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## FINANCIAL SELF-SUFFICIENCY OF RURAL COMMUNITIES IN UKRAINE IN THE CONTEXT OF ADMINISTRATIVE-TERRITORIAL REFORM (ON THE EXAMPLE OF LVIV OBLAST)

*SAMOWYSTARCZALNOŚĆ FINANSOWA SPOŁECZNOŚCI WIEJSKICH UKRAINY  
W KONTEKŚCIE REFORMY ADMINISTRACYJNO-TERYTORIALNEJ  
(NA PRZYKŁADZIE OBWODU LWOWSKIEGO)*

**Key words:** rural communities, financial self-sufficiency, administrative-territorial reform, local budgets, Ukraine

*Słowa kluczowe:* społeczności wiejskie, samowystarczalność finansowa, reforma administracyjno-terytorialna, budżety lokalne, Ukraina

**Abstract.** The paper aims at assessment of revenues of local budgets of rural communities in Ukraine under conditions of current administrative-territorial division. In order to perform an in-depth analysis on the local level the case of Lviv province (oblast) and its districts (rayons) is used, showing revenues of local budgets, aggregated at the level of rayons. Since the financial support of rural development is found insufficient, an analysis of current flaws in financing is conducted. Recommendations toward improvement of financial self-sufficiency of rural communities are offered, as well as for increase of their financial resources and development abilities in the process of upcoming administrative-territorial reform.

### Introduction

Development of rural areas is a complex issue, which cannot progress unless all of its components are functioning properly. Agriculture, non-agricultural economic activities, social services, infrastructure – all of these depend on efficient and realistic rural development policy and its responsible and consecutive implementation. One of the main objectives of rural development in Ukraine is the formation of efficient and optimal mechanism of financing, which would support the development of rural communities. An upcoming and long-discussed administrative-territorial reform in Ukraine is a chance to decentralize the financial flows and create an opportunity for endogenously triggered growth of local communities (unlike today, when local communities are depending on state budget to support them). Most of economically developed and developing countries have been active in decentralization and regionalization, thriving to make the local communities strong and sustainable, thus protecting the country from the negative influences of globalization.

The Article 24 of the Constitution of Ukraine [*Constitution of Ukraine... 1996*] states that Ukrainian citizens have equal constitutional rights and freedoms, as well as are being equal in the light of the Law. This means that all citizens of Ukraine, regardless of their place of residence, ethnic or social background, wealth or other features, should have the access to all the services guaranteed by the state. Yet in reality, execution of this right depends on many factors, one of the most influential being the inadequate financing and therefore financial inefficiency of local communities, primarily the rural ones. Currently rural communities are forced to depend on centralized financial support, which is usually insufficient in volume and inefficient in distribution, primarily due to many contradictions in supervisory and executive powers of two main authorities: local self-government and central state bodies.

An upcoming administrative-territorial reform is a chance to rebuild the system, including the division of authority and finances. A need for support of rural development is clear to most, yet the current system does not urge the local communities to be active, as well as does not aid them financially to the needed extent.

### **Material and research methods**

In order to analyze the financial situation and self-sufficiency of rural communities in Ukraine, the report on rural local budget execution of Lviv Regional State Administration for the year 2013 [*Report on rural... 2013*] was used. According to this data a comparison of different rayons of Lviv oblast is conducted, during which a typology of rural areas is used in order to group the rayons according to their economic or spatial peculiarities, thus showing common characteristics and problems. The typology is based on former investigations [Prytula et al. 2014], as well as on classification given by Pavlov [2011].

The theoretical grounds for research of administrative-territorial reform in Ukraine were based on the works of Storonianska [2014], Kozoriz and Vozniak [2011], who are for many years actively substantiating the solutions for existing issues with financial support of local rural communities and looking for ways to strengthen the self-governments and create the preconditions for efficient local development. The budgetary relations are deeply reviewed and grounded by Ganushchak [2012], who is one of the creators of budgetary reform in Ukraine, thriving to lay it on the principles of financial federalism and subsidiarity.

