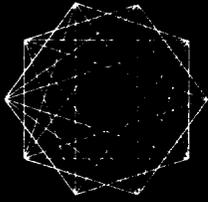


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PLANNING AND DEVELOPMENT COLLABORATIVE INTERNATIONAL, INC.

Conference on National Legislative Reform in Ukraine

**Financing Local Government and
Town Infrastructure in Ukraine**

Kharkiv, Ukraine

June 29, 1993 - July 1, 1993

Sponsored by
The Ministry of Finance
State Committee on Housing and Communal Services
State Committee on Land Resources
United States Agency for International Development

Prepared for
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Financing of Kharkiv Local Government Bodies and Infrastructure:

Present Situation and Future Prognosis

By

**Evgeny Kushnaryov
Chairman of Kharkiv City Rada of the People's Deputies**

Local self-government in Ukraine began developing in 1991 when the *Law on Local Radas of the People's Deputies of the Ukrainian SSR and Local Self-government* appeared.

The changes introduced into this law in 1992 establish three levels of government in Ukraine: state, regional and local, the powers of each being strictly outlined. In the first place the powers of the local self-government bodies were determined in regard to budget and finance issues as well as ownership and oversight of municipal property and land. Along with their own functions, the local self-government bodies realize the powers delegated to them by the state.

Town (city) radas of the people's deputies are defined as the basic level radas. The basic level radas are funded by the incomes that are stated by the law and that remain, either fully or according to some fixed tax rates, at their disposal. The main income sources of the local self-government bodies are as follows:

- Income tax paid by Ukrainian citizens residing in the given territory - 21.3%

- Income tax paid by the local industrial enterprises and institutions and profit tax paid by the cooperative societies - 24.3%

These incomes make up 84% of the town budget revenue while only 6% is derived from State-regulated incomes.

In addition, the basic level radas have the right to set up local taxes and charges for replenishing the town public purse. Local taxes and charges introduced in Kharkiv include a street selling-space charge, charge for the issue of a flat-order, advertisement tax, hotel charge, market charges, and some others.

Local self-governments have at their disposal additional incomes secured through the local self-government budget implementation as well as the amount of excess of receipts over expenses resulting from the cost savings. That is why any town rada is extremely interested in attracting supplementary incomes.

The Kharkiv City Rada of the People's Deputies has eight extra-budgetary funds and a currency fund at its disposal and spends them on local programs. Of these funds, the major ones are The Fund of Social Protection of Kharkiv Inhabitants, the Town's Socio-economical Development Fund, the "Law and Order" Fund, and the Cultural Fund.

The rada of people's deputies perform functions delegated to them by the basic level rada. Delegation of functions is carried out simultaneously with the transfer of financial resources, with which aim the city rada annually establishes the amount of allocations from the fixed and regulated income resources into the regional budgets.

The local self-government bodies independently decide on how to use their budgetary resources. Their main tasks include financing the following:

- Maintenance expenses for the institutions supervised by radas of national education, culture, medical service, social security, physical culture and sports. In 1993, 40.4% of our city budget is allocated for this purpose.
- Measures for social protection of the population according to the decision of the Supreme Rada of Ukraine and local authorities - 29.1 % respectively.
- Expenses connected with the development of housing construction and public services - 11.6%.
- Program of capital construction of housing, public services, amenities and socio-cultural projects - 8.1 %.

- Maintenance expenses of the management bodies established by the local radas -1.7%.

Absolute budget figures are not given deliberately because, under uncontrollable inflation, they must be revised every three months or even every month.

At present the local authorities have to maintain the functioning and development of the town economy under the extraordinarily hard economic situation. With extremely scarce financial resources, Ukrainian towns are practically deprived of the opportunity to construct local infrastructure projects necessary for the population. This problem is one of the most serious for large cities such as Kharkiv.

Only some years ago Kharkiv, where large industrial enterprises are concentrated, had as its main financial resource for building city economic projects the centralized State capital investments received from the Soviet Union ministries and departments, ranging up to 55% of the total amount of investments. The share of Republican [Ukrainian] budgetary resources made up 5%, but those allocations were enough to build almost 40 kindergartens (nursery schools).

Since 1991, with Ukraine having gained its independence, the Soviet Union budget as the resource of financing the city infrastructure, has ceased to exist. At the same time the amount of funds allocated from the Republican budget hasn't increased. The avalanche-like

inflation and accompanying sharp rises in construction costs have resulted in the city's inability to build anything at all with the state capital investments allocated to the local radas. Thus, while that amount was enough to build 6 kindergartens in 1991 and 4 in 1992, in 1993 the 769 million rubles received isn't enough to build even a single kindergarten.

Prior to 1991 the city rada Executive Committee constantly attracted non-centralized funds from the city enterprises and institutions amounting to more than 40% of the total level of capital investments in order to construct housing, amenities and facilities for social and municipal purposes. But in 1992 this resource was reduced to 25% because of the rise in construction costs and the limited financial capabilities of enterprises and institutions. And in 1993 we've come to the conclusion that, under the existing galloping inflation, there's no use seeking out the funds from enterprises.

Under these conditions in 1991, on the city rada Executive Committee's order, the city rada had to allocate budget funds to provide capital construction financing. The share of such funds in the total level of capital investments constituted 20% in 1991 compared to 50.9% in 1993. Data about the minimum number of basic projects for the population that we can build using available funds prove that city infrastructure development is being suspended.

We see the way out of the present situation as follows:

1. If town infrastructure maintenance and development issues are really within the

competence of local authorities, these activities must be supported with adequate finance resources. In order to use the local budget as a source of town infrastructure maintenance and development, it is necessary to adopt a standard principle to form the budget and to regulate tax policy. Combined with the standard method, strict differentiation of local versus federal taxes, the latter being a discharge source of State expenses only, might prove fruitful.

2. Stabilization of the economy will provide the opportunity for the largest city of Ukraine [Kiev] to renew the funding source of economical development, i.e. the funds of enterprises and institutions.

3. We also see, as the way to attract foreign investors, the city's policy on land and uninhabited buildings as well as the population's financial resources.

New Approaches to Budgeting in Ukraine

By

V. Iljin

First Deputy Minister of Finance of Ukraine

Ladies and gentlemen, colleagues:

I would first of all like to express my heartiest gratitude to our foreign guests of this conference for their consent to participate in discussing problems of vital importance for Ukraine, contained on the schedule of the conference and to present their views on possible forms and methods of solving them in Ukraine.

My special gratitude is due to the representatives of the United States Agency for International Development in Ukraine who were directly involved in making this conference a reality. In fact, they have initiated a country-wide discussion of reforming the *process* of state and local budgeting, implementing land reform, and improving financial relations in the system of communal organizations so that they can use the experience of other countries to assist the Government of Ukraine in choosing the most optimal forms and methods of solving pertinent problems.

Ukraine today has firmly and irrevocably embarked on the path of reforming its economy, implementing new economic forms, privatization, denationalization of property and

demonopolization of production. The viability of reforms underway in Ukraine can be substantiated by a significant increase in income earned by small businesses and cooperatives, attaining in the first quarter of this year 200 billion karbovanets or 6.7% of the overall national income, compared with 3.8% in 1992. At present there are 169 commercial banks in Ukraine as well as 1,900 industrial enterprises working on a lease basis, which is 24.6% of the total Republic's industrial enterprises. Of these, 151 enterprises have a collective form of ownership and around 2,000 have a mixed type of ownership.

About 12,000 stores and public food catering enterprises are operated on a lease basis with a general volume of commodity exchange that well exceeds 20%, while over 35% of the total volume of everyday services are covered by servicing businesses working on a lease basis.

There is an ever-increasing number of joint ventures with foreign partners in Ukraine, whose number today exceeds 1,200. During the first quarter of this year [1993] they [joint ventures] manufactured 93 billion karbovanets worth of goods. Total volume of Ukrainian domestic production from enterprises, entities and individuals equals 102 billion karbovanets plus \$38,200 million (U.S.). External trade volume from joint ventures in the first quarter of the current year equalled \$104 million (U.S.), which is 1.5 times higher than the export amounts of these businesses. The majority of joint ventures have been set up with partners from Poland, the United States, the Czech and Slovak Republics, Hungary and Germany.

From January through April of this year, Ukraine produced more than 4.5 trillion karbovanets of income, although 11.5% or 265 businesses have been unprofitable, with total losses equalling 731 billion karbovanets. Among them there are 357 transportation system enterprises and 747 housing and communal services entities whose losses constitute 555 and 45 billion karbovanets respectively.

Unfortunately the period of reform now underway in Ukraine is accompanied by a substantial production decrease in practically all branches of the national economy as well as inflation and increases in prices of industrial production and food stuffs, which are caused by both internal and external factors. Under such conditions, Ukraine's budget from January to May of this year [1993] has realized revenues of 4,493 billion karbovanets (55.3% of the annual total budget approved by Ukraine's Supreme Rada and expenditures of 3,979 billion karbovanets (43.7%). Thus revenues exceeded expenditures by 514 billion karbovanets.

During the same period, the State budget of Ukraine had revenue of 2.3878 billion karbovanets (51.5%) compared to expenditures of 2,544 billion karbovanets (45.3%). Expenditures exceeded revenues by 156 billion karbovanets, while the approved annual deficit equalled 983 billion karbovanets. Simultaneously, following an increase in prices for gas and oil supplied by Russia, an increase in prices was observed in practically all the goods manufactured by Ukrainian enterprises. This necessitated the Government of Ukraine to revise the minimum salary rate, pensions, allowances and expenditures for purchasing equipment and food. The State budget deficit increased sharply under both these conditions and under the

state budgeting methodology used for the current year, which anticipated the possibility of expenses exceeding revenues, or budget deficit, at the State level.

Computation is still going on at the Ministry of Finance; but, according to tentative estimation, as a result of the above changes, revenues in Ukraine's budget will increase by two times to 17.2 trillion karbovanets compared to the 8.1 trillion karbovanets approved by Ukraine's Supreme Rada . Expenditures are going to increase by 2.73 times, reaching 29.2 trillion karbovanets. indicating a revenue excess over expenditures of 11.9 trillion karbovanets. This is 31.9% of the gross national product, which had been set by the Ministry of Economics at 37.6 trillion karbovanets or 41.1% of Ukraine's budget expenditures.

We must also take into account that, during the last two years, regional government authorities and local radas of people's deputies have placed tremendous pressure on local governments, particularly from the Republic of Crimea and cities of Republican subordination, to increase standards for transferring national taxes and revenues to local budgets and to build and use these revenues. Under such conditions for determining national budgets, the necessity of revising existing budget systems at all levels in Ukraine comes into fore.

Ukraine's budget system today is based on the *Law On the Budget System*, approved by the Supreme Rada of Ukraine in 1991. It consists of State and local (regional) budgets, comprising the budgets of the regions, the Republic of Crimea and cities of Republican subordination. Furthermore, local budgets are subdivided into regional, city, district, rural

and township budgets. The total number of these budgets is about 11,300.

The total sum of local budgets was estimated as 8,210 trillion karbovanets or 28.15% of the total volume of Ukraine's budget expenditures of 29,158 billion karbovanets. The main sources of income for local budgets are local taxes and fees (32.9%), transfers from national taxes and fees, and provisions from the national budget (3.3%).

Formation of local budgets revenues on account of proceeds from the first and the third sources is not in question and requires no discussing with respect to transforming them into new types and forms. The only dispute could be the volume of such sources regarding the types of taxes and the standards of budget recovery to be entrusted to local governments. Other disputable issues today are the scope and types of production and branches eligible to be communal property whose revenues should be directed for forming regional budget funds.

These problems have been partially solved in Ukraine legislatively. I refer to the decree adopted by the Government on local taxation, which also regulated the transfer of a portion of state property into communal ownership. This document is aimed foremost at expanding the rights of local governments in reinforcing the revenue basis of local budgets, i.e. their own sources of revenues. At the same time we think this task is not completed yet, and in this connection we would like to hear from our experts, scientists, and foreign participants in the conference regarding any possible steps to be taken for strengthening the revenue basis of local budgets through local funding sources.

As far as national allocations to local budgets are concerned, I would like to emphasize that national sources can really exist, but their size should constantly decrease depending on regional infrastructure development as well as the growth in volume of local sources at all levels. The second of the above sources - transfers of part of the national taxes and fees to local budgets - is most likely liable for possible transformations.

The problem remains to determine the most optimal variants of distinct demarcation between revenues of both levels, and a search is in progress for a transfer mechanism which would most fully satisfy both the Republican and regional governments in providing budget revenues at all levels from necessary financial resources. A search for possible solution of this problem was started in Ukraine long before cessation of the former Soviet Union (This was way back 15 years ago.) by an experiment in which part of the profits of enterprises of the then existing eight ministries and entities of Republican subordination was transferred to local budgets. This positive experiment resulted into practically 100% donation-free formation of local and republican budgets, given centralized regulation of the scope of transfer with respect to other national taxes and fees then prevailing in Ukraine that were allocated for local budgets. As it becomes obvious now, however, it never contributed to USSR deficit-free budgeting as a whole.

In the current year [1993] for drawing up the national budget and the budgets of the Republic of Crimea and regions and cities of Republican subordination, the Ministry of Finance shortened to three the number of national revenue sources regulating local budget

revenue as follows:

1. Income tax from profit of enterprises and entities of republican subordination at 1,242 billion karbovanets - 49.7% (25 - 100%)
2. Value added tax at 2,855 billion karbovanets - 961.2% (44,100%)
3. Excise duty at 1,031 billion karbovanets - 54.7% (10-100%)

As in previous years, the scope of transfer from these types of national taxes was defined by the total volume of expenditures, dependent on the availability of ones' own local budget revenue source as well as on national taxes and fees which are fully transferred to local budgets.

Our experience in drafting national budgets and laws and discussing them in the Supreme Rada of Ukraine prove the expedience of changing the local budget process and moving to a qualitatively new process which would include:

- Providing communication between local government finance offices about their respective resources

- Giving authority and impetus to local government to find necessary funding
- Expanding the independence of local government to tackle problems concerning infrastructure expenditures and development
- Providing transparency, stability and simplicity in handling
- Communicating national interests in general with regional interests for stabilizing the economy in the shortest possible time; combining freedom of handling [funds] with the legal observance of issues of obtaining and using funds, providing communication of expenditure and revenues at every government level

What is to be done to provide the system of local budgeting that would satisfy fulfillment of the above conditions? First of all a legal framework is to be adopted to fix the distribution expenditures between various levels of government - Republican, regional, city, district, rural and township levels.

Until now major attention has been paid in Ukraine, as in other parts of the New Independent States (NIS), to problems of the distribution of revenue sources among national, Republic of Crimea, and local budgets. This has been the major issue in national budget deliberation and decision-making, in speeches by people's deputies at the Supreme Rada of

Ukraine, and in budget deliberation and approval at all levels. To our mind this approach is just a tug-of-war competition - the strongest one is likely to win. Legislative expenditure limits and respective budgets among levels of government can initiate problem-solving of clear-cut revenue differentiation between budget levels. The solution of this problem by former methods reminds me of a situation in which a horse is harnessed to the rear of the cart, in which case movement is possible but happens to be very inconvenient and slow.

Distribution of expenditures between budget levels, to our mind, should be based on the following principles:

1. Expenditures spent on financing national requirements should be funded at the national level. Primarily, these monies will go to support Ukraine functioning as an independent state: guarding the state borders; defense expenditures; maintaining offices of interior, legislative and executive powers; court and prosecutors' services; combating the consequences of the Chernobyl disaster; social protection of the population; expenditures involved in returning previously deported people; payments for Ukraine's internal and external debt as well as expenditures for restructuring the national economy; and subsidizing the national programs of the agricultural and industrial complexes. This also should include expenses connected with fundamental scientific research in the framework of national and international programs. Expenditures aimed at levelling the social security of various regions should also be financed from the same sources.

2. Expenditures connected with solving local-level problems should be financed through respective local budgets.

3. Expenses of local administrative and territorial units should be financed through regional budgets.

Based on these revenue distribution principles between budgets of various levels that are yet to be legislatively specified by the Government's respective decisions, the basic cost level of estimated expenses should be determined to provide financing by budget resources of all levels.

After this task is completed and the decisions on budget distribution are legislatively approved, it will be possible to initiate reform in the system of budget revenue. In the current Ukraine *Law on the Budget System*, the above provisions are not included, which is its major disadvantage; therefore, a law is due which would ensure these principles.

There exist a number of longterm problems that prevent the transition to new budgeting methods in Ukraine with due respect to social justice in relation to regions, cities and districts. These problems are as follows:

1. Uneven development of national revenue streams in the regions of Ukraine. Almost one-third of the regions are unable to cover all the costs to be financed through the local

budget by local and national taxes collected in their respective territories. The costs not covered are now financed by providing general subsidies from the national budget. Levelling profitability in the various regions, or at least covering the region's own costs, is a long-term problem which requires substantial capital investments to develop productive forces.

2. Unevenness in establishing in various regions social and cultural norms and the absence of scientifically-grounded standards of social sufficiency for the population, depending on the type of administrative/territorial unit - city, village, or township. The absence of such standards prevents us from accepting scientifically grounded decisions to direct funds to one regions or another with the aim of balancing the provision of cultural and social establishments.

3. The difficulty of developing regional social and cultural organizations under a market economy. State enterprises in Ukraine have always been and still remain the major funding source for many types of expenditures required by both urban and town-township economies. With the current market economy in tilemaking in Ukraine, production costs cannot be further financed because of the enterprises' financial conditions themselves and should be transferred to local governments. It is essential to emphasize that such issues have been raised by enterprises, especially by those ones which had changed the type of ownership and transformed into joint stock, private businesses and by those that are now applying new types of economy, in other words, financing the enterprises that are now counting their money. Furthermore, according to our estimation, these problems are gaining still greater importance.

It's proper to take this into consideration when solving the issue of budget revenues and cost distribution between budget levels. In the long run state enterprises will have to participate in local budget finance in the same fashion as the [private] enterprises by paying just the taxes and fees which are due and not more than that.

The three problems I've just enumerated are longterm problems that cannot be solved in one or two years. On the other hand, it is rather difficult to consider them in creating new legislation on Ukraine's budget system, specifying the distribution of revenues and expenditures between budgets of various levels. This is why our proposals on solving these problems could be used in preparing Ukraine's *Law on the Budget System*.

