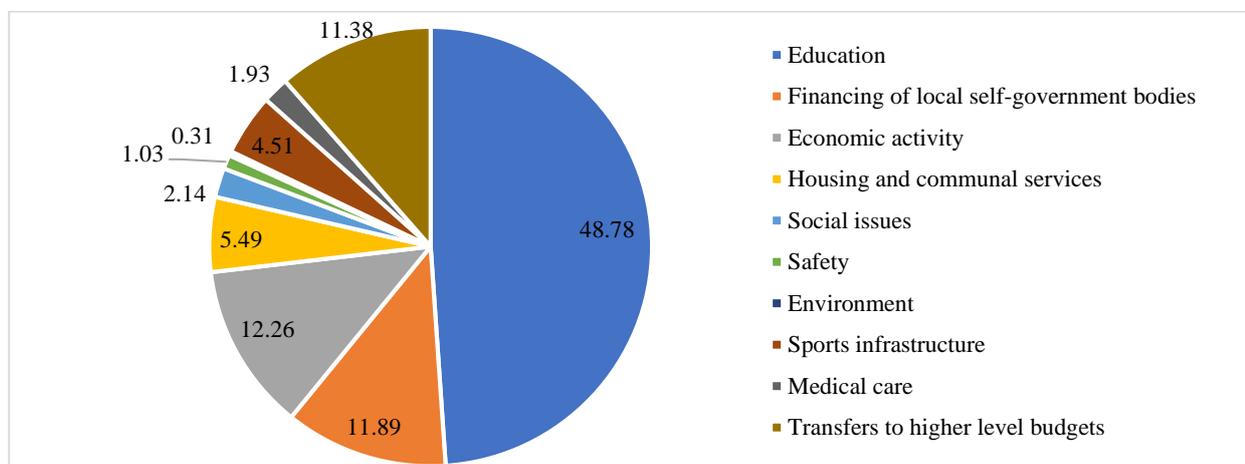


Fig.4. Average expenditures of budgets of selected 10 UTCs in percent  
 Source: Ministry of Finance of Ukraine, state budget portal (Stand 03.02.2018) and calculations of authors

In all communities, except Rozsoshanska, educational expenditures (kindergartens and schools) have the biggest share, which is an average of 48.78%. The subvention for educational expenditures at the moment is quite a significant part of the subventions and subsidies, because before the implementation of the decentralization reform educational activities financing was carried out from the state budget and therefore, without additional support, most of the communities are not able to independently fund kindergartens and schools for the time being. The cost of own economic activity is on average 12.26%, all the other expenses are aimed essentially at maintaining the social and technical infrastructure of the UTCs [7].

It should be noted that the deficit of the budget of the communities is directly proportional to the share of expenditures on

education and financing of local self-government bodies and is inversely proportional to the share of expenses for own economic activity. Transfers to higher level budgets mainly relates to health, safety and environmental measures that are co-funded by several communities through a higher level budgets. That is why these expenditure items have such a low share (Fig. 4).

Consequently, measures that would contribute to the improvement of rural development indicators are practically not implemented, therefore hoping for economic development and growth of budget revenues for communities is useless. Communities are not able to independently finance measures to diversify production on their territory, there are no funds for business development, lack of skills in attracting investors, and therefore it is difficult to create new jobs. There are also no

opportunities for funding local people's initiatives and training local administrators.

According to Article 64 of the current Budget Code of Ukraine, the vast majority of local budget revenues are personal income tax, a single tax for entrepreneurs, payments for land and other real estate, excise taxes (fuel, alcohol, tobacco products) and corporate income tax [1].

That is why these measures should be financed from the state budget of Ukraine, as they will promote economic growth, entrepreneurship development and increase of workplaces, and in the long run also to the growth of population, which will lead to an increase in revenues to local budgets.

Fig. 1 shows the distribution of funds provided by the CMU to local budgets in the form of subventions and subsidies. We note that only 1 bln. UAH. (2.8%) of the total amount of 35.45 bln UAH is used for implementation of these measures (this is insignificant volume and is financed only by the residual principle). Although for the subvention aimed at social and economic development 4.7 bln. UAH is allocated, it is almost entirely spent on the maintenance of social infrastructure.

Thus, public funds are mainly aimed at building and maintaining existing social and technical infrastructure of communities (covering local budget holes) and almost do not promote diversification of production, creation of points of economic growth, development of entrepreneurship, increase of workplaces, training of local population and realization of their initiatives.

## CONCLUSIONS

As a result of our study, we analysed the system of distribution of funds, which are used as subventions and subsidies of the Ukrainian government between the budgets of the UTCs, as well as by their purpose. Only 1 bln. UAH or 2.8% of total funds is spent on the development of UTCs. Taking into account the results of our calculations, according to which most communities need to increase their budget revenues by 6.9-10.0% annually, financing of programs of economic

development of UTCs must be substantially increased. It is really necessary to direct the funds of the state budget directly to the development of the UTCs, and not to their maintenance, which cannot lead to active economic development.

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