An elaboration on the current administrative-territorial division of Ukraine is needed to understand the definitions used in the article. The country is divided into oblasts (oblast is a largest administrative-territorial unit in Ukraine, there are currently 24 oblasts and an Autonomous Republic of Crimea), which then divide into rayons, which are later split into *selyshchni* and *silski rady* (these two are basically equivalent and differ only by the type of main settlement as their centre: *selyshchni rady* are created around “urban type village” and *silski rady* – around regular villages. Both of these can include from one to few villages under their authority and are the lowest level of administrative-territorial division in Ukraine. When a term “rural community” is used in Ukrainian scientific literature it reflects the level of *selyshchni* and *silski rady*).

### **Research results**

A precondition for creation of an efficient mechanism of financial distribution is the evaluation of financial abilities of rural communities, which would allow estimating the internal potential of analyzed regions.

Currently the main sources of financial support for the rural communities in Ukraine are the local budgets. Such local budgets always consist of two main parts: general and special funds. The general fund is formed by selected taxes, primarily from personal income tax (25% of which is directed to local budgets, the rest goes to state budget), land rent and unified tax for entrepreneurship activities. The special fund is formed of finances from various sources (including transfers from state budget, grants, donations, etc.), yet their use is limited to their particular assignments and they cannot be used otherwise. The separation of general and special fund is motivated by the need of stricter control over the use of available local budget finances. While the use of resources from general fund are more liberal and up to the local community, the use of special fund resources can be executed only for predefined goals. Formation of the special fund of local budgets demonstrates the high centralization in financing of local development, since all the expenses made from this fund are highly controlled by the state authorities. Still, these two components of local budgets are the total aggregated resources, available for the local development.

In order to understand the current situation of local rural financing and see the peculiarities of different rayons in generation of resources, let us analyze data of local budgets in Lviv oblast in Ukraine in the year 2013 (Tab. 1).

Table 1. Revenues of rural local budgets in Lviv oblast in 2013 (aggregated on the level of rayons)  
*Tabela 1. Przychody wiejskich budżetów lokalnych obwodu Lwowskiego w roku 2013 (zagregowane na poziomie rejonów)*