Dear colleagues, the Ministry of Finance has scrutinized the revenue and fee distribution models between budget levels that are used in Switzerland and the United States. In these countries there exist "coinciding rights to taxation", in which local administrative units (cantons and states) are allowed to collect taxes from corporations, on personal incomes, and on natural resources. In Australia as a rule the system of tax distribution is used (just like in Ukraine now). In Canada authorities can impose an additional tax to be added to the national income tax, and proceeds from this tax go directly to the provinces. In Hungary a combined system is applied to distribution of tax proceeds and share participation through a return to the territory of the "tax source". Systems existing in other countries have been also studied.

On this basis the Ukraine Ministry of Finance has defined principal approaches that will serve as the foundation of the *Law on the Budget System*, which can be summarized as follows:

- Distinct definition of State budget revenues sources through formulating specific types of revenues which go into the State budget. We would suggest that the major source of the State budget would be the value added tax (VAT). This includes an intention to avoid difficulties associated with VAT return between regions and also to preserve the same tax rate. Taking into account that customs duties in all countries are practically national taxes owing to their strategic significance for external economic trade policy and industrial development, it is proposed to allocate this money to the State budget. It is proposed to refer into State budget the revenues which were received on regional territory and thus are national property. It is probably necessary to determine the payments from the profit of enterprises of Republican subordination by regulating all-national costs for balancing the State budget. All these ideas have been included into the draft of the *Law on the Budget System*.
- Of no less importance is to fix legislatively the longterm nature of revenue distribution between budget levels in Ukraine to facilitate the cash perspective and to determine the respective national and regional programs for social and cultural development, national economy development, and social assistance to poorer people.

- The *Law on the Budget System* has to expand radically the rights of local governments in forming the revenue portion of the budget and utilization budget resources. I mean first of all giving the right to the local radas to define local tax rates as well as additional taxes to be collected, along with all-Republican rates on Republican budget revenues sources for financing regional programs.

These are the approaches of the Ministry of Finance; although the final decision has not been approved, we are still searching.

Proposals are coming from various regions, too. For instance, it is proposed that all regional revenues collected should be left for the local budget. Following coordination with the Republican government, part of these revenues will be transferred to satisfy national requirements. We think this proposal would lead to complete chaos and Ukraine's destruction as an independent state into a bunch of separate regions. By the way, experts from the International Monetary Fund (IMF) hold the same view of this proposal.

Dear colleagues, in my report I have outlined the most outstanding problems in creating a qualitatively new budget system in Ukraine and have cited principle approaches of the Ministry of Finance in solving them. At the same time we are not arrogant and dogmatic in our approaches, and we do really hope that, by discussing these problems at this conference, we are going to find a correct path to solve them.

Taxes, Other Revenues, and Intergovernmental Transfers:

The International Experience

By

**Larry D. Schroeder
Professor of Public Administration and Economics
The Maxwell School
Syracuse University**

I. Objectives and Tradeoffs

Nearly all countries rely to some extent on local governments or local administrative units to provide certain types of public services. There are, however, considerable differences in the degree to which these local entities are emphasized and even greater differences in the manner in which they obtain the resources necessary to pay for these services. The principal objective of this paper is to provide an overview of the how local governments mobilize resources and the variety of ways in which central governments transfer resources to localities.

The choice of which local resource mobilization instruments to use and the methods to employ to transfer funds to local governments is obviously a policy decision that must be made in light of the specific circumstances of any country. There are, however, certain objectives that are generally believed to be desirable in any country, particularly countries in which market mechanisms and consumer choices are being emphasized. Thus, the paper begins with a brief discussion of the objectives that might be sought in any local revenue system.

Section II focuses on the methods that local governments use to mobilize resources of their own, while Section III discusses of intergovernmental grant mechanisms. In each of these sections, several of the more important issues associated with each revenue instrument are discussed so as to enlighten the discussion of which instruments are most appropriate in the Ukrainian context. The final section contains a summary of the paper.

A. Objectives

There are several different objectives that can and are generally sought from revenue instruments. Unfortunately, these objectives often conflict. Thus, a local tax instrument that achieves one of these objectives may not fare well when evaluated on other grounds. At the heart of the decision process facing policy-makers is choosing from among these objectives. Nevertheless, it is useful for policymakers to recognize how different revenue instruments might or might not achieve such goals.

Five principal criteria are commonly included in any assessment of local revenue instruments. These include:

- 1. Revenue adequacy and growth.** Revenues must be adequate for local governments to have the ability to provide necessary public services. Of particular importance is that the revenue source grow in response to increased spending needs associated with increases in local population, economic growth, and inflation, since each of these factors is associated with

increased spending needs.

2. Economic efficiency. Nearly all taxes alter economic behavior. For example, a tax on certain goods will discourage taxpayers from consuming those items and instead [encourage them] to save or to consume non-taxed goods and services. Since the structure of the tax instrument used can have such effects, it is important for policy makers to consider what sorts of reactions by consumers and investors are likely to occur and to evaluate the degree to which those reactions will likely be disadvantageous to society.

3. Equity. A tax should treat different taxpayers fairly. This rule can, however, have different interpretations. One is that taxpayers with greater abilities to pay should pay more taxes than those with lesser abilities, and that two taxpayers with equal abilities should pay similar amounts of taxes. A second interpretation of equity holds that individuals who derive greater benefits from the services financed from a tax should pay more than those who benefit less. Any evaluation of the equity of taxes must also recognize that what matters is who ultimately bears the burden of the tax and not necessarily who initially sends the money to the government. Thus, although the tax on a building is paid by the building's owner, it may be the renter of space in the building who bears the burden of the tax since the rent paid is greater than it would have been if no tax had been imposed.

4. Administrative costs. Whether or not a tax can be administered fairly and at low cost is particularly important in countries where there are relatively undeveloped financial markets,

where many transactions are outside the formal market system, or where it is costly to keep the records necessary to insure that taxpayers are treated equitably. It does little good to design a tax system that, on paper, appears to be perfect but, in practice, cannot be administered fairly and cheaply.

5. Political acceptability. Regardless of the theoretical criteria that may be desirable for a local revenue system, ultimately the decision concerning which revenue sources to use is a political one. Thus, some attention must be given to the question of whether a potential revenue source will be politically acceptable to political leaders as well as to the public as a whole. Without the support of political leaders, it is unlikely that the source will be adopted and, without the support of the public, there may be widespread evasion of the levy.

B. Tradeoffs

It is unlikely that any revenue source can fully satisfy these several objectives. Sometimes a tax which is deemed efficient will be inequitable on either benefit or ability-to-pay grounds. Or a tax which can be administered cheaply may not yield revenues that grow in response to an expanding local economy. Thus, at the heart of the policy-making process must be an assessment of the importance of these various objectives and how willing the makers of policy are to give up one objective in order to achieve another. In any case, it is important for these various objectives to be kept in mind as alternative revenue sources are debated.

II. Local Revenue Sources

An extremely long list of revenue sources is relied upon by local governments throughout the world to help generate the resources necessary to provide public services, and this brief paper cannot fully review them all. Instead, the discussion here is limited to only some of the highlights of local revenue mobilization techniques and some of the major issues that arise when governments consider alternative local taxes.

Revenues for local governments can be divided into (1) own-source revenues and (2) intergovernmental revenues. Two categories of own-source revenues are (a) taxes and (b) user charges. (In some countries, a significant portion of the resources available to local governments is derived from public enterprises, but they will not be addressed here since a major aspect of economic liberalization involves moving away from such enterprises.) User charges are emphasized in another paper being presented at this conference; thus, the discussion of own source revenues here will concentrate on local taxes.

Local taxes in nearly all countries are tied to some type of economic activity. The only exception to this are various forms of 'head' or 'poll' taxes used in some African countries (and, for a very brief time in the United Kingdom, with rather disastrous results). A recent book by Bahl and Linn published by the World Bank reviews the kinds of taxes imposed in 43 different major cities in developing countries. Eleven different major types of taxes are shown including taxes on : (1) property, (2) transfer of property, (3) income, (4) general sales, (5)

goods "imported" into a city, (6) beer, (7) gasoline, (8) entertainment, (9) industry and commerce, (10) motor vehicles, and (11) gambling.

Obviously, not all of these tax sources are applicable in every country; in fact, in none of the cities studied were all of the taxes levied. However, the property tax is, by far, the most common and is used in nearly all cities throughout the world. Because of its widespread use and the fact that the tax is naturally tied to privatization of land ownership, the next portion of this section is devoted to it. That is followed by a discussion of a variety of other local taxes that may be applicable within Ukraine.

Property Taxation

Taxing property can be justified on several grounds. First, it can be justified on equity grounds. Since many local government services provide benefits to the owners of property, the market value of that property will be enhanced by such services. For example, if the local government undertakes investments in drainage or streets or provides street lighting, the value of properties served by these activities will likely increase as potential buyers of the property realize that they will obtain greater benefits from such services. Furthermore, owners of higher valued land and buildings are likely to have a greater ability to pay taxes than are non-owners or owners of lower valued properties. Thus, if property taxes are closely related to the value of property, they can achieve both of the equity objectives discussed above.

Second, although property taxes on capital improvements may discourage such investments, taxes levied on the market value of the land cannot be escaped; therefore, land taxes will be borne by landowners and will encourage the best use of that land. As such, taxes on land can be said to be economically efficient.

Whether or not property taxes yield adequate and growing revenues will depend greatly upon how they are structured and administered. It is, however, the case that for many local governments throughout the world, the property tax is, by far, the most productive locally raised source of revenue. Furthermore, the value of land in urban areas of developing countries often rises at rates exceeding the general rate of inflation which means that a well-administered property tax can yield growing revenues in the face of increasing economic activity and inflation.

One important reason for the relatively heavy reliance upon property taxes in many countries throughout the world is that central governments often reserve for themselves most other potential revenue sources and assign property taxes to local governments. But the political acceptability of the property tax is strengthened by the previously-mentioned fact that many of the services financed from the tax create benefits primarily for local residents. This link between taxes paid and benefits received can also enhance the willingness of taxpayers to comply with the levy.

Property Tax Structures

The potential revenue yield of any tax, including the property tax, is determined by the combination of its rate and the base of the tax. That is:

$$\text{Tax Liability} = \text{Tax Base} \times \text{Tax Rate}$$

Design of a property tax must, therefore, first consider how each is to be determined. This choice should recognize the objectives discussed above. Below we consider the special important features of administering such a tax and note how, because of administration, tax liabilities do not necessarily equal actual taxes paid.

Tax base. Two different bases for property taxes are used in various countries around the world. A *capital value* tax uses the market value of the property as the tax base. That is, the tax is levied against the amount that a property owner would be willing to sell the property. A *rental value* tax is based on the annual flow of income from the property. That is, the tax is levied against the amount of rent which the property owner derives from the property (or the rent that an owner-occupier would obtain if the property were rented to someone else). Rental value-based property taxes are most common in those countries which were controlled by Great Britain under its colonial rule, e.g., countries in the Indian sub-continent and countries formed from its colonial holdings in Africa. Capital value-based taxes are common throughout Latin America and in many countries in Southeast Asia. An

advantage of capital value taxes is that the market value of property should reflect not only the current income from that property but, as well, its potential future use. As such, a capital value tax will provide a stronger incentive for land to be used most efficiently.

Regardless of how taxable property values are to be based, another policy issue concerns what properties are to be included in that base. Again practices vary; however, most commonly properties used for religious or charitable purposes, hospitals, cemeteries, etc., remain untaxed. It should not, however, be easy for individuals to assert that the property is being used for these purposes when, in fact, they are not being used in that way. Another related issue pertains to the taxability of government-owned property, especially state-owned enterprises. Since these properties often derive benefits from the services purchased from property tax revenues, an argument can be made that they too should be liable for the tax. Whether this is politically feasible is, however, another question; and in many countries local governments are not permitted to tax government-owned property.

In some countries, properties owned by very low income persons are exempted from paying the tax. Although this may be defended on ability-to-pay equity grounds, it has the disadvantage of narrowing the tax base. Furthermore, ensuring that the property owner is, in fact, unable to pay can be difficult.

Tax rate. In addition to defining the tax base, it is necessary to determine the appropriate rates of the tax. Especially important in this regard is whether each local

government is free to set the tax rate at whatever level it wishes or whether a nation-wide uniform tax rate is to be used. Again, actual practices vary around the world. Allowing local discretion in rate setting enhances decentralized local decision-making and should be encouraged. However, tax rate competition which gives tax breaks to individual firms to encourage them to move into the area should not be encouraged. Such politics may simply result in lower property taxes for some without stimulating additional economic activity (at least when evaluated on a nationwide basis). A compromise position is for the central government to prescribe upper and lower bounds for the tax rate with localities free to choose from within that range.

Tax rate structures also vary widely across countries. In some, the rates rise progressively depending on the value of property; in others, a single flat rate is applied to all. In some countries, land and improvements are taxed at different rates and, in other places, commercial property is taxed at rates which differ from the rates imposed on residences. Although such features may enhance the apparent equity of the tax, they greatly complicate tax administration, may have undesirable incentive effects, and commonly do not accomplish what they purportedly are to achieve. Since property taxes are sufficiently difficult to administer fairly in any case, these additional complications may not be desirable.

Property Tax Administration

Five different steps are required for the proper administration of property taxes. These

include:

1. Discovery of all taxable properties. A tax roll should include information regarding the location and current physical condition of the property. It is crucial that the roll include all properties within a jurisdiction if the tax is to be fairly administered. Compiling the tax roll may rely on self-reporting by property owners or by an inventory of all properties conducted by the taxing authorities. Although self-reporting is less costly, unless taxpayers are fully willing to cooperate, the resulting tax roll is much less likely to be complete than if the local or central government carries out this effort. Maps showing all property boundaries, while expensive to construct, have been found to be particularly useful in insuring that all properties are included on the tax roll.

2. Assessing the value of those properties. Property tax assessment is a crucial step in the process with some countries relying upon central governments to assess property values, while, in others, the local government is responsible for this activity. An advantage of using central assessment bureaus is that they are less likely to be influenced by local elites in determining property values. Furthermore, since assessing property requires some technical expertise, local governments may have insufficient technical abilities to oversee this effort. The disadvantage of using central assessments is that important localized information may not be as readily available to a central assessment group as it is to local residents and local leaders.

Regardless of the procedure used, the assessment process should also permit property

owners the opportunity to protest assessments which they feel are unfair. Finally, the rules regulating administration of the tax should also insure that properties are reassessed on a regular basis - for example, every three years. Without continual reassessment, the tax is likely to become less equitable since some properties are likely to gain value much more rapidly than are other parcels.

3. Determining the amount of tax due. The product of the tax rate and the assessed value is the tax liability. This is not a difficult task. It does, however, require that the administrative structure of the tax office be capable of maintaining accurate records on tax assessments along with up-to-date information on current taxpayers. This means that the record keeping system should be easy to update as new information is obtained.

4. Informing the taxpayer of the amount to be paid. If taxes are to be collected, the billing system must be capable of informing the taxpayer of the amount of the tax due. Many countries define the property owner as being liable for the tax rather than whoever happens to occupy the property. Under such a system, owners of multiple properties can be sent a single bill, thereby reducing the number of bills that must be sent. In addition, owners may have a stronger incentive to comply with the tax, particularly if they realize that the property itself may be seized by the taxing authority in the event the tax is not paid.

5. Collecting the taxes due. Since taxpayers are likely to wish to avoid paying the taxes due, the taxing statute must also provide sufficient incentives to encourage compliance with the

tax. Penalties and interest should be added to taxes paid after the stated deadline. If taxes remain unpaid even longer, the taxing authority should also have the power to impose additional penalties. For example, if taxes remain unpaid for over one or two years, procedures should be put into effect which will permit the taxing authority to sell the property (or, in some countries, the personal property of the delinquent taxpayer) at a public auction. The proceeds from the auction are first used to pay all past due taxes along with any penalties and interest with any remaining money given to the delinquent taxpayer. Since this is a very heavy penalty, the procedures should also provide the delinquent taxpayer with sufficient warning and with judicial safeguards. Other less onerous approaches to encouraging compliance with property taxes are also available and may, for example, tie other services, such as electricity service, to compliance with the tax. It is also desirable that taxpayers find it convenient to pay the tax; for example, many countries allow such payments to be made at banks or at decentralized tax collecting offices rather than at the main office of the municipality.

There are many more details concerning administrative features of property taxes, but space limitations here do not permit a full elaboration on them. In any event, it is important to realize that successful implementation of a property tax will require that each of the above steps be written into the tax law or the rules governing the administration of the tax, since failure at any of the stages will result in a tax which does not achieve the several objectives discussed above.

Other Local Taxes

It is not possible in this paper to provide much detail about the long list of taxes other than property taxes which are used around the world. We can, however, point out some of the principal advantages and disadvantages that certain taxes have for local governments.

Sales-Based Taxes. A tax on retail sales within an area can be a productive source of local revenue; and, since the volume of sales increase as prices rise, tax revenues are likely to keep pace with inflation. Such a tax, however, may be inequitable, as it can impose greater tax burdens on those less able to pay. This problem can be lessened by exempting some purchases - for example, food - from the tax. With many retail outlets within a city, administration of such a retail-based tax is extremely expensive since it requires that each retailer be monitored to insure that all taxable sales have been reported. Such taxes can, therefore, encourage the creation of an "informal" or "underground" economy. While this expense can be avoided through taxation at the wholesale or manufacturing levels of production, such taxes unfairly discriminate in favor of localities with many such firms.

Where the central government is already imposing a value-added tax on the consumption of goods and services, an alternative approach is for the Government to share some portion of the tax with localities. As is discussed in the following section on grants, these taxes may be shared on the basis of the localities in which the taxes were collected or may be distributed to localities on some other basis.

Entertainment and Sumptuary Taxes. Closely related to sales taxes are taxes on particular types of activities such as various entertainments or the consumption of beer, liquor or tobacco. Many local governments tax cinema tickets or gambling establishments as well as tourist hotels and restaurants serving tourists and, at least in some countries, these taxes have proven to be good revenue producers.

Administering such taxes can be difficult since they generally require that the taxing authorities be able to examine the books of the taxed establishments. While taxes on alcoholic beverages and tobacco may be considered desirable to discourage such activities, they may also encourage consumption of untaxed products, e.g., locally distilled liquor, which are unsafe. Furthermore, taxes on alcohol and tobacco are generally thought to be regressive, falling more heavily on lower income persons.

Local Income Taxes. Taxes on incomes can certainly satisfy the desire to impose heavier taxes on those more able to pay. In addition, revenues from these taxes are likely to increase as economic activity expands or as prices rise. At the local level, such taxes can, however, be quite difficult to administer especially if there is no broad-based income tax already imposed by higher levels of government. Particularly difficult in this respect is taxing incomes from sources other than wages and salaries. Even then, insuring that all labor incomes are reported can be difficult without elaborate administrative arrangements. A better alternative to direct taxation of incomes by local governments is tax sharing, where a higher level of government collects the tax and shares a portion of the revenues with subnational

governments.