| Rayons/Rejony    | Revenue of general fund of local budgets/ <i>Przychody funduszu ogólnego budżetów lokalnych</i> |                                    | Revenue of special fund of local budgets/ <i>Przychody funduszu specjalnego budżetów lokalnych</i> |                                    | Total local budgets (general + special funds)/ <i>Razem budżety lokalne (fundusz ogólny + specjalny)</i> |                                    | Level of state subsidization of local budgets/ <i>Poziom państwowego dotowania budżetów lokalnych [%]</i> |
|------------------|---|------------------------------------|--|------------------------------------|--|------------------------------------|---|
|                  | thous. euro/ <i>tys. euro</i>   | euro per capita/ <i>euro/osoba</i> | thous. euro/ <i>tys. euro</i>  | euro per capita/ <i>euro/osoba</i> | thous. euro/ <i>tys. euro</i>  | euro per capita/ <i>euro/osoba</i> |   |
| Brodivskiyi      | 1552.16   | 25.49                              | 438.10   | 7.19                               | 1990.26  | 32.68                              | 79.2  |
| Buskyyi          | 1474.15   | 31.63                              | 422.09   | 9.06                               | 1896.25  | 40.69                              | 82.9  |
| Ghorodotskyyi    | 1405.05   | 20.16                              | 543.44   | 7.80                               | 1948.49  | 27.96                              | 80.7  |
| Droghobyt'skyyi  | 2030.34   | 27.33                              | 722.15   | 9.72                               | 2752.50  | 37.05                              | 89.7  |
| Kamyanka-Buskyyi | 1936.00   | 33.61                              | 1870.89  | 32.48                              | 3806.89  | 66.09                              | 67.8  |
| Mykolayivskyyi   | 2454.40   | 38.65                              | 772.13   | 12.16                              | 3226.53  | 50.81                              | 71.2  |
| Mostyskyyi       | 1373.71   | 23.89                              | 381.67   | 6.64                               | 1755.38  | 30.53                              | 82.9  |
| Peremyshlianskyi | 909.68  | 22.24                              | 201.67   | 4.93                               | 1111.35  | 27.17                              | 83.4  |
| Pustomytivskyyi  | 4329.30   | 38.72                              | 2353.11  | 21.05                              | 6682.41  | 59.77                              | 70.2  |
| Radekhyivskyyi   | 2088.24   | 42.62                              | 503.90   | 10.28                              | 2592.14  | 52.90                              | 76.7  |
| Sambirskyyi      | 1946.93   | 27.81                              | 555.28   | 7.93                               | 2502.21  | 35.75                              | 90.0  |
| Skolivskyyi      | 2092.70   | 44.43                              | 343.33   | 7.29                               | 2436.03  | 51.72                              | 85.6  |
| Sokalskyyi       | 3338.99   | 35.52                              | 487.37   | 5.18                               | 3826.35  | 40.71                              | 69.1  |
| Starosambirskyyi | 1750.89   | 22.30                              | 400.20   | 5.10                               | 2151.09  | 27.40                              | 88.3  |
| Stryiskyyi       | 3758.05   | 60.61                              | 1598.10  | 25.78                              | 5356.15  | 86.39                              | 63.0  |
| Turkivskyyi      | 1225.86   | 24.32                              | 202.19   | 4.01                               | 1428.05  | 28.33                              | 89.9  |
| Yavorivskyyi     | 2806.18   | 22.87                              | 920.52   | 7.50                               | 3726.70  | 30.37                              | 80.9  |
| Zhydachivskyyi   | 1700.38   | 23.49                              | 441.06   | 6.09                               | 2141.44  | 29.58                              | 77.9  |
| Zhovkivskyyi     | 3473.63   | 31.75                              | 995.96   | 9.10                               | 4469.59  | 40.86                              | 81.4  |
| Zolochivskyyi    | 1407.52   | 19.99                              | 387.39   | 5.50                               | 1794.91  | 25.50                              | 80.6  |

Source: own calculation based on [Report on rural... 2013] and average annual exchange rate of euro at National Bank of Ukraine in 2013

*Źródło: obliczenia własne na podstawie [Report on rural... 2013] i średniorocznego kursu wymiany euro Narodowego Banku Ukrainy w roku 2013*

For deeper analysis a visualization of spatial location of rayons in Lviv oblast is needed (Fig. 1), on which one of the used indices is shown, namely the total local budget per capita in each rayon, which allows us to group some of the regions according to their specialization (agricultural, tourist-recreational rayons) or spatial characteristics, such as closeness to an international border (border rayons) or administrative center of the oblast (suburban rayons).

The best results (calculated per capita) in creation of revenue for local budgets in Lviv oblast were shown by rural communities of such rayons as Stryiskyyi, Kamyanka-Buskyyi Radekhyivskyyi, Skolivskyyi, Mykolayivskyyi and Pustomytivskyyi. The income of their rural budgets is closely dependent on their typical socio-economic features, as well as on their location and potential.

In Stryiskyyi rayon around 55% of the territory is covered by protected nature parks, present are the deposit and extraction sites of oil and natural gas, as well as the water sources, used for remote major urban systems as Lviv, Droghobych, Morshyn, Truskavets, Stebnyk. Eleven structural divisions of National Joint-Stock Company "Naftogaz of Ukraine" are located and performing their operations in

this rayon, which makes substantial input into creation of local revenue. Other high-income rayons in this list (Kamyanka-Buskyi Radekhivskiy, Skolivskiy, Mykolayivskiy) are mixed types, focusing partially on agriculture, agricultural processing, non-agricultural industries, and to some extent (applies to Skolivskiy rayon) – tourism and recreation. Pustomytivskiy rayon, being suburban to the city of Lviv, is also showing high revenues of the general fund of rural communities, primarily due to comparatively developed small and medium businesses (over 14 thousand people of the rayon work in industry and over 30 thousand are employed in various areas of economy). All this is due to adjacency to the city of Lviv, which serves as an economic and social center, allowing the inhabitants of nearby Pustomytivskiy rayon to take advantage of their location. This is the cause of the largest aggregated general fund of local budgets in the whole region – over 4329 thousand euro, all generated locally.