Because of their administrative complexities, locally collected income taxes are more common in higher income countries such as Japan, the Scandinavian countries, and the United States. Lower income countries that allow local governments to collect income taxes generally rely on taxes on only some wage earners or resort to taxes which are only partially tied to incomes. As such, they are generally considered to be inequitable.

Taxes on Local Industry and Commerce. Local governments in some countries are permitted to impose taxes on individual business establishments. A wide variety of tax structures is used for this purpose. In some countries, the taxes are little more than permits to do business with rates kept very low and uniform for all businesses regardless of their size. Such taxes are generally not good revenue producers. The revenues do not respond significantly to increases in economic activity, and they also may be inequitable. In other countries local governments attempt to tax businesses on the basis of the size of the establishment, e.g. gross sales. While this structure may be deemed more equitable, it still does not differentiate between businesses on the basis of their profitability and can be hard to administer. Furthermore, such taxes do not reflect well the differences in benefits received from public services. Finally, since these taxes may be passed on to consumers in the form of higher prices, they can be quite regressive.

Vehicle Taxes. Taxes on motorized vehicles can provide a good source of revenue for

local governments. Since automobiles are often owned by wealthier segments of society and are users of costly streets and highways, such taxes are generally viewed as being equitable. Furthermore, since the demand for vehicles is likely to rise as incomes increase, tax revenues can grow in response to increasing economic activity.

One approach to such taxation is through the use of registration fees that can be imposed at different rates depending upon the size and value of the vehicle. These fees should, however, be raised as the general price level rises in order for revenues to keep pace with inflation. Gasoline taxes can also be imposed; however, if localities charge different rates, such taxes may encourage purchase of petrol in lower taxing jurisdictions.

Conclusion

There is a very long list of taxes other than property taxes imposed by local governments throughout the world including others not included here. All of these levies have particular strengths but also some very important weaknesses. In any consideration of building a local government tax structure, a variety of considerations must be kept in mind. Among these are:

- Ensuring that the tax base is defined in such a way that it can be assessed fairly but without great difficulty
- Ensuring that records concerning payment and non-payment of the tax can be kept without incurring considerable expense

without incurring considerable expense

- Ensuring that the tax can be collected and that penalties can be imposed against those who have not paid their taxes
- Ensuring that the economic incentives or disincentives that the tax creates do not lead to significant economic inefficiencies and impediments to economic growth
- Ensuring that the burden of the tax does not fall excessively on those least able to pay or on those who derive little or no benefits from the services which the tax revenues help pay for.

III. Intergovernmental Grants

Transfers of funds from one level of government to another are used in nearly every country of the world. There are several good reasons for using grants to **finance** local public services.

(1) Higher levels of government generally have at their disposal a broader range of more highly productive revenue instruments and, therefore, collect a significant proportion of all taxes and charges mobilized within an economy.

(2) Local governments may be unwilling to invest in services which yield benefits to those living outside the local jurisdiction. Intergovernmental transfers permit granting governments the opportunity to encourage such activities by providing local governments with the funds necessary to undertake these activities.

(3) Since not all local governments have equal capacities to raise revenues of their own, a central government may wish to use grants to insure greater equality in the levels of local public services which are provided throughout the country.

There are several ways for governments to transfer funds to local governments with different types of grants having certain advantages and disadvantages when judged against a set of evaluation criteria. The objectives that might be sought from a grant system are quite similar to the objectives discussed in Section I above. They include, as before:

1. Revenue adequacy and growth. As in the case of local taxes, intergovernmental transfer revenues should grow as local spending needs, which cannot be met through local taxation, grow. Even though the grant system is supposed to yield a flow of funds to local government, this flow is controlled by the granting government, which may decide not to transfer the funds to local governments or to delay in transferring these monies. Such behavior greatly impedes good fiscal planning by local governments.

2. Stimulate local expenditures while not discouraging local tax effort. Grants can be designed to encourage local governments to spend more money on certain activities that a higher level of government deems desirable. At the same time, since grants can decrease the need for local governments to mobilize resources of their own, these transfers can result in lower efforts on the part of recipient governments to mobilize resources of their own.

3. **Fiscal equalization.** Equalization of spending across different jurisdictions is often deemed a desirable attribute of a grant system. (This criterion is similar to the equity criterion discussed previously.) Different grant programs have different abilities to accomplish this objective. Furthermore, some countries have opted to forego the equalization objective in favor of providing greater funds to those localities with the greatest economic growth potential, regardless of whether they are poorer or wealthier jurisdictions.

4. **Enhance accountability.** Granting governments are usually very concerned that local governments use the transferred funds wisely and not waste them. Different grant programs provide differential amounts of control over the use of these funds. At the same time, greater central control over the use of grant revenues often mean that local governments will have less autonomy in allocating the money. Thus, the desire for central control can conflict with the benefits that are available from greater local autonomy in using the funds.

5. **Administrative costs.** Again, as in the case of local taxation, different transfer instruments have different costs to administer. Some grant types require data which are not easily available in lower income countries, and others require that the recipient locality expend significant amounts of resources simply to apply for a grant program. The latter case can, of course, result in less fiscal equalization than was intended for the grant scheme.

6. **Political acceptability.** Since the granting level of government generally controls the allocation method used, it goes without saying that the intergovernmental transfer program

must be acceptable, at least to this level of government.

All this again suggests that there are certain major tradeoffs that must be recognized in designing grant systems. In what follows we first discuss the types of grant instruments that are generally used in countries throughout the world. That is followed by a discussion of certain basic decisions that must be made in designing a grant system.

Different Types of Grants

One important distinction in grants concerns the amount of discretion which local governments have in using the transferred funds. Spending of a categorical grant is limited to the particular purpose determined by the granting government; general purpose or block grants can be used in whatever manner the local government deems most reasonable. Since spending of categorical grants is restricted to particular purposes, granting governments are likely to prefer these mechanisms, whereas recipient jurisdictions are likely to prefer general purpose grants. Categorical grant programs are, however, likely to be more costly to administer than are simple block grants, since they require that the granting government insure that the funds have been spent as originally planned. Furthermore, many categorical grant programs require that the local government apply for the grant, which also increases total administrative costs (and, since wealthier jurisdictions may be more capable of putting forward high quality grant proposals, such grant schemes can be counter-equalizing).

Another important aspect of grant schemes, at least for categorical grants, is whether the local government is required to use some of its own revenues to match the funds provided for by the granting government. Such "cost sharing" or "matching grants" are more likely to encourage the local government to spend the funds wisely, since it is investing some of its own resources. Similarly, these grants are less likely to discourage local governments from raising revenues of their own.' Lower matching requirements provide stronger incentives for local governments to be willing to accept the funds.

Design of Grant Systems

In designing any grant system, two basic decisions must be made. One concerns the size of the grant pool. This means determining how much money is to be distributed in total to all local governments. The second decision concerns how that grant pool is to be distributed among the several recipient governments.

Size of Grant Pool. There are basically three different ways the total size of the grant pool can be determined. They include:

- (1) **As a percentage of revenues collated.** The granting government may decide to distribute some percentage (up to 100 percent) of the revenues from one or more of its taxes. The advantage of such a method is that it is more likely to lead to certainty in the distribution of funds (although granting governments generally maintain the power *not* to distribute it all);

and, if the revenues grow in response to a growing economy, the method is more likely to yield a growing local source of resources. The disadvantage of this approach to granting governments is that they lose some control over the use of their own resources.

(2) On an annual basis as part of the budget process. Granting governments most commonly prefer not to promise a certain size of the grant pool. Instead, they budget the size of the grant pool on an annual basis simply as a part of the usual budget process. This gives them greater control over the use of their resources, which sometimes leads to considerably greater fiscal uncertainty for recipient governments.

(3) Depending on the amount of funds spent by local governments. Although not very common, it is possible for a granting government to declare that it will reimburse local governments for all or some part of the money it spends for particular purposes. One reason why these types of grants are much less common is that they greatly diminish the amount of control which granting governments have over their own budgets. The only way a granting government is likely to be willing to enter into such an agreement is if it retains power over the use of the funds by the local governments. Thus, for example, a grant to finance local government employee wages and salaries is unlikely to be implemented unless the granting government also controls the number and types of employees working for local governments.

Distribution of Funds Among Recipient Jurisdictions. There are generally four different ways in which grant monies can be distributed amongst local governments. They

include:

1. Origin of collection of the tax. Under such a distribution system, those local jurisdictions in which greater amounts of a tax are collected will, in turn, receive larger grants than jurisdictions where smaller amounts of taxes have been collected. An obvious disadvantage of this approach is that it does not lead to equalization of resources; instead, it is counter-equalizing. Such tax sharing arrangements do, however, lessen the need for local governments to engage in costly administration of their own taxes and are likely to be politically popular among local officials, since they are not required to tax directly the residents of their local jurisdiction.

2. Formula. Some type of formula is used in many countries to distribute the funds across jurisdictions. Perhaps the most common formula relies only upon the population of the local jurisdiction. Thus, a city with twice as many residents as another would receive two times the amount of grant. Formulas can be made more complex, but more complexity is likely to increase the costs of administering the grant program and require that the necessary data are available. For example, in some countries population, land area, and number of miles of road are used (with differential weights applied to each factor) to distribute the funds. Thus formulas can be devised specifically with various objectives such as fiscal equalization in mind.

3. Reimbursement of costs. The granting government may decide to reimburse the local government for all or some predetermined proportion of the expenditures it makes for

particular types of spending. Such grant programs are nearly always categorical rather than general purpose in nature and commonly include some matching requirements. These grant distribution schemes are often used to allocate funds to be used for capital infrastructure investment. For example, the granting government may agree to reimburse the local government 50 percent of all the spending the local government makes on expanding its sewer system.

4. As a part of the annual budget process. Instead of using any of the previous techniques, the granting government may decide to allocate grant funds to recipient local governments as year as a part of the granting government's budget. Such a technique provides the granting government with the greatest amount of control over allocation of the funds; however, this is much more likely to lead to considerable lobbying by local governments to receive greater amounts of funds and is also likely to lead to much less certainty in the flow of these funds. Most importantly, annual budget allocations are likely to result in ad hoc allocations which fail to achieve any well-defined set of objectives.

Grant systems commonly include several different grant programs that rely on a variety of the combinations of grant pool determination and distribution methods. For example, local sharing of some central government tax revenue based upon where the tax is collected may be one portion of the grant system used to provide general operating funds. Another portion of the grant program may be a cost reimbursement grant program for capital spending on certain types of infrastructure. Finally, additional funds may be distributed on a formula basis to

ensure that those jurisdictions with greater needs are provided with larger amounts of grants. While such arrangements are commonly the result of political compromises, the overall grant system when viewed in its totality may be working at cross purposes when the several different objectives for grant systems are considered. Only careful analysis of the effects of different grant programs and explicit consideration of the objectives can determine whether the overall grant system is rational.

IV. Summary

The methods used by local governments throughout the world to finance public expenditures through taxes and intergovernmental grants are amazingly complex and it is impossible to conclude that there are only one or two "best" ways of carrying out such financing. It is, however, possible to conclude that there are various, often competing, objectives which policy makers would like to achieve from such systems. Indeed, it is probably the case that the great heterogeneity of local financing techniques is due to the fact that there are these competing objectives. As the Government of Ukraine considers how to enhance the ability of local governments to finance the many important local public service needs, careful consideration needs to be given to the objectives which policy makers deem most important. Only then can a local financing system be devised that is likely to achieve those objectives.

Formation of Local Budgets of Ukraine

By

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Indices for the 1993 budgets of the Republic of the Crimea, the regions, and the cities of Kiev and Sevastopol were calculated by the Ministry of Finance on the basis of forecasts of area economic and social development in accordance with the indicative plan, existing legislation, normative acts and materials submitted by the Council of Ministers of the Republic of the Crimea, the regions, and Kiev and Sevastopol city administrations.

The total volume of local budgets in Ukraine for this year makes up 3,556 billion karbovanets or 39.1 percent of all State budget resources. Local budget revenues were formed by their entities, ensured by the law, revenues, and also by deductions from State taxes and fees (value added tax; enterprise and organization revenue tax, which is state property; and excise duty).

Deduction and allotment norms to local budgets from State taxes and fees were calculated at the same time the Supreme Soviet of Ukraine approved the State budget. They are determined on the basis of costs needed to cover expenditures and existing local budget revenues, proceeding from State's financial resources which can be directed at balancing the

local budgets.

On the whole, from taxes, fees and obligatory payments the revenue allotted for local budgets in accordance with the existing legislation is set at 1,592 billion karbovanets. This revenue covers 44.8 percent of the corresponding expenditures. From the total sum of State tax and fee assignments, a percent goes to local budgets. In connection with this, State budget financial resources are decreased accordingly. To ensure full coverage of local budget expenses, State taxes and fees are assigned as different sums of money, including 47.2 percent of enterprise and organization revenue taxes, which are State property; value added tax; and also 54.2 percent of excise duty.

Norms of assignments from value added tax to the Donetsk and Dnipropetrovsk regions' local budgets are set at the rate of 22.1 percent and 24.3 percent respectively, with revenue tax set at 25 percent and excise duty at 10 percent. This is accounted for by the fact that, in these regions, owing to considerable production potential, the local revenues together with revenues from State taxes and fees almost fully meet the cost needs.

At the same time it should be noted that, even with 100 percent assignment of State tax and fee allotments to the local budgets of the Republic of Crimea, seven regions (Volyn, Zhitomir, Transcarpathian, Kiev, Rivno, Sumy and Chernivtsy), and the city of Sevastopol and with availability of local revenues ensured by the law, the budget needs for the assigned expenditures are not covered.

These nine budgets will get grants-in-aid of 68 billion karbovanets from the State budget. The allotment rates from State taxes, fees and payments going to regionally-administered city budgets are determined by the Supreme Rada of Ukraine as specified in Article 11 of the Ukrainian *Law on Local Radas of People's Deputies and Local and Regional Government*.

In 1992-1993 these allotment rates were determined and approved individually for every city by regional radas of people's deputies in accordance with Article 12 of the *Law on the Budget System*, proceeding from the expenditure rates calculated on the basis of the existing financial standards, including revenues rates formed by taxes and fees and ensured by the existing legislation.

With budgets allotted 100 percent of citizens' taxes, 10 percent of value added tax, revenue tax on enterprises which are under the authority of the republic, and excise duty, the Ministry of Finance's calculations for 93 towns of the Republic of the Crimea and its regions showed that, under 1992 conditions, revenues would exceed expenditures by a total of 14 billion karbovanets in 37 towns, and in 56 other towns deficit would equal 29.4 billion karbovanets. Thus in the Lugansk region all 14 regionally-administered towns would have budget revenues exceeding expenditures by the sum of 8.9 billion karbovanets, while the Kirovograd, Lviv, and Cherkasy regions appear unable to balance any of their town budgets..

It is noteworthy that in some towns even 100 percent assignment to the budget of all

State taxes raised at the corresponding territories does not provide budget self-sufficiency without State subsidies. For example, the budget of the town of Pershotravenska in the Dnipropetrivsk region was formed by the assigned revenues which made up 4.4 percent of expenditures. After the assignment to it budget of all state taxes raised in the town, the deficit still amounted to 110 million karbovanets, or 60.8 percent of expenditures. The assigned budget revenue of the town of Yaremcha of the Ivano-Frankivsk region was 20 percent. After the assignment to this budget of all State taxes, the deficit constituted 76 million karbovanets, or 50.7 percent.

The Supreme Rada of Ukraine in the *Law on the State Budget* for the years 1992 and 1993 specified that the Supreme Rada of the Republic of the Crimea, the regions, and the Kiev and Sevastopol City Councils of People's Deputies determine the allocation and distribution of State taxes and fees among regional, district and town budgets. Also the authorized revenue among all levels of local budgets of the Republic of the Crimea, the regions, and the cities and towns of Kiev and Sevastopol is the revenue tax from the citizens of Ukraine, foreign citizens and persons without citizenship.

In present-day conditions balancing local budgets can only be achieved if certain standards are set up for allotments from State taxes and fees at large for the Republic of Crimea and the regions, with further appropriate cost distribution received among the lower level budgets. But if such State tax and fee allotment norms are set up for towns under regional government authority (district, region), budgets with no assigned revenue sources,

and also budgets of towns without industry, the majority of townships and village radas are incapable of financing even expenditures of primary importance. That is why there seems to be an urgent need for budget system reform, which is one of the first and foremost prerequisites of financial system stabilization. When introducing a market system that forms State proposals on the basis of demand and supply, the budget acts as one of the means of pursuing economic and social policy.

The budget formation process at all levels should be preceded by the formation of a financial resources summary to facilitate development of the State financial policy and to make it possible to analysis the status of financial resources on the whole, as well as their sources and directions, and to make decisions about the possibility of financing various programs and projects.

The objective of consistent implementation of economic administration methods for State and local government activity can only be successfully achieved if thorough coordination of regional social-economic development with advanced results in financial resources formation is ensured and if regional financial budget planning is reconstructed.

To achieve this goal it is necessary to undertake a deep reorganization of the whole budget revenue and expenditure system. The system has to distinguish strictly between the revenues coming to State and local budgets and the expenditures carried out in every link of the budget system. There must be new approaches to obtaining revenue at all budget levels on

a strictly normative long-term foundation that clearly specifies the rights of appropriate government entities to approve such norms.

An important area of rada activity is creation of the appropriate financial base, the chief representation of which is the budget. Budget independence is ensured by the availability of local revenue sources and by the right to define the directions of their implementation. To ensure independence in forming and fulfilling the budget, it is necessary that every link of the budget system should have a revenue base clearly defined by the Law.

Relationships between the Ukrainian State budget and local budgets of the Republic of the Crimea, the regions, and the Kiev and Sevastopol city budgets must be regulated on the basis of long-term allotment norms from State taxes and revenues approved by the Supreme Rada of Ukraine. Such norms can be universal for all the above mentioned administrative-territorial localities.

The Ministry of Finance was authorized by the Supreme Rada of Ukraine to prepare a new edition of the *Law on the Budget System* of Ukraine. The draft of the law is not yet final; it will be further defined. The draft provides a distinction between revenues and expenditures for the State budget and budgets of the Republic of Crimea, the regions, and the cities of Kiev and Sevastopol.

Specifically, Ukrainian State budget revenues are formed by:

- 70 percent of the value added tax
- 50 percent of excise duty allotments
- 50 percent of land rent
- Allotments from international economic activity
- Allotments form state property
- Other revenues assigned by Ukrainian legislation

Budget revenues of the Republic of Crimea, the regions, and the cities of Kiev and Sevastopol are formed by:

- 30 percent of the value added tax and the enterprises and organizations revenue tax
- 50 percent of excise duty allotments
- 50 percent of citizens' tax allotments
- State customs
- 70 percent of land rent

- Revenues from the forests
- Transport owners' tax
- Natural resources payment
- Local taxes and fees
- Other revenues assigned by Ukrainian legislation and revenues defined by the radas of people's deputies in accordance with legislation

Expenditures of all Ukrainian budgets are differentiated as those that are included either into the current expenditures budget or into development budget.

In the State budget the following expenditures will be realized:

- Production and non-production construction, geological research and design, nature conservation and other projects
- State centralized programs aimed at people's living standards, housing maintenance and improvement, and social protection
- Activities of socio-cultural institutions and organizations that are State property

- Defense
 - Maintenance of State government, administration and jurisdictional entities
 - Creation of State material and financial reserves
 - Other projects which are financed from the State budget
- The budgets of the Republic of the Crimea, the regions, and the cities of Kiev and

Sevastopol include the following expenditures:

- Enterprises and organizations that are under the authority of the Republic (Crimea) or local economy
- Projects carried out by socio-cultural institutions and organizations under local administration
- Maintenance of State, regional and local government operations
- Other projects financed as assigned by the legislation from the budgets of the Republic of the Crimea, the regions, and the cities of Kiev and Sevastopol

On the basis of the indices taken into account when Ukrainian State budget for 1993 was approved, the Ministry of Finance calculated revenue variants at different budget levels and assigned equal allotments from State taxes and fees to the budgets of the Republic of the Crimea, the regions, and the cities of Kiev and Sevastopol. They will require very thorough

check-out and in-depth analysis of their impact on the local radas' financial base.

Proceeding from the revision offered in the draft law discussed above, 25 regional budgets will need grants-in-aid from the State budget, while the Donetsk and Poltava regional budgets will be formed with revenues exceeding expenditures. A very important issue for local radas financial independence is finding ways to raise budget revenues. To expand the local radas' revenues base, the Ukraine Cabinet of Ministers adopted a decree determining local taxes and fees types, as well as their rates and charges. The following types of local taxes and fees have been introduced:

- Hotel fees
- Car parking fees
- Market fees
- Fees for giving out apartment orders
- Dog owners' fees
- Health-resort fees
- Hippodrome races participation fees

- Advertisement tax
- Fees charged for the right to use local Symbolics
- Fees charged for the right to shoot films or television programs
- Fees charged for local auctions, competitions, sales and lotteries
- Fees charged for the organization of public services and amenities

It is necessary to reconsider the areas underlying State and local budgets. The State budget will cover expenditures of primary importance for the State economy functioning as an integral unity, for defense, for State administration, and national programs aimed at people's living standards and housing maintenance and improvement.

State expenditures for social issues and local economic development must be financed from local budgets. The rate of assignments from local budgets should be determined with due regard for the people's social security level guaranteed by the State throughout the whole country of Ukraine. Thus local government divisions will have an opportunity to form their budgets independently proceeding from the differentiation of revenues and budget expenditures. But it should be taken into account that, because of the uneven economic and social development of some local governments, some radas will be unable to meet expenditures from their local and assigned revenues.

This situation may result from several objective factors. First of all there is industrial and agricultural specialization in some regions, owing to natural climatic conditions and the availability of geologically-developed natural resources, and State production concentrated for the benefit of the economy as a whole.

Complex analysis of regional social-economic development testifies to essential interregional differences, based on indicators of national revenue produced, social infrastructure projects provided, the natural economic potential used, and the ecological situation.

Half of the regions are characterized by rather insignificant economic potential. Their contribution to the country's national revenue is meager, comprising from 1.5 percent to 2.8 percent (Volyn, Rivno, Ternopol, Chernivtsy, Kirovograd, Mikolaiv, Khmelnytsky, Chernihiv, Ivano-Frankivak, and the Cherkasy regions). On the other hand the contribution of six industrially developed regions (Dnipropetrovsk, Donetsk, Zaporizhya, Kiev (with the city of Kiev), Lugansk and Kharkiv) constitutes about 50 percent of national revenue and almost 60 percent of basic industrial revenue.

As the result there are considerable interregional fluctuations in national per capita revenue. These differences comprise 45 points between the Transcarpathian and Zaporizhya regions. At the same time international studies of the index that provides for maintenance of the social balance in local governments show that, in various regions, fluctuations do not

exceed 20-25 points.

The processes of regional social-economic development are seriously influenced by demographics, in which disproportions in the population's employment rate are quite considerable.

The financial capabilities of some of the administrative divisions are not sufficient to meet the needs of the population in the areas of education, health protection, culture, housing and communal services, etc. On the other hand all the citizens, wherever they live, have equal rights guaranteed by the Constitution to have their social needs met from public consumption funds.

Thus, if social protection expenditures for one citizen of Ukraine average about 24,000 karbovanets, this index appears to be higher only in the Republic of Crimea, Dnipropetrovsk, Donetsk, Zaporizhzhya, Kirovograd, Kharkiv, Kherson, and the Cherkassy regions as well as the cities of Kiev and Sevastopol.

Accordingly financing Ukrainian socio-cultural institutions and establishments provides average expenditures of 37,000 karbovanets for one citizen. This cost is higher in the Republic of the Crimea, Volyn, Zhitomir, Transcarpathian, Mikolaiv, Rivno, Sumy, Ternopol, Kherson, Khmelnytsky, Cherkassy, the Chernivtsy regions and the city of Kiev.

Important State tasks include the development of appropriate legislative and economic conditions for solving existing problems and eliminating shortcomings in regional economic development, thereby balancing regional social-economic development.

In summary, it should be noted that at present it seems to be necessary to preserve the financial resources distribution mechanism among the local governments and the budget system divisions. This distribution will be carried out by means of cost allocations to lower level budgets in the form of grants-in-aid for levelling production and social infrastructure. I find it reasonable that the rules of giving and using subsidies should be defined by the law.

Development of modern budget regulation policy adapted to market economy conditions requires special attention. It is necessary to find optimum proportions of financial resources for distribution.

Budget regulation practice must start giving local governments reimbursement loans from the State. Among the urgent tasks in this matter is the development of special purpose programs for local government.

**Capital Infrastructure and Operating Expense Budgets at the Local Level:
Considerations Related to the Organization and Management
of Finance and Finance-Related Procedures**

By

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I. An Introductory Note

The world over, government leaders use finance and finance-related procedures to (1) establish and maintain administrative order and (2) provide vehicles for policy formulation and program attainment. These are extremely important effects. Experience within the United States and elsewhere provides evidence that finance power, properly exercised, can produce the following important, positive benefits for municipal organizations and the communities they serve:

- Finance-related information and procedures, useful in the formulation and execution of policies and programs.

- Vehicles for the representation of the values of economy, efficiency, and effectiveness throughout the government, and the attainment thereof.

- Broad finance-related policy advice on program and project issues.

The positive benefits just described will flow most assuredly if finance power, and finance-related procedures, satisfy criteria of proven validity. Consequently, this essay advances a set of design considerations concerning a positive role for finance and finance-related procedures in local governments. These considerations are thought applicable to the local governments of Ukraine.

II. Finance organization and procedure

Consult Exhibit 1. It displays 16 aspects of finance and finance work which should be subject to the application of criteria.

A. Authority

Within an overall governmental framework, truly decentralized units enjoy financial amplitude and discretion. The criteria express basic requirements of autonomous local government:

A.1. Concerning revenues, local government units:

- a. Raise substantially all their revenue requirements from local sources.

- b. Set budget-related tax, fee and service charge rates.
- c. Receive formula-allocated, unconditional grants from superior governments.

A.2. It adopts and executes comprehensive operating and capital investment budgets.

EXHIBIT 1

Aspects of Local Government Finance and Finance Management Subject To Criteria

A. Authority

1. Revenue
2. Borrowing
3. Budgeting

B. Prime Concerns

1. Availability of money (liquidity)
2. Recovery of money (recapture of investments in regulatory services and enterprises)
3. Cost of money (finance management costs, including interest)
4. Productivity of money (socioeconomic returns on investments in services and facilities)

C. Organization

1. Unified, accountable leadership
2. Flexible task/problem-based staff deployments
3. Appropriate capitalization of finance work

D. Procedure

1. Bank accounts
2. Data integration
3. Formal process controls
 - a. Segregation of certain duties
 - b. Formal delegation of signature power
 - c. Data entry/output
 - d. Reconciliation
 - e. Reservation

E. Operations

1. Integrity/accuracy

A.3. It borrows capital when required.

B. Prime concerns

In general, finance officials practice financing management by engaging in specific "core" activities as listed below:

- Budgeting (embraces finance planning)
- Accounting/control (embraces internal audit)
- Assessing subjects/objects for tax purposes
- Collections
- Procurement
- Accounts Payable
- Treasury (cash management)

Although finance officials must address particular concerns activity by activity, the four identified as B.1. through B.4 in Exhibit 1 are thought to be transcendent and universal.

Consequently, they represent the prime concerns of local government finance management.

B.1. *Availability* refers to cash and the ability to meet obligations when due. B.2. *Recovery* of money refers to the application of the beneficiary payment principle. B.3. *Cost* of money refers to (1) interest charges on borrowed funds and (2) the financial burden of administering the finance function. B.4. *Productivity* of money refers to the net benefit earned by the allocations to the various purposes of the local government.

B.1. The availability of money (liquidity)

Goal: pay obligations when due

Analytical focus: financial status/projections/policies

Management variables:

- Cash balances/reservations
- Expenditures (budget) related to revenue estimates
- Tax and service charge coverage/rates (see B.2)
- Receivables (billing cycles/collection/delinquency)
- Payables (spending plans/commitments/payment cycles)
- Deposit practices
- Loans

B.2. The recovery of money

Goal: maximize cost recapture

Analytical focus: regulatory and "enterprise" services

- Cost accounting/cost finding procedures

Management variables:

- Cost composition and service charges

B.3. The cost of money

Goal: minimize finance management costs

Analytical focus: organizational arithmetic

- Systems and methods analysis
- Performance ratios (unit costs/unit times)

Management variables

- Finance organization and procedure
- Borrowing: amount/duration/timing/interest rate

B.4. The productivity of money

Goal: maximize investment returns

Analytical focus: community arithmetic

- Community analysis (socio-economic studies)
- Investment returns (benefit/cost assessments)

Management variables:

- Service program benefits/impacts/costs
- Capital investments

C. Organization

By requiring unified, accountable leadership, C.1 supports the concept of finance centralization within local governments. C.2 provides guidance concerning the internal organization of an integrated finance establishment, counseling against rigid divisionalization of the establishment and the narrow specialization of finance personnel. Increasing the capitalization of finance work, as required by C.3, and the advance of the data integration ideal, D.3, also promotes flexible task/problem staff deployments.

D. Procedures

D.1 refers to the desirability of limiting the number of bank accounts, preferably to one. D.2 requires that procedures should be evaluated against the ideal of integrated data management, a perspective which demands the elimination of redundant data and superfluous routines in favor of continuous assembly of outputs. It follows that local governments should adopt and execute comprehensive budgets, covering current charges and capital investments. Further, the budget system should be supported by a comprehensive accounting system covering all transactions. Comprehensive accounting systems, segmented internally by inter-

related "funds," are very common among local governments in the United States. The Government Finance Officers Association recommends the following array of funds:

- Governmental funds
 1. General fund
 2. Special revenue
 3. Capital projects (includes special assessment projects)
 4. Debt service

- Proprietary funds
 5. Enterprise
 6. Internal service

- Fiduciary funds
 7. Trust and agency

D.3 embraces five requirements. The first two, concerning segregation of certain cities, D.3.a, and formal delegation of signature power, D.3.b, are classic, well-understood "internal controls." In computerized finance environments, passwords are now employed to the same effect. Prior to the advent of computers, double entry accounting, supplemented by reconciliation and proof-reading practices, provided ways to satisfy D.3.c concerning process

controls on data entry and output. In contemporary computerized finance environments, the data entry and output controls include passwords, menus, batch controls, input verification, editing, audit trails, post entry review and "back-up" files.

D.3.d refers to reconciliation, also a classic, well-understood practice, applied to prove the accuracy of different data arrays. Centralized finance establishments, and those practicing data integration, have less need to employ reconciliation procedures. Criterion D.3.e refers to reservations. Reservations provide fundamental budget controls, starting with the concept of appropriations, which is a reservation. Allocations, allotments and encumbrances represent additional applications of the reservations concept in the process of controlling expenditures.

E. Operations

Reflecting a user's point of view, E.1 through E.3. represent quality controls applied to finance work and outputs.

In addition to supervising the day-to-day conduct of finance-related activities, local government finance officials, especially the chief financial officer, are expected to help formulate policy, including, at the highest level of finance thinking, recommendations concerning the "fiscal policy" of local government, that is, the relationship of local governmental finance (the arithmetic of the organization) to the local economy (the arithmetic of the community).

III. Revenue Planning and Collection

To be regarded as fair and effective, governments must strive for revenue equity among the people required to pay taxes, fees and service charges, and, revenue sufficiency to fund needed and desired public programs and investments. These are important public objectives. The importance of the revenues clearly justifies the establishment of a formal revenue research process, culminating in the adoption of an annual Revenue Collection Action Plan (RCAP). Exhibit 2 lists 17 aspects of revenue planning and collection procedure subject to criteria.

A. Organization

Organizational arrangements should encourage (a) leadership, (b) teamwork, (c) agendas and work plans, (d) documentation and (e) periodic performance reviews.

A.1 Timing. To be useful in the budget process, a complete draft of the proposed RCAP should be available to the chief executive's office at the beginning of the annual budget formulation process

EXHIBIT 2

Aspects of Revenue Planning and Collection Subject to Criteria

A. Organization

1. Timing
2. Staff assignments
3. Research agenda
4. Performance review

B. Documentation

1. Standards
2. Documentation
3. Files

C. Research: revenue management

1. Management considerations
2. Workplans
3. Performance reviews
4. Collection effectiveness
5. Cost of collection

D. Research: specific revenues

1. Preliminary steps and considerations
2. Research methodology
3. Key standards
4. Criteria for revenue-related legislation

E. Reporting

A.2 Staff assignments. RCAP formulation and implementation require the cooperation of all officials with revenue collection responsibilities; active, committed leadership of the jurisdiction's chief executive and the leading revenue collection official; teamwork among assigned staff; and definite allocation of documentation responsibility, including the composition and production of the RCAP Report.

A.3 Research agenda. Subject to the approval of the chief executive, an agenda should be set immediately following a review of the current year's experience to date, especially the status of actions listed in the current year RCAP.

A.4 Workplan. Following Agenda preparation, the RCAP Team should compose a Work Plan for its realization. The worktime and output expressed in Work Plans provide essential benchmarks for periodic performance reviews.

A.5 Performance reviews. Reviews provide periodic opportunities to report (a) performance for the latest completed Work Plan period, (b) revised estimates for the current period, and (c) projections for the coming period.

B. Documentation

B.1 Documentation standards. The following criteria should be applied to the

research process and its documentation: consistency, transparency, scholarship and relevance.

B.2. Documentation. Data requirements concern (1) the effectiveness/efficiency of revenue management and (2) specific revenues.

a. Revenue management. An effective organization attains its stated goals. An efficient organization attains its stated goals at "minimum," or "lowest" cost. Assessing the effectiveness and efficiency of any organizational activity requires the development and maintenance of data, and data arrays, as follow:

- (1) Input data, expressed in terms of money and/or worktime
- (2) Output data, expressed by measures of production
- (3) A calculation dividing input by output, or output by input to derive a "unit measure"
- (4) One or more additional ratios based on comparable situations to provide a reference for evaluation of the subject unit measures.

Over time, using unit measures as a guide, the RCAP Team can evaluate input-output relationships, and then encourage planning to improve the relative efficiency of collections, that is, reduce the unit cost and the unit time of collections, and/or increase the output per workhour and per amount expended.

b. Specific revenues. In conducting research on specific revenues, the RCAP Team and its assigned staff will draw on many sources of data. To order this process, and to facilitate the annual RCAP updating, a file of basic data on each revenue is required, with a new file established annually. A basic data array should include an integrated record registering data on the following topics:

- (1) Name
- (2) Legal basis
- (3) Philosophical basis
- (4) Source(s)
- (5) Rate(s)
- (6) Collection performance/projection
- (7) Collection effectiveness
- (8a) Collection cost
- (8b) Service cost
- (9) Collection efficiency

c. Projection. Rather than extrapolation, a "factorial" approach to revenue projection is preferred.

B.3 Files. At the beginning of each fiscal year, a new set of files should be established. Each revenue file should include a copy of updated Basic Data

Arrays. Files are to also be required for revenue management topics. The production of the Annual RCAP Report and the updating of the Basic Data Arrays will be facilitated by computer technology and available software.

C. Research: revenue management

C.1 Management considerations. Management considerations include (a) the organizational complexities of the revenue collection process, (b) the special management requirements of revenue collection, and (c) the importance of time. First, many local governments in the United States and elsewhere concentrate revenue collection responsibility in a collector heading a revenue collection unity assigned to a centralized finance department; but for reasons of cost and public convenience, delegate certain collection duties to various service units.

Second, the very nature of revenue collection has implications for management practice. Revenue collection officials must be ever attentive to "negatives," rather than "positives." Generally, what's *not* happening to revenues is more important than what is.

Third, revenue collection officials must also be ever attentive to the timing of receipts. As a general rule, time is not on the side of revenue collectors.

Fourth, once institutionalized, the management environment is fundamentally shaped by the requirements of the RCAP process, especially its data demands and action timetables.

Formal Work Plans and Performance Reviews represent the best organizational response to these managerial considerations.

C.2 Work Plans. Revenue collection officials should strive for efficiency and effectiveness by maintaining data arrays quantifying the relationship between input and output.

C.3 Performance reviews. Reviews provide periodic opportunities to report (a) performance for the latest completed milestone period, (b) revised estimates for the current period, and (c) projections for the coming period.

C.4 Collection effectiveness. Even though, in certain cases, they may not approach the potential yield of each revenue source, the revenue targets incorporated in the Annual Budget must be treated as key management goals.