Lowest aggregated revenue of local budgets (calculated per capita) is shown by two types of rayons: border and agricultural. Turkivskiy and Starosambirskiy rayons both have an international border with Poland, but unlike other border rayons, are not utilizing the advantages of their location. The main reason is the lack of border crossings (Turkivskiy rayons has none, and Starosambirskiy rayon has only one fully-operational border crossing for motor vehicles and one for railroad crossing). In addition to this the road infrastructure to the border crossing is in such bad shape that it is barely used, even by local inhabitants. These two rayons are at the same time mountainous, which to some extent complicates their economic and infrastructural development. Other three low income rayons are Zhydachivskiy, Peremyshlianskiy and Zolochivskiy, all of which have specialized in the past in agricultural production and processing, which has decreased in past decades, leaving these regions without functional economies and sources for local generation of income. The same applies to Ghorodotskiy rayon.

During years 2001-2013 in Ukraine the dependency of rural local budgets on transfers from state budget has increased drastically. State subsidies transferred to local level have increased 15.25 times, and subventions – 10.15 times. At the same time 381 rural communities in Lviv oblast in year 2013 (which equals 57.2% of all rural communities in the oblast), were dependent of state budget transfers for over 50% of their expenses.

Most of the subsidized rural communities in Lviv oblast are located in Turkivskiy, Starosambirskiy, Sambirskiy, Droghobyt'skiy and Skolivskiy rayons, with the level of their subsidization varying between 85-90% of their budgetary expenses. Such situation does not empower local governance, since it transforms the areas into financially self-insufficient. These processes are intensified by slow, yet progressive centralization of financial flows in Ukraine, which discourages the local

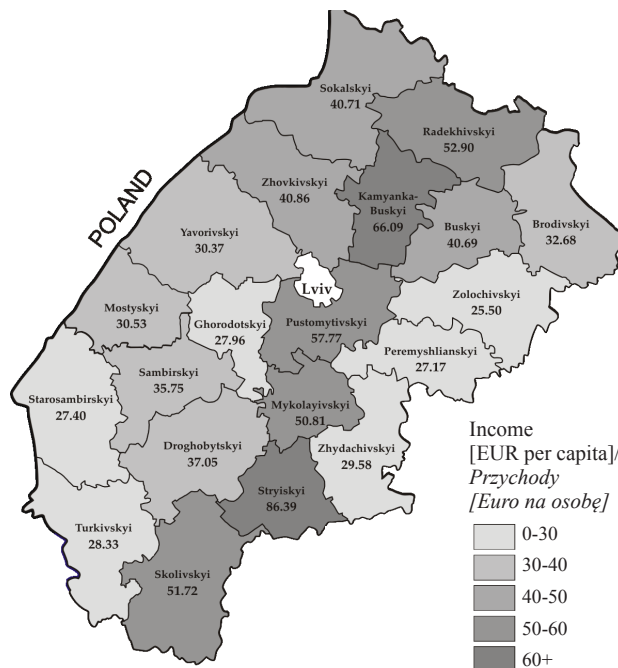


Figure 1. Total income of local budgets in Lviv oblast of Ukraine in 2013

*Rysunek 1. Przychody ogólne budżetów lokalnych obwodu Lwowskiego Ukrainy w 2013 roku*

Source: see tab. 1

*Źródło: jak w tab. 1*

governments from development of their areas. Also, expectations on the local level have transformed into paternalistic type, due to dependency on state authorities in management of centralized financial inflows, as well as because state transfers are usually based on the declared “according to the need” principle, which does not take into account efficiency of financial allocation or increase of general well-being on local level. Local authorities are also excluded from real influence upon system of taxation and principles of tax administration, definition of the level of taxes.