C.5 Cost of collection. Work Plans should incorporate plans to reduce the cost of collection ratio:

$$\frac{\text{Cost of Collection}}{\text{Collection}} \times 100\%$$

D. Research: specific revenues

D.1 Research methodology. Each revenue is a "dependent" variable, that is, the amount collected is a "resultant," traceable to the behavior of "controllable" and "uncontrollable" environmental policy and managerial variables. Consequently, revenue estimators must examine the context of each revenue, then formulate projections which (a) reflect the influence of "uncontrollable" factors (population, inflation, economic activity) and (b) incorporate the revenue effects of recommended actions (coverage expansion, rate revisions) having a probable impact on the timing and amount collected. Appropriate factors are included in Exhibit 3:

Exhibit 3	
Factors for Research Methodology	
Factor	Action
1. Base estimate	
2. Coverage	a. Reach more subjects/objects b. Reduce leakage c. Reduce arrears
3. Population change	Automatic impact
4. Change in real income per capita	Automatic impact

Exhibit 3

Factors for Research Methodology

5. Inflation	Automatic impact
6. Rate change	Revise law
7. New development	Identify and register
8. New revenue source	Agreement on new law
9. Procedural changes	Agreement on changes

In general, with respect to each revenue, the assigned researchers should execute the following tasks:

- Define problems
- State goal, including multi-year projections
- Identify collaborators and affected parties
- Specify conditions required to secure goal attainment
- Formulate work plans:
 - Activities/Tasks
 - Measurements of Effort (Cost and Work hours)
 - Outputs
 - Checkpoints (Milestones)
 - Performance Ratios

D.2 Key standards. Once institutionalized, the Collector's management environment is fundamentally shaped by the requirements of the RCAP process, especially its data demands and action timetables. Because the RCAP concept also includes the application of revenue collection standards, the RCAP process puts a spotlight on local government revenue planning and policy, as shown in Exhibit 4 below. To meet or exceed these standard ratios, local governments must be committed to the frequent execution of the following procedures: coverage studies, cost of collection studies, cost of service studies, and rate revisions.

Exhibit 4		
Average Annual Inflation Assumptions Standards		
	Less than 2.5%	2.5% or more
1. Revenue Amount Year on Year % Change	=, > inflation %	=, > inflation %
2. Effectiveness a. Coverage Study b. Coverage Ratio	Biennially Equal, > 95%	Biennially Equal, > 95%
3. Collection Cost a. Collection Cost Study b. Collection Cost Ratio	Annually Equal, < 10%	Annually Equal, < 10%
4. Service Cost a. Service Cost Study b. Service Cost Ratio	Annually Equal, < 90%	Annually Equal, < 90%
5. Efficiency Collection Ratio	Equal, > 95%	Equal, > 95%
6. Rate Revision	Biennially	Annually

D.3 Revenue-related legislation. Regarding inflation, local government legislatures should avoid inserting fixed amounts when adopting revenue-related legislation.

Instead, they should adopt legislation defining policy for the timely adoption of taxes, fees, and service charges by the chief executive of the jurisdiction, setting standards for action, notice, and reporting.

E. Reporting

The RCAP Report should include (1) organized revenue-related data, (2) studies of specific revenues, (3) action proposals for improvements in revenue policy and collection performance, and (4) revenue projections reflecting the implementation of the recommended action proposals.

IV. Budgeting for operations and maintenance

Of all finance-related procedures, budgeting is the most important instrument of local government policy and performance. Exhibit 5 lists a total of 10 aspects of budgets and budgeting procedure which should be subject to the application of criteria.

Exhibit 5

Aspects of Budgeting Subject to Criteria

A. General specifications

B. Format

1. Cost Center Array

C. Allocation

1. Formal Allocation

D. Documentation

1. Multi-Year Perspective
2. Formulation
3. Presentation

E. Estimation

F. Control (goal attainment)

1. Allotment
2. Reservation
3. Performance review

A. General specifications

First, the budget and its supporting procedures should be comprehensive, implying a single government-wide process, including formulation and execution by a competent administrative authority, adoption by an accountable appropriation authority, and an audit by

an independent, qualified party. Next, all expense and revenue should be aggregated and reported in gross rather than net terms, thus avoiding understatements.

B. Format

Formats are important. People tend to think about that which comes before them. Options include the following:

1. **Line-item budgeting (LIB).** Features things to be purchased. By relating appropriations to commodities, line-item budgets represent a "shopping list" approach to allocation problems. This approach is thought to express official and citizen interest in the values of economy and control. This is known as traditional budgeting.
2. **Performance budgeting (PerB).** Relates appropriations to workloads and targets. By featuring unit measures, performance budgets are thought to express officials and citizen interest in managerial value of efficiency.
3. **Program budgeting (ProB).** Relates appropriations to goals, rather than organization units. Consequently, organization units participate in goal attainment efforts, often using team work and task force approaches. Program budgets are thought to express official and citizen interest in planning and the effective use of resources.
4. **Planning-programming-budgeting system (PPBS).** A more elaborate form of program budgeting. Relates appropriations to goals rather than organization units, relying on analysis of alternatives to determine allocations. This approach is thought to express official and citizen interest in planning and the effective use of resources.
5. **Zero-base budgeting (ZBB).** Relates appropriations to priorities, using ordinal

ranking of expenditure proposals, independent of historical experience and comparisons. This approach is thought to express official interest in economy and efficiency values.

In the United States, wholesale attempts to introduce the formats and procedures of PerB, ProB, PPBS and ZBB in pure form have been tried by many governments, including the Federal Government, with indifferent results. Adaptation and elaboration of the traditional Line-Item approach, selectively incorporating key features of these non-traditional procedures has been the rule. Although the alternatives to Line-Item Budgeting require differing techniques, all four agree on this very important point: Budget procedures and documents should concentrate on what is to be done (output) or achieved (outcome)- rather than what is to be bought (input). Consequently, the quality of a budget, in whole or in part, depends on (1) the relationship of allocated resources to purposes (the less the better) and (2) the comparative worth of these purposes (the more the better).

B.1 Cost center array. Whatever the format, every government requires a Chart of Accounts listing the titles and code numbers to be used in identifying, recording and reporting budgetary decisions and transactions. Cost center criteria follow:

a. Significance. As organizing concepts, cost centers should focus attention on significant activities, purposes, and goals.

b. Productivity. Every cost center should relate to output indicators.

c. Accountability. Every cost center must be assigned to a specific manager who shall have sufficient power to be deemed responsible for meeting, and exceeding, performance targets.

d. Reportability. In order to avoid excessive accounting and reporting, each

cost center should be tested for recording ease and accuracy.

e. Acceptance. Simply stated, those doing the work must understand and agree with the cost center concept and its productivity implications.

C. Allocation

C.1 Formal allocation. As a practical matter, most operating and maintenance budget allocations represent pragmatic responses to circumstances rather than formal, analytical considerations. First, governments function to assist and stabilize society, favoring unevaluated service continuity and the supporting appropriations. Second, everywhere in the world, officials appear quick to respond to social, economic and political disequilibria, seeking to protect rights and correct wrongs by appropriating funds for government programs. Finally, budgets frequently include appropriations complementing decisions previously made, such as operating and maintenance programs related to new facilities. Recognizing that a high proportion of annual budgets reflect the application of pragmatic criteria, especially the effect of program inertia and ad hoc responses to disequilibria, key policy officials in every government should strive to counter-balance these tendencies by enlarging the role of formal criteria in the formulation, adoption and execution of budgets.

a. Unit measures. Unit measures automatically relate program effort to results. These measures are formed by dividing numbers representing input by numbers representing output, and the reverse, as follows:

Exhibit 6 Evaluation		
Focus	Calculation	Unit Measure
Effort	$\frac{\text{Cost}}{\text{Output}} =$	Unit Cost
Effort	$\frac{\text{Worktime}^*}{\text{Output}} =$	Unit Time
Results	$\frac{\text{Output}}{\text{Cost}} =$	Units Per Cost
Results	$\frac{\text{Output}}{\text{Worktime}^*} =$	Units Per Worktime*

* May be hours, days, weeks, months, or years.

b. Investment returns. Expressed as follows:

$$\frac{\text{Benefits}}{\text{Cost}} = \text{or} > 1 + r$$

where "r" is the opportunity cost, expressed as the prevailing rate of interest.

c. Weighting and scoring. Comparative values can also be established by using weighting and scoring.

d. Modeling. Best described as hypothetical statements, models comprise an ordered set of assumptions about causes, effects and objectives. They can isolate the key variables which "make a difference" in program performance.

D. Documentation

D.1 Multi-year perspective. To enhance their ability to analyze, evaluate and coordinate resource allocations, those officials responsible for budget formulation should draft a Budget Perspective as a prelude to issuing the annual call for estimates.

D.2. Formulation. To provide budget documentation and to stimulate thought and planning, every cost center manager should be supplied with forms facilitating the completion of the following tasks:

- Define the problem(s) to be attacked programmatically
- State goal(s) in a multi-year perspective
- Identify collaborators and affected parties
- Identify the conditions required for goal attainment
- Formulate the preferred solution(s) and a workplan
- Identify alternatives considered and reasons for reflection
- Formulate a budget in a multi-year perspective

D.3 Presentation. Using completed forms as source documentation, cost center managers should be given the responsibility to prepare drafts of the pages to be

included in the submitted Budget.

E. Estimation

Aggregating an overall budget from a mass of subordinate cost centers and detailed estimates helps to produce an accurate total, because the inevitable plus and minus errors inherent in a mass of estimates tend to cancel one another. Provided each estimate is prudently and honestly formed, a mass of estimates tends toward zero variation. In forming estimates, budget estimators generally rely on the requirements approach, extrapolation, or correlation. Each is briefly discussed below:

- 1. Requirements approach.** Requirements (staff, supplies, etc.) are listed, priced and summarized. This approach is very common to many officials in budgeting, especially the supervisor, whose participation in budgeting has been restricted to listing and pricing commodities.

- 2. Extrapolation.** Estimates are derived from an evaluation of recent experience, especially current year estimates, classification by classification. Frequently, if the program environment is stable, current year estimates are simply adjusted for inflation and submitted for the new year.

- 3. Correlation.** Less common, but preferred, this approach requires the

identification and evaluation of independent variables, especially factors which conditions of determine expenditure and revenue amounts. Sometimes called the "factorial" method, in contrast to the shopping list and extrapolation approach, the correlation approach centers attention on input-output relationships.

F. Control (goal attainment)

F.1 Allotments. Many governments allot appropriations during the fiscal year, by quarter or month, with quarters preferred.

F.2 Reservation. Appropriation reservations represent a fundamental form of budget control. At any given time, unallotted appropriations form a reserve which, within limits, can be used to fund unanticipated expenditures. Many governments expressly incorporate an allotment for contingencies. Most important of all, the budget system should require the encumbrance of appropriations, reserving funds to meet anticipated future obligations. All purchase orders should rest on appropriation reservations. If possible, requisitions, prior to the issuance of purchase orders should be defined as encumbrances, requiring appropriation reservation.

F.3 Performance review. Without periodic performance reviews, budgeting degenerates into an annual estimating ritual. More than any other step, it is the institutionalization of formal reviews which invests the budget system with "managerial

muscle".

Exhibit 7	
Aspects of Capital Improvements Programming and Budgeting Subject to Criteria	
A. Organization	<ol style="list-style-type: none">1. General specification2. Accounting3. Inter-jurisdictional investment integration
B. Programming	<ol style="list-style-type: none">1. Planning linkage2. Funding and finance
C. Allocation	<ol style="list-style-type: none">1. Capital improvements program
D. Control (goal attainment)	

In many parts of the world and increasingly in nations now committed to "decentralization," local governments have the responsibility to emplace, maintain and operate essential public facilities. These facilities must adequately support the development and maintenance of the local economy, yet not burden that economy with costs which place its production at comparative disadvantage in the wider economy. Additionally, most local governments live with limits on their revenue raising power and their ability to borrow. Consequently, the desire, and, in many cases, the

necessity, for costly investments in infrastructure is constrained by (a) limited financial resources and (b) fear that the resulting costs, transmitted into the economy through taxation, fees and service charges, will retard or reduce production. Capital improvement programming and budgeting represents an important institutional response to these concerns and cross pressures. Exhibit 7 lists seven aspects of capital improvements programming/budgeting subject to criteria. "A. Organization".

A.1 General specifications. Organizational arrangements should 1) establish the chief executives responsibility for capital programming and budgeting, 2) require consideration of project proposals in relation to community development plans and policies and 3) ensure adequate project evaluation. These criteria can be best satisfied by empowering the chief executive to appoint a committee of key administrative officials, including the chief financial officer and chief budget officer, and the secretariat to be.

A.2 Accounting. Project accounting, and in a broader sense, asset accounting, are important. In the United States, local government capital programming and budgeting are supported by an array of separate funds, including a Capital Projects Fund and a Debt Service Fund. However, unless the investments are made by government-owned enterprises, asset depreciation will be not recorded or reported, a serious omission. In general, asset depreciation should be calculated, even if not funded, in order that local government officials can assess the impact of proposed projects on the government's net investment in public facilities.

A.3 Inter-jurisdictional investment integration. The facility investment plans of other governments must be taken into account. If the investment activity of other governments is frequent and significant, formal representation on the capital improvements committee, or strong liaison is warranted.

B. Programming

B.1 Planning linkage. Intended, or not, the emplacement and operation of public facilities influence the form and substance of community development. Proven by recent practice in the United States and elsewhere, the impact of public facilities can be multiplied if local governments consistently link their capital investments with the exercise of regulatory power and other mechanisms to influence community development in desired ways.

Consequently, a systematic linkage should be established between project proposals and local government plans and policies to influence the form and substance of the community. Satisfying this key criterion of effective capital investment programming and budgeting presupposes that the local government has authoritative development plans and policies.

Each year, the programming process starts with (a) the submission of documentation and cost estimates on new investment proposals and (b) where needed, updated documentation and cost estimates on those proposals already assigned a place in the existing multiyear Capital Improvements Program (CIP). In addition to officials, civic and business organizations should be permitted to submit proposals. Applying "admissibility" criteria set by the CIP Committee, the Committee secretariat evaluates each project proposal on its merits, unconstrained by reference to funding or financing. Admissibility criteria include proper documentation of technical features, cost estimate, estimated receipts and/or benefits, future operating and maintenance cost estimates, environmental impact, etc.

Although, in general, project evaluation can proceed without continuous reference to the multiyear financial plan under consideration by finance and budget officials, the Committee secretariat and these officials must work closely together on

those proposals having substantial revenue implications, especially those which provide an opportunity to recover costs through fees or service charges or those which can be supported by grants from other governments.

The project evaluation process concludes with the formulation of a tentative Capital Improvements Program(CIP), assigning proposed project appropriations to appropriate years by reference to project timing and project relationship criteria.

B.2 Funding and finance. In the next phase of the process, the project investments listed in the tentative CIP must be balanced against financial and institutional capabilities. Usually this process results in changes in the composition and timing of the investment program. Thus constrained, the resulting CIP should rest on strong institutional and financial foundations.

Representing "free money," unrestricted grants from superior governments are the preferred means of funding capital projects. Restricted grants, while welcome, are less desirable as their availability may distort local priorities, resulting in underused facilities and unbalanced development. General revenues, operating and maintenance expenditures, unencumbered reserves and unappropriated surpluses represent the third most desirable source of capital funds. Because interest charges on long term loans increase the eventual cost of projects, financing projects with borrowed money is the least desirable option. It must be noted that, in the United States, at least, a significant number of projects included in local government CIPs will be financed by borrowing rather than immediately funded by current revenues. Amortized by annual charges against current revenue over a long period, indebtedness is regarded as the best way to allocate the capital cost of public facilities to the inhabitants enjoying its benefits.

C.1 Capital improvements program (CIP). Listing projects and their estimated costs by the year of appropriation, a multi-year table provides the key exhibit of the

CIP document. This table usually shows the means of funding or financing. Although CIPs may span any number of years, five, and six year terms are common. Invariably, the projects listed for action in the tables' first year will constitute next year's Capital Budget. Exhibit 8 presents a Capital Improvements Program in generalized format as follows:

Exhibit 8						
Appropriation Year, Source of Funds/Finance						
	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Expenditure						
Project 1					xxx/A	xxxx
Project 2		xxx/B				xxxx
Project 3			xxx/C			xxxx
Project 4				xxx/D		xxxx
Project N	xxx/A					xxxx
Total	xxx	xxx	xxx	xxx	xxx	xxxx
Funds/Finance						
Current Revenue A	xxxx				xxxx	xxxx
Reserves B		xxxx				xxxx
Loans C			xxxx			xxxx
Grants D				xxxx	xxxx	xxxx
Total	xxxx	xxxx	xxxx	xxxx	xxxx	xxxx

Project evaluation implies criteria. First, criteria must be applied to determine which

project proposals will be admitted to the Program. In the United States and elsewhere those charged with the duty of selecting projects for inclusion in the CIP try to minimize the impact of purely "political" considerations by establishing formal criteria in rank order, applied uniformly to every proposal. This process results in a score for each project, and, thus, a relative rank in comparison to all other proposals. This process usually provides insight into the relative merits of each project, and, thus provides a good basis for the application of additional considerations and reasoned adjustment of project rankings.

Every array of projects will have a boundary, a so-called cutoff point for inclusion. Consequently, the relative ranking and possible exclusion of projects close to the CIP boundary deserve the most careful consideration.

To facilitate project evaluation and to provide the assigned officials with guidance, every local government should adopt formal criteria, appropriately reflecting its development situation.

Once admitted, a project appropriations must be assigned to a particular year. The local government's ability or willingness to fund or finance particular projects in particular years will have much influence on the timing of project appropriation. Maintaining a rather level appropriation total across the years has much merit. If this policy is pursued, projects are more likely to be assigned their places in the CIP by reference to financial criteria rather than strictly project-related considerations.

D. Control (goal attainment)

Experience in the United States, and elsewhere, indicates that capital investment projects are rarely completed on time and within budget! Also reflecting experience, and even more serious, adherence to project specifications during project development must be deemed problematical. Combating these tendencies requires (1) appointment of a project manager for each project, (2) a project management workplan, and (3) periodic formal performance reviews.

**Financing Local Self-Government
and Infrastructure of Cities in Ukraine**

**By
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Deputy Minister for Construction and Architecture of Ukraine**

I. Introduction

The problem under review is of extraordinary importance for the effective reformation of economic and public relations that have been begun in Ukraine today. The role of the government in providing the population with the most essential types of public services is undergoing radical change. There is an obvious tendency to reduce this role as far as financing is concerned. The most eloquent example is the twofold decrease in the volume of housing construction in 1992 as compared with 1987, which was the most favorable year in this respect.

At the same time we have to deal with yet another significant public tendency - the growing importance of local governments in solving the problems of the vital activities of their regions and inhabited localities. To a certain extent this has been secured in the legislation on local self-government and local Councils of People's Deputies. But there still remains the problem how to ensure the financial opportunities of local governments in providing the most essential public services and, especially in developing engineering and social infrastructure.

There has to be an intensive search for methods for mobilizing resources by the local governments to solve these and other problems, to define the sources of augmenting the budget as well as the principles of its distribution under absolutely new economic conditions.

Privatization of public property will have a decisive influence on this process. It is precisely the tax on property related to privatization which is decisive practically worldwide in shaping the budgets of local governments and providing them with the main opportunities for financing various development programs. Therefore, we deem it necessary to dwell on several points that we believe are essential for ensuring effective development of urban infrastructure -- the most important foundation of urban development.

II. Documentation for City Planning and Building

This is a crucial question for our cities and regions. The state of providing city planning documentation at the present moment can be defined as utterly inadequate. Here are some of the reasons:

A. Almost all of the General Plans were developed for conditions under which there was no place for private property or land, and the decisions on urban development were handed down from above without, as a rule, taking into consideration area ecological circumstances. Thus, the principles of functional zoning incorporated in the General Plans will have to be substantially revised, and this also holds true for the planning methodology that must reflect

the new socioeconomic relations.

B. Unfortunately, while shaping the expenditure parts of their budgets, the Councils more often than not do not fully realize the importance of social factors and the role that substantiated city planning decisions play in these factors. So it is small wonder that given the unsatisfactory augmentation of the budget, the expenditures for providing the inhabited localities with the necessary volume of documentation are sacrificed up front. As a rule, the budget does not have the resources for this purpose.

The decreasing involvement of the State in the problems of urban development means reduced allocations for planning from the State budget, which hampers project planning and timely documentation. But at the same time resources are being found in the local budgets for designing and building specific projects.

Since there is an acute need for resources for topographic surveying and designing, the current legislation must foresee a certain quota in the local budget for the needs of city planning as a category of public activity.

C. There are also serious problems related to the untimely preparation of construction sites: removal of facilities, engineering preparation, and engineering support, to which repurchase of land will be added in the near future. This is a costly item of a city's budget expenditures, and every attempt at economizing on that item leads to building delays,

reductions in the volume of construction, and even more expensive siting choices, which have an overall negative social effect.

From this follows the growing role of long-term city planning (within the framework of implementing a master plan) and its convergence with the objectives of city budget planning. This can be solved on the basis of using the land/economic improvement plans for inhabited localities (Regulations on these plans have been prepared by the Ministry for Construction and Architecture and submitted to the Government for consideration.), since these plans take into account procedures for the entire scope of land development and utilization measures in inhabited areas as well as economic measures, including the budget increases through land payments.

D. While shaping local budget items, the principle of proportional development of all the municipal services and facilities must prevail at last. It is outrageously criminal to tolerate the lag in the development of water supply and effluent purification when it comes to meeting ecological requirements and protecting the health of people. If housing construction dominates over infrastructure, even when noble aims are pursued, the result will yield real damage.

Some thorough thinking must be exercised to regulate this process legislatively, not only in the laws on environmental protection but also in the economic mechanism of distributing expenditures for various types of construction.

E. Urban development problems have certain financial barriers that a local budget can hardly surmount (even with the involvement of private business resources). These problems include the water supply in some cities (such as Lviv, Kirovograd, Berdiansk), the construction of bridges, subway lines, expensive measures for developing engineering and transportation infrastructure, and the creation of large and prestigious facilities.

Then there are barriers related to financing projects related to the nation's cultural and historical heritage. Tourism can be a good budget income item for a historical town (e.g., Pereiaslav-Khmel'nitsky in the Kiev Region). But such a town lacks the resources for creating a corresponding infrastructure as well as for keeping the historical monuments in good shape. To surmount these barriers State aid is needed; but the State is decreasing its involvement in urban development. Consequently, a lot of problems remain unresolved for a long time, and this produces huge material and social losses.

Judging from the preceding practice in city planning, there are several ways to solve these problems through personal contacts with government officials, lobbying, and other methods of influence. It would be expedient to raise the question of regulating such a situation legislatively, when the local governments would have the right to demand from the State direct participation in the solution of their problems.

F. The problem of Private ownership of land in the cities is bewilderingly complicated. By current legislation a city land plot can be leased for a term of up to 50 years, but the lack

of well-defined mechanisms of transferring land for lease has so far made it impossible to implement a single project in Ukraine.

In a city, land is the most important real estate element. Transferred to ownership, land becomes a source for augmenting the budget through taxation of property; additional investments, including foreign investments, for the building and maintenance of roads, utility systems, and bridges; and for the creation of a network of modern public facilities (hotels, stores, office buildings and the like).

In order for all that to work properly, it is necessary not simply to introduce amendments to the Land Code and other legislation, but to draft essentially new laws which would really create a most favorable legal environment for the functioning of the real estate markets. This also presupposes the development of all the required market mechanisms (auctions, property valuation, property taxation, registration of property, etc.).

Such work has been launched jointly with the experts of the U.S. Agency for International Development. It has been approved by Ukraine's Prime Minister Leonid Kuchma, and we expect our first developments to be submitted to the Cabinet of Ministers of Ukraine in early 1994.

Of great importance in this respect will be the implementation of demonstration projects in Kharkiv that will be carried out in accordance with a memorandum of cooperation

between the Kharkiv City Council of People's Deputies and the U.S. Government.

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**Private Real Estate Development, Infrastructure Provision,
and Land Use Regulation:**

Making Development Pay Its Fair Share

By

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I. Introduction

Faced with the financial pressures from expanded municipal responsibilities, decreased intergovernmental transfers, and political resistance to higher taxes, local governments around the world have increasingly turned to private developers to provide or pay the costs of public infrastructure needed to service their private developments. The basic rationale is simple. New private development places additional demands on publicly financed infrastructure. For example, a new residential project or office building requires water and sewer pipes connected to the main system, a road connected to the main street, and so forth. Since it is the new private development that creates the need for this additional infrastructure, it is fair to ask the private developer to shoulder the extra financial burden.

This paper examines approaches taken by local governments to make private developers provide or pay for additional public infrastructure needed by their development. First, the paper examines the basic rationale underlying the use of special approaches for

charging private developers with the provision or payment for certain public infrastructure necessitated by their development. Second, the paper describes the techniques and their applications. Third, the paper examines the use of general land use regulatory approaches to reduce costs of public infrastructure.

II. Basic Rationale

Although the specific allocation of authority and responsibility to governments and agencies varies, local governments around the world traditionally play a major role in providing, operating, and maintaining the public infrastructure of local roads, water and sewer systems, recreation facilities and parks, government buildings, and the other features that make it possible for urban development to occur. As a general rule, local governments have the legal obligation and practical responsibility to install a community's trunk infrastructure on an equal and timely basis to all land users within the jurisdiction. They receive much of the money for financing this infrastructure from tax revenues collected from individuals and businesses living within the local government's jurisdiction, from intergovernmental transfers, and sometimes from user charges (see *Taxes, Other Revenues, and Intergovernmental Transfers: the International Experience* by Schroeder and *Provision and Pricing of Communal Resources* by Hubbell). Thus, for example, all property owners pay property taxes into the general account of the local government, and the local government uses that property tax revenue, along with its other receipts, to cover its annual operating expenses and capital expenditures (see *Capital Infrastructure and Operating Expense Budgets at the Local Level:*

Considerations Related to the Organization and Management of Finance and Finance-Related Procedures by Lehan).

In free market economies, where private persons and companies own most of the land and develop most of the buildings, the question naturally arises as to how the burden of providing or paying the capital cost of the public infrastructure specifically needed by new private development should be distributed. For example, should it be financed exclusively out of general tax revenues collected from all residents and employees of the city, or from all property owners or land users? Or should there be a more targeted approach, in which the developers of new private projects are made to cover all or some of the costs of the additional public infrastructure attributable to their new development?

To the extent that local individuals and businesses pay taxes to the local government, and local government provides the services and infrastructure required by such individuals and businesses, the principle of "beneficiary pays" is broadly satisfied. That is to say, those who *benefit* from government services and infrastructure generally *pay* for the costs of such services and infrastructure. This is not a finely tuned calculation, however, and the correlation between taxes paid and service/infrastructure consumption is frequently inexact. In theory, governments would be able to ascertain exactly the amount of services and infrastructure consumed by specific taxpayers, and subsequently to allocate the tax burden according to this determination. While government might choose for policy or social equity reasons to impose a tax burden higher than that indicated by the allocated cost of

services/infrastructure, it would do so knowingly and fairly. In reality, we know that there is no allocation of tax burdens for reasons ranging from analytical complexities, data unavailability, and political hurdles.

In the provision and financing of certain public infrastructure, however, local governments over the past 40 years have taken a more aggressive approach to the "beneficiary pays" principle. Through such commonly employed techniques as *exactions*, *planning gain*, *impact fees*, *betterment levies*, and *incentive zoning* - techniques applied through the land use regulatory process rather than through the taxing process - local governments have imposed separate targeted obligations on private developers whose new projects create additional needs for public infrastructure.

Advocates of these mechanisms rely on the following rationale:

- New private development generates a measurable additional demand for public infrastructure.
- If the needed public infrastructure is not provided, the public will be harmed.
- Taxes and user charges (if applicable) imposed on the development do not uniquely or adequately cover the costs of such infrastructure.
- New private development should provide or pay the costs of the infrastructure specifically necessitated by such development.
- New private development should not provide or pay for more than its fair share of the

additional required infrastructure.

This rationale expresses a political as well as an analytical point of view. Without expressly stating so, it imbeds a preference for existing over new land users. Why assume that only new development places demands on infrastructure? Indeed, if existing development, equivalent in infrastructure needs to the proposed development, were magically erased from the landscape, then the proposed development would not place additional demands on the trunk infrastructure. If true, then why should new development be asked to pay more than existing development? The answer, of course, lies in the political realities of community governance. Since existing residents and businesses "outweigh" newcomers in terms of numbers of vote and relationships with local government officials, they understandably exert far greater political influence over local government policy. It is hardly surprising, then, that a generational bias would creep into such governmental policy and succeed in shifting some of the costs of public infrastructure from existing to new development.

III. Description of Techniques

Imagine the following situation. A private developer proposes to build 50 separate houses on five hectares of land to sell to families. The proposed development will need its own internal street and sidewalk network allowing residents to drive and walk from their houses to the local sidewalks and streets of the city. In addition, each house will need to run water and sewer pipes from the house to the local water/sewage treatment system, or to have a

separate water and sewage treatment solution through a well and septic tank. In addition to on-site concerns, there will be off-site impacts. The streets and sidewalks nearby the proposed five-hectare project will now be more congested, especially when people go to and return from work. Nearby parks will be more crowded in the evening and on weekends when newly resident parents bring their children to play. Other public facilities, such as schools, libraries, and community centers, will be more crowded.

Since the 1950s, governments in the United States, Western Europe, and, more recently, in Asia, have extensively applied a wide array of techniques to require or encourage private developers proposing residential, commercial, and industrial projects to provide or pay the capital costs of the public infrastructure needed for such developments. *Exactions, planning gain, impact fees, betterment levies, and incentive zoning* are among the most popular techniques used to obtain public infrastructure from private developers. Each of these techniques is authorized by formal laws enacted at local, regional, and sometimes even national, levels of government. The laws clearly describe when and how these techniques are to be used, the methods for determining the financial obligations of private developers, when such financial obligations apply, and so forth.

It is important to recognize that these techniques are considered land use regulatory [devices] rather than tax devices, and that they are administered within the land use regulatory [process] rather than the tax process. As discussed above, it is the use and development of land that create the infrastructure impact, and it is the land use regulatory process that may or

may not allow certain development to occur. Landowners have a choice. If they do not develop their land, then they are not obligated to provide or pay for new infrastructure. Only if they want to develop their property are they asked to provide or pay for additional infrastructure. In the usual case, the development application to governmental authorities seeking permission to develop triggers the mechanism.

Although the techniques have many similarities, they also vary according to the following five issues:

- Dedications/"in-kind" contributions versus payments "in lieu of" dedications
- On-site versus off-site obligations
- Traditional public infrastructure versus expanded public infrastructure obligations
- Negotiated versus formula-derived obligations
- Mandatory versus voluntary obligations

A. Exactions and Planning Gain. *Exactions* and *planning gain* are obligations imposed upon private developers for either the actual provision or the financing of public infrastructure, determined on a project-by-project rather than a fixed formula basis. The developer will apply for permission to develop the project and will submit a proposed plan showing the location of buildings, streets, infrastructure, and other elements. Land use regulatory officials will review the plans, assess potential impacts, and make an initial

determination of what obligations to impose. This review is conducted with the developer's participation and the process frequently has the air of a negotiation.

1. Dedications/In Kind Contributions Versus in Lieu of Payments. The obligations imposed on the developer commonly take two forms: *dedications/in kind contributions* and *payments in lieu of dedications*. First, developers may *dedicate* land owned by them to the public, for use as road or infrastructure corridors, or for parkland. The developer may also actually build the road or public facilities necessitated by the development. In both cases, the developer in effect gives the land (and structure) to the local government as a condition for receiving development approval. Second, the developer may make a *payment in lieu of dedicating* land or building the infrastructure to the government, which in turn applies such money to build the infrastructure.

2. On-Site versus Off-Site. In recent years, obligations imposed upon developers through exaction and planning gain programs expanded beyond uncontroversial *on-site* obligations to a new category of *off-site* obligations. Take the five-hectare 50 house project described earlier. The provision of internal streets and sidewalks or water and sewer pipes hooked into the trunk lines would be considered standard fare for many countries. Today, however, many local governments would ask the developer to make *off-site* improvements or cash contributions. For example, since the 50 houses mean more traffic on the streets and sidewalks outside the five hectares, then the developer

should be required to widen the public street and add an additional meter in width to the sidewalk. In the alternative, the developer should pay money to the government to do the same. Since most developers are not street builders, they choose the option of paying money. The more off-site the obligation imposed, the more controversial it becomes. For example, some local governments ask developers to build or pay for community centers or recreation facilities located kilometers away from the proposed development.

3. Traditional Public Infrastructure Versus Social Infrastructure.

Furthermore, the list of exacted infrastructure has gained new, debatable elements. Where early exaction and planning gain programs limited themselves to traditional public infrastructure such as roads and water and sewer, newer applications seek to address social concerns. Thus, for example, private developers might now be asked to build housing for poor families or a new library in return for development permission. Although it is possible to argue that residents of the new project will use existing library facilities, and thus that new library facilities are in order, the connection between the development and such facilities is probably more tenuous than that between the project and water/sewer needs.

When housing for poor families is involved, it is difficult, although not impossible, to justify requiring a developer of housing to dedicate certain units for poorer families, on the argument that his or her proposed 50-unit housing development

will create a need for such poor family housing. To be sure, society needs housing for poor families, but the question remains whether it is fair to ask individual entrepreneurs to meet needs that society, through public revenues and government actions, normally meets.

4. Legal Tests of Rational Relationship and Proportionality. The idea of shifting public infrastructure costs, and thus the tax burden associated with it, from all members of a community to a selected few holds political appeal. When majorities attempt, as they sometimes do, to abuse their position and impose unfair burdens on minorities, it is frequently the judiciary that assures the observance of constitutional and legal protections. In the area of exactions, planning gain, and impact fees, the risk exists that private developers will be asked to provide more than their fair share of public infrastructure. Judges in Western Europe and the United States have developed sophisticated tests to guarantee that property owners are not asked to bear burdens which, in all fairness and justice, should be borne by society as a whole. These tests usually ask three questions:

- a. Does the proposed development generate an additional need for public infrastructure?
- b. Is the exaction, planning gain, or impact fee reasonably related to the additional need?
- c. Does the exaction, planning gain, or impact fee address the need in a proportionate way?

Thus, asking a developer of a 50-unit housing development to build a four-lane highway five kilometers from the site would fail this judicial test, while requiring provision of feeder roads from the development and some road widening near the site would be permissible.

B. Impact Fees. *Impact fees* are usually one-time cash payments, assessed at the time a building permit is sought and calculated according to a prescribed formula varied only by type of development. Thus, unlike the situation under exaction and planning gain programs, developers typically may not satisfy an impact fee by building the infrastructure, nor may a developer through negotiation reduce the charge for his or her particular development. To adopt an impact fee program, local governments must make four determinations.

- 1. Local governments must determine norms of usage, expressed on a unit basis, for different categories of infrastructure according to different categories of development.** For example, a typical house in the five hectare project will hold three persons, who together will consume an average of "X" liters of water daily, and who will create "Y" amount of additional congestion on the roads. For an office building or apartment building, the norm may be expressed for each square meter of development, instead of for each housing unit.

- 2. Local governments must determine the amount of additional infrastructure**

capacity necessitated by an extra square meter or unit of development. These determinations are made by engineering experts based on general and specific information gained from past experience. Of course, this is not as easy as it may first appear. Assume that the sewage treatment plant is currently operating at peak capacity, and that any additional sewage pumped into the system would overwhelm the plant. Thus, any new development will require the construction of an entirely new treatment facility. Does one additional square meter of development thereby require an entire new treatment plant? In a limited sense, the answer is yes. For purposes of calculating impact fees, however, average and marginal infrastructure impact analysis must be intelligently conducted to obtain an accurate correlation between development and infrastructure. Other users will be taking advantage of this new plant in the future, since it will have far more capacity for processing sewage than that needed solely by the one additional project.

3. Local governments must calculate the capital cost associated with constructing the additional infrastructure attributable to a square meter or other unit of development.

4. Local governments must credit new private development for any payments it makes under existing tax programs that are used to finance new public infrastructure to assure that new development does not "double pay" for the project.

C. **Betterment Levies**

Betterment levies are fees assessed on the increased value of land resulting from the provision of infrastructure improvements (and sometimes from changes in land use regulations). Unlike exactions, planning gain, and impact fees, betterment levies do not attempt to connect the cost of providing infrastructure to the increased infrastructure demands of the project. Instead, betterment levies focus on increased market value. Imagine the market value (what a willing buyer would pay a willing seller) of a 10 hectare parcel of land located five kilometers from the nearest road and water and sewer line. Imagine the market value after the government builds a new highway and water and sewer trunk line next to the parcel. Betterment levies attempt to capture some (or sometimes all) of the increase in value owing to public investment, in the belief that the landowner is not entitled to benefit from that increase in value. Of course, this raises a fundamental question about what creates value in land at the outset, and betterment levies have their philosophical roots squarely planted in the soil of the 19th century social economist Henry George.