Excessive social focus of local budgets in Lviv oblast (85.4% of total budget finances are covering social needs) leads to underfinancing of other important development issues. Analysis of financial allocation into capital assets in the structure of local budgets in Lviv oblast in 2013 has demonstrated the lowest level in Peremyshlianskyi rayon – 1.32% of total budget expenses, and highest in Pustomytivskyi rayon – 6.11%. Financing of capital assets in rural areas of Lviv oblast in general equaled 12.44 euro per capita in year 2013, and such low financing of capital investments of rural communities does not allow them to develop, but just to maintain the current state. Although one needs to remember of depreciation, so in result instead of development of rural areas, a regress is taking place.

During years 2012-2013 the state policy towards the financing of rural areas development has slightly changed, with more attention being paid to their problems. Yet financial support is still insufficient and inefficient. Among the top issues are:

- inconsistency between current tendencies in financing of local budgets of rural communities and the needs of increase of their financial self-sufficiency and sustainability;
- disincentive toward efficient utilization of financial potential of rural areas;
- major differentiation in locally-generated and state-directed financial support of different rural communities and rayons;
- inefficient structure of local budgets;
- low level of financing from local budgets of rural communities towards strategic medium and long-term development needs.

Listed problems are all of systemic origin, meaning they are the results of the flaws in the system of state and regional financial management. Therefore they can be solved only by reforms of the system, recreating it in order to allow rural communities be the managers of their areas not only in administrative context, but in financial as well. Critical point is the growing financial self-sufficiency and as a future result – sustainability of rural communities, yet for this an institutional and fiscal decentralization in Ukraine is needed. The main objectives in order to reach this are:

- enlargement of territorial communities at basic level and expansion of authority of self-governments over their areas;
- changes in the structure of budgetary system in order to allow the local self-governments to be financially independent and manage their own finances;
- correct the functions which have been delegated to territorial communities according to the principles of subsidiarity, primarily expanding their functions in education, healthcare, social services;
- expansion of financial abilities of rural communities by transferring the number of taxes and fees (or their shares) to local budgets. For example, transfer of 75% of personal income tax, 25% of corporate income tax, ecological tax, fixed agricultural tax and other, which are generated locally and with the use of local resources.

## Conclusions

Insufficient financing of rural development in Ukraine has proven to be true: only a small share of locally-generated taxes (being the finances needed for development) is being kept in local budgets, while a high level of state subsidization exists. While some of the rayons would be able to sustain themselves and finance their development, the current system of financial centralization and administration directs most of the financial flows to state budget, returning only limited volumes, thus weakening the development abilities for these rayons. At the same time less developed rayons are also not being stimulated by existing system to take initiative and use their strengths to search for development possibilities, as the state budget would support them to some extent in any situation. These tendencies need to be changed during the upcoming administrative-territorial reform. Implementation of offered financial decentralization measures should support transformation from paternalistic model of budgetary relations to endogenously-oriented model of socio-economic development of rural communities and efficient utilization of their own financial potential.

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## Streszczenie

*Celem artykułu była ocena przychodów budżetów lokalnych społeczności wiejskich na Ukrainie w warunkach obecnego podziału administracyjno-terytorialnego. W celu przeprowadzenia dogłębnej analizy na poziomie lokalnym wykorzystano przykład obwodu Lwowskiego i jego rejonów, wykazując przychody budżetów lokalnych, zagregowanych na poziomie rejonów. Ponieważ wsparcie finansowe okazało się niewystarczające dla rozwoju obszarów wiejskich, przeprowadzono analizę wad finansowania. Zaproponowano zalecenia dla poprawy samowystarczalności finansowej społeczności wiejskich, jak również dla zwiększenia ich zasobów finansowych i możliwości rozwoju w procesie nadchodzącej reformy administracyjno-terytorialnej.*

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