D. Incentive Zoning. Under *incentive zoning* programs, cities use their land use regulatory authority to give private developers the right to build larger projects that generate additional profit, if the developers agree to provide certain desired amenities such as parks, housing for poor families, child care centers, museums, and other desirable additions to urban life. Incentive zoning differs from exactions in that it is considered a voluntary program

applied at the margins. Developers may build substantial projects without participating in an incentive zoning program. If they want to build even larger projects, then they can do so as long as they meet the incentive zoning guidelines for providing amenities. For example, a developer may construct a 5,000 square meter office building as a matter of right. In the alternative, the developer may construct a building 20 percent larger, or 6,000 square meters, if he or she provides a public park and a child care center on site.

IV. Using Land Use Planning and Regulatory Strategies to Decrease Costs of Public Infrastructure

Exactions, planning gain, and impact fees all deal with the additional impacts of new development on publicly provided infrastructure. If, for example, a house is constructed 10 kilometers from the nearest road and water and sewer trunk line, then that owner should have to provide or pay part of the cost of the needed public infrastructure. Another approach is to employ intelligent land use planning and regulatory strategies that reduce the need for, and thus the cost of, infrastructure provision. The approaches adopted by local governments around the world rely on five basic components:

- Greater coordination and connection between land use and capital planning/budgeting functions
- Provision of adequate information system on land use and available infrastructure

- Capital planning and provision as method to guide, rather than respond to, growth patterns
- Determination, use, and enforcement of development patterns with low infrastructure costs
- Examination of norms used for infrastructure standards and provision of service.

A. The preparation of land use plans and implementing regulations must be coordinated with the preparation of capital plans and budgets. Too often, General Plans guide the location of land use and development without adequate information about or control over plans and budgets for infrastructure provision. Government departments responsible for capital plans and budgets are frequently different from those responsible for land use plans. Goals and professional backgrounds (engineering/accounting versus planning) diverge. Legislated coordination and institutional arrangements can help assure that one plan or action does not undercut another.

B. Reasonably conceived cost-effective land information systems can contribute to the preparation of intelligent land use plans, capital plans, and capital budgets. Such information systems would ideally contain information about actual development and land use patterns, type of land, ownership, and existing infrastructure networks, on a parcel-by-parcel basis, especially in areas experiencing or slated for urban development.

C. The provision of capital infrastructure should serve as a positive strategic planning tool to reduce overall costs of infrastructure for both the private and public sectors.

Providing an adequate supply of serviced land in advance of demand, while prohibiting development in areas where infrastructure does not exist, are ideal goals that are articulated more often than achieved. Unfortunately, capital infrastructure planning has too often responded to, rather than led, development.

In developed countries, infrastructure provision has frequently followed decisions of the private marketplace as to where development should occur. On the one hand, this is a great strength of the market, allowing economic forces rather than centrally planned administrative decision-making to determine the contours of the developed landscape. On the other hand, it can lead to inefficient, even inequitable, overall patterns of development, with little consideration given to infrastructure costs or energy consumption.

In extreme situations, the refusal to provide capital infrastructure is a reasonable approach. Some areas reach maximum capacity. Some governments simply lack the financial capacity to service all new growth. Under the banner of "growth management," communities in Western Europe and the United States have sometimes just said no, or, in the alternative, have dramatically slowed growth ("no growth," "slow growth" or "phased growth"). They have adopted moratoria on developer hookups to their water and sewer connections, or on access to public streets. Under the so-called "concurrency" doctrine, they have denied development permission unless and until the developer can show that the public infrastructure

network will be adequate concurrently with the commencement of operations of the new development.

Under growth management capital improvement programs, governments may lay out timed infrastructure investment plans in a geographically specific fashion over a specific term of years, and indicate when they will connect a parcel of land to the infrastructure system. Developers may choose either to wait until their year arrives in the plan, or to provide or pay for the necessary infrastructure themselves (the so-called *Ramapo* approach, named after a famous town name and judicial decision from the United States). It is hardly surprising that techniques such as exactions, planning gain, and impact fees, which shift the cost of infrastructure from public to private pocketbooks but do not stop development altogether, would gain popularity. Even as developers complain about the cost of such obligations, they continue to build their projects.

In developing countries, governments are virtually always operating under a service deficit approach, attempting to catch up to development that far outstrips their public financial resources for infrastructure.

D. Research indicates that certain patterns of development achieve less expensive per units costs of infrastructure than other types of patterns, especially with regard to roads and water and sewer provision. For example, within broad ranges, higher density clustered development patterns have lower unit infrastructure costs than low density sprawl

development. This makes intuitive sense. The size of the collection and distribution network for both roads and water and sewer will be reduced if the distance between service points is reduced. In addition, development allowed in areas with bad natural drainage (wetlands, swamps) and steep slopes tends to incur higher infrastructure provision costs. Land use plans and implementing regulations should consider such costs along with the other concerns balanced in such plans. Without undercutting reasonable public goals, plans should discourage or prohibit development with high infrastructure costs.

In some cases, capital infrastructure investments themselves can promote inefficient patterns of development. The construction of linear arterial roads usually leads to linear development patterns on both sides of the road, instead of higher density clusters. Rather than containing growth, the building of a ring road can open up new areas for growth. And once individuals take root and build informal, let alone formal settlements, it is enormously difficult to remove them. Indeed, they usually become a force with which the political decision-makers on infrastructure provision must reckon, and a self-fulfilling prophecy for where infrastructure investments must next take place.

E. Technical norms for infrastructure provision sometimes exceed the actual needs of users and thus result in unnecessary costs. High maintenance technologies, over engineered mechanisms, and excessive standards are not uncommon in countries around the world. Standards for roads and water and sewer provision may deliver a level of infrastructure neither affordable nor truly needed by the area in question. A top-to-bottom review of norms can lead

to substantial savings in infrastructure provision. A review of service levels may also reduce infrastructure costs.

**Problems of Housing and Communal Services Finance, and
Reform of Pricing and Tariffs for Housing and Communal Services**

By

**A. Dron
Chairman, State Committee of Ukraine on Housing and Communal Services**

The housing and communal services industry, being a constituent part of Ukraine's national economy, occupies an important role in satisfying the everyday needs of the population.

I believe everyone in the auditorium is well aware of the structure and direction of activities in communal services. Therefore I am not going to dwell on that. I will just point out that the State Committee on Housing and Communal Services is in charge of more than 20 kinds of communal services, the major ones being water supply and sewage, communal energy system, housing maintenance and repair, elevator servicing, verdure provision, city electric transportation facilities, and sanitary cleaning.

This industry comprises more than 2,400 enterprises and entities, concentrating almost one fourth of the basic funds of Ukraine's national economy and giving jobs to nearly 630,000 people. Ninety percent of basic industry funds have been transferred to communal ownership.

Directly subordinate to the Committee are 25 machine-building plants and car-repair enterprises, 3 scientific and research institutes, 7 major and about 30 smaller planning institutes, a number of civil construction and alignment and commissioning entities, educational institutions, etc.

There are many factors which have a negative economic impact on housing and communal services enterprises and entities, such as a large production capital capacity, the existence of large non-production funds, a considerable number of unprofitable and low-profit enterprises, and a rather high budget allocation level. Besides, this industry's enterprises render services and carry out tasks are paid for depending on the solution of many social issues.

Until recently the financing of housing and communal services was a strictly centralized system. Money was allocated from the State's Ministry of Housing and Communal Services budget, which then was distributed to enterprises and entities through organizations at a lower level. Since this industry is neither a leading nor a fundamental one, its financing was effected on what is known as "the principle of remaining resources."

Under present conditions, when budgeting is based on utterly different principles, a mechanism of decentralized financing has been set up and, accordingly, reimbursement of losses is provided by housing and communal enterprises. As a result of the deep economic crisis today, the problem of creating viable local budget financing mechanisms has taken on

acute importance.

Ukraine's new system of budgeting has been in existence for two years now (The *Law on the Budget System* was adopted on Dec. 5, 1990.), and we believe it has to be further improved. I believe detailed discussions of this problem with foreign experts' participation in the framework of this conference will help to determine the most reasonable directions for solving the issues of housing and communal services finance.

It is common knowledge that the State budget, together with local budgets, makes up the Ukrainian budgeting system now. Every regional, city, district, township and rural rada of people's deputies has its independent budget. The basis for budget independence is provided by local budget revenues proper as well as revenues in all categories of the budget system.

The Supreme Rada of Ukraine determines the mix and volume of the Republican [Ukrainian] taxes, fees and payments that go into local budgets, depending on the respective social and economic standards, budget provisions, size of the population and the state of local revenue sources.

In conformity with the *Law on the State Budget of Ukraine in 1993*, subsidies to the housing and communal services economy are included in the standard allocations from national taxes and fees (i.e. tax on profits of enterprises and entities, excise duty, and value added tax). Distribution of this subsidy, according to the current legislation, between the budgets of the

Republic of Crimea, the regions, districts and cities is determined by the Supreme Rada of the Republic of Crimea, and regional, Kiev and Sevastopol city administrations. However, tension over the financial state of the national economy has resulted in the inability to transfer necessary amounts to local budgets through standard deductions from national taxes and fees.

The amount of subsidies to enterprises of housing and communal services industry in 1992 was 59.1 billion karbovanets (karbs.), while in the national budget for 1993, subsidies for maintaining the housing stock, water supply and sewage, heating and hot water supply, gas supply for household needs and electric public transportation were estimated at 562.7 billion karbovanets, which is just half of the required amount. As a result, the debt of the enterprises and entities reached almost 23 billion karbovanets as of May 1, 1993, which badly deteriorated the financial state of the system's enterprises and entities.

Given a new increase in prices for energy bearers and a simultaneous increase in prices and tariffs paid by the population, the estimated value of the subsidy reached 2,552.6 billion karbovanets.

Under present economic conditions, the budget cannot stand such a subsidy. According to projected calculations in 1993, the value of subsidies for housing and communal services equals 4.1% of Ukraine's gross national product, well within the limits of the standard size of the overall deficit compared to the gross national product, accepted throughout the world. However, the question arises as to what other non-production entities can be

supported? To show how much of a strain this subsidy puts on Ukraine's economy, I will mention that in the first quarter of this year the actual amount allocated to enterprises of housing and communal services for covering the losses will only equal 44% of the projected value of the subsidy. This share is expected to rise constantly. And even if we propose the most effective mechanism of subsidization, whether from republican or from local budgets of various levels, the enterprises of this industry will not be able to work efficiently without a drastic reform of prices and tariffs on housing and communal services.

According to the viewpoint held by the Committee, there is no alternative except for this industry to function without subsidies. A gradual transfer to tariffs that correspond to actual expenditures and also target compensations to consumers of services, as it has been proposed by the Committee on Housing and Communal Services, will ensure normal operation of the services under market conditions, thus providing people with adequate services.

We have been engaged in this type of activity for some time now. Last year we changed to payments based on general residential living space. Tariffs were raised 30 to 50 times for major services starting in December, 1992; however, we will not forget that prices for fuel and other products that our industry consumes rose 200 to 300 times.

Under these conditions it was expedient to find a solution for compensating such a manifold increase of retail prices. An increase in expenditures on housing and communal services was compensated both last year and this year by the government of Ukraine from the

state budget and partially by increasing prices and tariffs for the population on housing and communal services. This was stipulated by Decree #403 of the Ukraine Cabinet of Ministers dated June 3, 1993, the *Law on Changing Pricing and Tariffs*, which granted an increase in tariffs for communal services of 5 times for water supply and sewage; 8 times for heating and hot water supply; 4 times for rent, fixed at 10 karbovanets per square meter of general living space; and 15 times for gas at 25.5 karbovanets per 1 cubic meter.

Accordingly, beginning June 4, 1993, the cost of housing and communal services for an average one-room 3.14 square meter apartment for one person will cost 3,008 karbovanets per month; a 2-room 46.3 square meter apartment for 3 persons, 5,672 karbovanets; and a 3-room 66.2 square meter apartment for 4 persons, 7,795 karbovanets. per month. In addition actual expenditures to maintain a one-room apartment equal 33,164 karbovanets; a 2-room apartment, 59,873 karbovanets; and a 3-room apartment, 83,526 karbovanets.

It is obvious that tariffs compensate only an insignificant portion of the expenditures for industry enterprises and entities to provide housing and communal services: housekeeping costs are about 8.3 percent; water supply, 12.1 percent; sewage, 18.6% percent; heat supply, 8.7 percent; and daily gas supply, 25 percent of the total amount of expenditures. A sharp decrease in the living standard and a change in the family budget in buying foodstuffs instead of other expenditures do not allow compensation to the housing and communal service industry for higher costs.

We are, nevertheless, confident that, parallel with reforming the salary system, the State should gradually shift this burden to the shoulders of the direct consumers of services, giving targeted compensation to the respective population strata based on income.

We believe it is reasonable to authorize local governments to set up the tariffs themselves. It is hardly clever under these new conditions to establish the same unified prices for supplying water, heat, rent, etc. in Kiev, other major cities, and smaller towns where the cost of services differs.

One of the specific features of the housing and communal services industry is that, under any conditions, it has to ensure stable functioning of the system to satisfy vital population needs. It makes this industry's transition to market relationships more vulnerable than that of other industries; however, the Government's current economic policy doesn't take this into account. Thus, by Decree #71 of the Cabinet of Ministers, the *Law on Regulating Funds of Consumption in 1993*. payment variations to communal services workers were not taken into consideration, and it was only owing to the joint efforts of the Committee and a number of regional leaders that we managed to introduce certain corrections recently.

A second feature is that the procedure for paying the VAT [value added tax], which was adopted in 1993, is not sensitive to those entities which provide services regulated by tariffs. The situation in this case is sometimes paradoxical when the size of this tax exceeds the volume of consumer proceeds. Unstable subsidization from the budget causes financial

crises for enterprises, but granting privileges is still pending the imposition of the VAT on unprofitable enterprises of operational housing and communal service divisions .

A third feature is that, in preparing the 1993 State Budget, we proposed to grant privileges on taxing land parcels allocated for this industry's production needs, but this proposal was not accepted either. A decision in this respect to index the rates of this tax 14.8 times will lead to an increase in losses of about 40 to 50 billion karbovanets.

A fourth feature is that, since one-fourth of the national economy's funds is concentrated in the housing and communal services industry, and this industry's enterprises are, on the whole, physically worn out, it seems necessary to find investment sources for their renovation. This issue can be solved by creating an extra targeted budget fund for housing and communal services development by local governments that will incorporate proceeds of up to one percent from the labor payment funds of self-supporting enterprises, irrespective of the forms of ownership.

As far as the national economy is concerned, I would like to point out a problem that is extremely important, not only to communal services workers but to the entire national economy. This is the conservation of resources. I will remind you of some figures. The housing and communal services industry:

- Consumes 10.5 billion KWh of power per annum (i.e. 17 percent of total national power consumption)
- Treats and supplies 5.2 billion cubic meters of water per year to both the population and to the manufacturing industry
- Produces and supplies 54 million H\cal. of heat energy per year (i.e. 771,000 tons)
- Consumes 15.4 billion cubic meters of natural gas and 0.8 million tons of liquid gas

Today nobody - neither suppliers nor consumers - is really interested in saving these resources. This cannot be the situation in a market economy.

It is true that we are approaching a comprehensive solution of this problem. We have developed and are beginning to manufacture water meters. Next will come heat and gas meters. Tariff reform has begun, which will result in the habit of people and industry saving the above resources. The privatization process which is underway will also have a favorable impact upon the economy.

So far the main thing is missing, however; neither enterprises providing water, sewage, heat and gas nor housing and communal services entities are much interested in actual

conservation. A mechanism to stimulate such saving has not been suggested yet.

I would suggest the year of 1993 should be a breakthrough in this respect. A comprehensive program is now being created, and a number of enterprises are preparing to test new approaches. The mechanism for improving the financing of enterprises and entities is proposed as follows:

- Eliminate all types of taxation on the portion of revenues which is directed for production development (expansion, modernization) in all industry enterprises and entities
- Scrutinize priority expenditures from local budgets that are included in financing the housing and communal services industry
- Provide industry enterprises and entities of the industry with privilege credits

It is obvious that problems facing the housing and communal services industry are manifold and deal with many complicated issues. All the problems involved can possibly be solved only with the close cooperation of the highest State management offices with local radas and administrations. The issue of reforming the rent payment system requires a separate analysis.

We believe the rates of rental payment for State housing stock must be fixed by the owners of such buildings, i.e. by local radas of people's deputies, enterprises, entities and

organizations. Apartment rental payments should consist of the following:

- Actual expenditures for technical and sanitary maintenance of the building and the adjacent property
- Depreciation for repairs
- Depreciation for complete renovation of housing stock

In addition charges for building maintenance and repair are computed on the general floor space of the apartment. Payments for future repairs should be computed based on the age of the building at a factor of 0.8% of the building's remaining cost balance and should be distributed among tenants proportionally to the general floor space of their apartments. In the same fashion the payment rates should be calculated with respect to the complete building renovation cost. Costs for regular repair and complete renovation of the residence will be paid from the housing owners' special accounts and will be spent as targeted [by the accounts]. Tenants whose apartments are located on the first and top floors of multi-storied buildings (having more than 5 stories) can pay for repairs at 0.7% of the remaining cost of the building; they will therefore be compensated for the inconveniences incurred.

Payment privileges will be granted to the following categories of tenants:

- Families in which every family member's income is lower than an established level should be fully exempt from paying rent.
- Tenants who inhabit shabby housing and buildings acknowledged as unsuitable for

habitation. Communal apartment residents will be exempt from payments for repairs and for full renovation.

- Tenants who occupy living space below an established minimum (8 square meters of general floor space per family member) will be exempt from payment for full renovation

In the second and third cases above, privileges will be covered by the housing owner. The State communal service enterprises must provide tenants with the list of jobs per the respective regulations as well as an account of expenditures.

It is impossible to change to such a type of rent pricing all at once. Today housing rental equals 2 percent of income, while the system proposed will equal 15 to 20 percent. Reform of rent pricing, therefore, is to be effected in stages according to our proposals, with limitations, though, on the State level. Again, as in the case of the first privileges group, provisions should be made to foresee coverage by the housing owner of the losses which the above limitations introduce into the State budget.

Privileges for wealthy citizens, as elsewhere in the world, should be cancelled in the established way.

It is natural that, under existing conditions of economic crisis, it is impossible to finally

define the concrete stages for carrying out pricing and tariff reform in the housing and communal services industry. We hold that such a reform is to be accomplished within 3 to 5 years in stages. During the first three years the following should be done:

- There should be a transition to unified prices and tariffs, bearing in mind that consumers' payments for services provided should be sufficient for housing and communal services enterprises.

- All expenses should be covered and an optimal profit level should be maintained.

- State subsidies to housing and maintenance enterprises for servicing State housing stock should be cancelled by 1994.

- During 1993-1994 State subsidies for water and sewage services should be eliminated by a gradual (quarterly) revision of tariffs aimed at bringing them to actual operating expenses.

- Until the end of the transition period, the State subsidies to heat supply entities should be preserved, to be accompanied by a gradual tariff increase for services rendered until the value of not less than 45% of the actual expenditures incurred by the enterprises is reached.

The proposed reform can only be carried out if salary reform is also effected. Apart from considerable budget savings, reforming the pricing and tariff system has some other advantages:

- A transition from subsidizing enterprises to making subsidy payments directly to consumers will create normal conditions both for producers and consumers and will also result in saving natural resources.
- Provisions will be made for implementing negotiable relationships between consumers and services producers which will improve the quality and economic backing of the transition to market relationships for housing and communal services enterprises.
- Subsidies to poorer population groups for additional costs will eliminate the existing inequality which has developed in recent years between citizens inhabiting State, cooperative and private apartments.
- Anti-inflation measures will be created, since the proposed pricing and tariff reform will cause a considerable decrease in the cost of services for self-sufficient enterprises and entities in other divisions of the national economy and a decrease in the cost of production.

- Setting rent at the actual cost level and paying subsidies directly to poorer consumers will create the financial conditions necessary for more active privatization of housing and community projects.

Without exception, all the states of the former Soviet Union face the same problem of reforming the pricing and tariff system. At the conference of the directors of housing and communal services agencies of the former [Soviet] Union which was held in Kiev, this problem was acknowledged to be the most important one. It was decided to coordinate efforts to find approaches to reforming prices and tariffs; however, I would suggest that we cannot do without taking advantage of the world's best experience, especially that of the developed countries of the West which have socially-oriented economies. I am, therefore, looking forward to assistance from the respective international agencies.

Provision and Pricing of Communal Services

By

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I. Introduction

This paper addresses the broad issue of the provision and pricing of communal services in developed countries.¹ While much of the analysis is drawn from the economic regulation practices of the United States, the practices and policies of other countries are considered as well. It begins with a discussion of the institutional setting for the provision of public services. The next section of the paper explores, in general, the pricing objectives of public service entities. This section is followed by a brief discussion of current pricing practices and issues. The final section examines specific pricing practices for four major urban services.

II. The Institutional Setting

The ways in which individuals and groups intervene in the process of setting communal service prices is largely determined by the institutional setting. The role of higher levels of government in determining these charges depends largely on intergovernmental fiscal

¹In this paper the terms "communal services," "public services," and "utility services," are synonymous. Technically, communal services are a broad range of services provided by government agencies and not-for-profit organizations. The term "public services" is often reserved for the goods and services provided through governmental organizations. Finally, public utility services are traditionally interpreted to include, at a minimum, the following; electricity, gas, water, sewerage, solid waste disposal.

relations. If the national authorities/ministries provide services directly, they normally have the direct responsibility for setting user charges. For example, national electric and telephone companies are common across Europe and Asia. These authorities, however, are by no means homogeneous in their method of financing capital expansion or in their pricing methods.

If national authorities do not provide service directly, they often build facilities for it, which are then handed over to local authorities for operations; or local authorities may build and operate their own facilities without national assistance. In each of the structural situations cited, the pricing of the public service may be determined by bodies or commissions unrelated to the service entity.

In the United States, for example, the pricing of public services is, for the most part, determined by organizations other than those providing the services. These quasi-governmental institutions are separate from the nation's traditional three branches of government--executive, legislative, and judicial. The regulatory bodies or commissions are sufficiently independent to constitute almost a fourth branch of government.

The primary goals of these bodies are:² 1) To ensure that the public service enterprises (privately owned utilities)³ fulfill their legal obligations to serve all customers within their

²A good discussion of regulatory goals is contained in Farris, M. and Sampson, R.J., *Public Utilities, Regulation, Management and Ownership* (Prospect Heights, Illinois: Waveland Press, 1989), pp 159-170.

³In the United States, privately owned utilities are actually investor owned, publicly traded, corporate entities. Ownership is widely held through publicly traded common stock.

jurisdictions; (2) to protect consumers from the monopoly power of a single producer by establishing a "reasonable price" for the public services rendered, one which only allows the utilities a fair return on their investments; (3) and to promote an efficient allocation and utilization of the resources employed in the regulated industries.

To illustrate, in the United States the wholesale price of electricity and natural gas are regulated by the Federal Energy Regulatory Commission (FERC). This Congressionally-constituted commission coordinates the country's energy policy and oversees the interstate pricing of these energy sources. With the exception of federal hydroelectric power projects, FERC is not directly involved in the generation and/or sale of electric power. A similar regulatory commission sets long-distant telephone service rates.⁴

A. Regional Regulatory Bodies

Independent regulatory bodies are also found at the subnational, or state and local government level. In addition to the electric and telephone services previously mentioned, typical local public services are water supply, sewerage service, solid waste disposal, and gas distribution.

The state regulatory commissions which oversee these services take several different forms. The Chairman of the commission and the commission members may be elected to the

⁴When discussing public service pricing, the use-related price may be referred to as the "rate," "tariff," or "charge" for the service. The three terms are used interchangeably in this paper.

position, appointed by the chief executive, or appointed by the chief executive with the consent of the legislature. The commission itself normally is divided into two parts--the commission staff and the commissioners. The staff is composed of professionals with experience in the areas of economics, law, accounting and engineering; and, as developed more fully below, they have the important function of evaluating public service companies' revenue requests and pricing schemes.

The function of the commission is to consider the evidence and recommendations of the staff, of companies, and of other groups, and then formulate the commission's public policies. Most commissions are structured by law so that no more than a simple majority of the commissioners can represent a single political party. The removal of commissioners is difficult, requiring evidence of malfeasance in office, neglect, or inefficiency. Commissioners generally have staggered terms of service and serve for terms of four to ten years.

B. Total Revenue Requirement

The crux of the public pricing issue is captured by the following question. What price should be charged for the service so as to meet simultaneously the demands of residents for the service and the utility's financial requirements? If the service in question is being provided through a government authority, the general response is that the adopted pricing scheme should be one that generates sufficient revenues to cover all the authority's current costs and debt service and makes some contribution to future expenditures. If the utility is a privately

owned company, the proper response is that the general level of prices should be sufficient for the company to recover all its current costs and earn a fair return on its invested capital.

Concentrating on the private company form, the traditional rate-setting procedure is a quasi-judicial exercise, called a public service rate case. Rate information is submitted in two parts to the regulatory commission. The first part addresses the issue of how much total revenue the company requires to provide the service, including a normal profit. The second part of the case is primarily concerned with the fairness of the company's proposed pricing scheme for raising the identified total revenue requirement. For example, the commission would examine whether small users, after adjustments for differences in the cost of provision, are being charged a higher price for service than are the larger consumers.

The procedure for determining the total revenue requirement is easily described in theory if not in practice. The company is to be granted overall revenues sufficient to cover its operating expenses and to allow it to earn just a fair return on capital. The concept can be reduced to the following simple equation.⁵

$$RR = E + s(RB - DEP)$$

RR = revenue requirement

E = operating expense

s = fair return on capital expressed as a percent

⁵This formulation of the Total Revenue Requirement comes from, Paterson, H.G., *Business and Government* (New York: Harper & Row, 3rd ed., 1989), p. 250.

RB=capital investment

DEP=depreciation

This is a cost-plus form of price setting. The regulatory body must decide the company's allowable expenses, what constitutes a fair rate of return on capital, what is the depreciated capital or rate base to which the fair rate is to be applied, and finally, the total revenue requirement necessary to cover the sum of expenses plus the return on capital.

The foregoing data are normally obtained from the company for a designated test year. Often the test year selected is the most recent 12-month period for which data are available. The advantage of the latter approach is the proposed rates coincide with the period for which the rates are being set. This is particularly important if the company is operating within an inflationary environment and an indexing mechanism is not in place to automatically adjust rates.

Operating expenses include materials and supplies, fuel, wages, salaries, maintenance, depreciation charges, and taxes. Depending on the public service, operating costs may represent from three-fourths to four-fifths of total revenues, especially for electric and gas service companies. Depreciation allowances are considered to be part of the firm's operating expenses. As in traditional economic theory, consumption of capital is an expense of producing the service that the company must allow if it is to maintain its financial health.

Taxes may be a major component of a privately owned company's operating costs; however, only direct taxes are recoverable through service charges, i.e., property taxes and taxes directly related to the company's provision of service. Most regulatory bodies do not allow the company to include income taxes or other profit related taxes in the calculation of total revenue.

As an aside, in many countries electric, gas and telephone utilities have become "tax collectors par excellence." First, they are normally of sufficient size to efficiently collect and administer taxes. Second the demand for electric and gas utility services tends to be relatively inelastic. Thus, any increase in utility prices triggered by higher taxes on the service will have relatively little effect upon the quantity of the service demanded. The significance of this fact is well understood by the taxing authorities who often see utilities as lucrative tax sources.

C. Rate Structures

Given the total revenue requirement, the second aim is to apportion this revenue burden fairly among different users of the system. In the case of households, this means judging the amount each income group will pay for the service both absolutely and as a percent of their income. If the service charges are unrelated to the costs of provision, as is common with residential solid waste disposal, then the determination of a fair price becomes a subjective decision. Further, in some instances it simply becomes a matter of political

If the position is taken that "fairness" should be judged solely on economic grounds--a criterion well accepted by politicians, public administrators and academics--it can be reasonably argued that fairness be interpreted in terms of the ability-to-pay principle. Yet even if we assume that unanimity exists among public service authorities that this is the appropriate principle to apply, what is equitable or fair is not always clear. For instance, where property values are used as the basis for pricing, an increase in the service rate may be borne by others than those envisioned. In multiple dwelling units, the charge could be shifted forward to the tenants, absorbed by the owners of the building, or split between the two parties, depending upon market conditions.

While "fairness" remains an important objective in the pricing decision, in recent years public authorities have given more serious attention to the efficiency effects of their pricing decisions. They have begun to realize that price structure adjustments provide signals that can be used to improve the allocation of resources in public service entities. If the price of electric service is increased, this sends a signal to consumers that they should reduce their consumption. The reduced demand for electricity in turn translates into less generating capacity, and hence a lower overall cost of capital for the company. Conversely, a price reduction signals that the consumer should increase consumption of the service and that the company should allocate more capital to its provision.

D. Marginal Cost Pricing

The basic rule of efficient pricing states that the price of a public service should be set equal to the marginal cost of producing the service. That is to say, welfare is maximized when the benefit of an additional unit of service to the consumer--which is reflected by the consumer's willingness to pay the price--is equal to the utility's extra cost of producing the last unit. A practical application of this rule should help to illustrate how it is applied in the regulatory context.

Water authorities often charge consumers a fixed monthly fee for connection to the service and water consumption. Under this "flat-rate" pricing scheme, the monthly bill is the same whether the consumer uses 1,000 gallons or 5,000 gallons of water. Consider the price signal that is provided to the consumer under this flat-rate pricing scheme. The marginal or extra cost to the customer of an additional gallon of water is zero. While it is true that the extra expense incurred by the water authority in producing an extra gallon of water is small, the provision of an extra 1,000 gallons can impose a substantial cost on the authority, particularly if all consumers are subject to the same flat-rate charge.

The above described pricing policy results in an inefficient allocation of resources, since the extra cost of provision of the service by the authority exceeds the extra benefit of this service to the consumer. The resulting overuse of water by the consumer is not only wasteful but imposes a higher cost of supply of this service on all customers. Put differently, flat-rate

pricing provides no incentive to the consumer to reduce consumption.

E. Fully Distributed Costs

While the marginal cost principle remains the guiding rule for efficient pricing, full application of the "pure" rule requires a formidable amount of empirical information as well as numerous restrictive assumptions. Recognizing these limitations, regulatory bodies, as a practical alternative to the marginal cost rule, have adopted the concept of *fully distributed costs* and *incremental costs*. When the fully distributed cost approach is used, those costs that are clearly related to a particular category of service are assigned to that service.⁶ All other costs are distributed to categories on the basis of some relative measure of physical output such as cubic feet of gas or gallons of water.

To illustrate the approach let us consider the following electric utility application. Normally, electric customers are divided into three consumer classes: (1) residential, (2) commercial businesses, and (3) industrial. Costs which are clearly identified with a particular class of customer are assigned to that class. Meters located at industrial sites, for example, are counted as part of the cost of providing industrial service. Costs associated with high-voltage transmission lines, on the other hand, are not clear-cut since the lines are used to deliver service to all three classes of consumers. Common costs like the high-voltage lines are

⁶Fully distributed cost pricing recovers total service costs from the recipients of the service, whether through use-related, access, or location charges.

allocated on the basis of consumption. If industrial users consume 50 percent of the electricity sold by the utility in a given period, then 50 percent of the designated common costs would be allocated to this service class. As one might guess, any method of fully allocating common costs will be criticized as being arbitrary.

Incremental costs are linked to the marginal cost concept previously discussed. They are the extra costs to the company of providing a service, over and above the costs of providing the remaining services. Incremental costs are often used to gauge whether a subsidy is involved in particular rate structure or to different classes of consumers. As discussed in the next section, it is also used in connection with time-of-day pricing and peak and off-peaking pricing.

III. Current Charging Methods

A brief survey of the pricing practices of public utilities reveals a bewildering number of charging methods. While the type of public service, i.e., electric, gas, water, and sewer service, dictates to some extent the pricing options open to an authority, there are elements common to all. In fact, close examination reveals that all pricing schemes are combinations of just three basic methods of pricing. With some variations on these basic forms, literally hundreds of different combinations are possible. The basic methods are:⁷

⁷The outlined charging methods come from an unpublished Public Utility Pricing paper prepared for the World Bank by R. Turvey and J. Warford.

- A lump-sum payment at the time a consumer connects to the service, determined by one or more of:
 - The cost of the connection
 - The size of the connection
 - Characteristics of the consumer directly relevant to the amount of consumption, i.e., number of taps, in the case of water
 - Characteristics of the consumer not directly related to usage, i.e., value of property or type of consumer

- A periodic fixed payment determined by one or more of:
 - Characteristics of the consumer directly related to the amount and type of service connection
 - Characteristics of the consumer not directly related to consumption, e.g., property value

- A periodic payment determined by metered consumption with one or more of:
 - A single rate or in blocks
 - Varied by season or time-of-day
 - Varied by type of consumer or property
 - Varied by geographic location

As suggested in the previous two sections of the paper, a utility's choice from among these pricing options, including the choice of the appropriate level, must be viewed in the context of four basic concerns. The adopted pricing scheme must ensure the utility's financial viability, be fair and equitable, promote efficiency, and be politically and administratively feasible. Although economists are prone to emphasize efficiency, all four concerns must be addressed by the utility if they are to arrive at a reasonable compromise among them. If they know from the onset that the pricing decision involves trade-offs, perhaps it will be easier for them to reach this compromise. Having addressed the importance of the first three issues earlier, let us now turn to the remaining concern, administrative feasibility.

A. Metering

Administrative considerations cannot be overlooked in the design of any rate structure. Of primary significance is whether or not metering is efficient. The considerable cost of metering electricity, gas, water, and sewer services goes well beyond the mere cost of the meter and its installation, and includes meter inspections, reading, repairs, accounting, and billing. All of these costs must be weighed against the expected benefits from metering, i.e. reduced production costs, the improved capacity to monitor consumption, and lower future capital costs.

A *prima facie* case exists for the metering of larger public service users, however. Compared to the residential class of users, the number of large consumers of electric, gas,

water, and sewer services is relatively small. Significant users of these basic services are readily known, and the benefits of metering far outweigh the administrative costs associated with them.

Of the major public utility services mentioned, water service may be the strongest candidate for nonmetering. Generally speaking, when water is not scarce, the substantial reduction in consumption (production costs) required to offset the cost of metering is difficult to achieve. Therefore, one should not consider metering as the preferred method of charging for this service in all situations. In some cases a simple lump-sum payment at the time of connection combined with a periodic fixed charge may prove to be the administratively efficient method or pricing.

B. An Efficient Rate Structure

Assuming the public service is metered, a three-part tariff or rate structure is likely to be required to efficiently price the service. First, a connection or lump-sum charge should be imposed to reflect the marginal capital cost of connection, including the administrative cost of meter reading and billing. As a practical matter, the fee could be levied upon connection or paid as a fixed periodic fee. Second, a consumption charge should be levied based on the quantity consumed and set equal to the average incremental cost of production or fully distributed costs. Third, if the distribution network (reticulation system) is expanding, a development charge should be applied to cover the extra cost of this system. This charge

should be prorated for each plot, whether or not it is immediately connected to the system.

In calculating an efficient rate structure, three additional refinements may be required before setting the rates. First, to the extent possible, inter-and intra-community spatial variations in costs should be accounted for in all three parts of the tariff. Second, if required, seasonal variations in costs and demand should be reflected in the consumption charge of the tariff. Third, consideration should be given to the need for equity adjustments to bring the cost of the service in line with the ability-to-pay of the poorest income classes. This may require cross-subsidies from one class of users to another, or from one group of users within a class to another group in that same class.⁸

IV. Charging For Specific Services

In contrast to the general discussion of the previous section, this concluding segment concentrates on the pricing of the four urban services--electricity, solid waste disposal, water, and sewerage services. So as not to go over old ground, the discussion focuses on the special tariff or pricing issues of each service. With the exception of solid waste removal, it is assumed that each of the services is metered.

⁸As introduced later, a rising block rate, which subsidizes consumers at the lower consumption levels but covers marginal costs for higher levels, is one form of this subsidy.

A. Electricity Pricing

Typically, customers are classified according to end use, demand elasticities, and the cost of provision. A large number of sub-groups may be found, but the primary classifications are residential, industrial and commercial. Service charges for residential users generally consist of a so-called energy charge, i.e., a rate per kilowatt-hour which commonly rises in blocks with the volume of usage. It is also common for the utility to charge a one-time residential connection fee. When the monthly usage is below a stated level, a flat monthly minimum charge may be imposed as well.

For industrial and commercial users, the tariffs are somewhat more complex. Often the tariffs consist of flat energy rates either in the middle or in the upper range of the residential charges, plus either a capacity-related charge or peak and off-peak rates. Capacity charges stem from the electric utility's obligation to provide adequate service to all customers in their area. To fulfill this responsibility, the utility's generating capacity must be sufficient to meet the maximum electric demand of all its customers. Providing this capacity is costly. Therefore, it is only appropriate that the customers who create the demand for generating capacity bear its cost. Clearly, all three categories of customers impose capacity costs on the utility, but this cost can practically be measured only for the industrial users. For the commercial and residential customers, the capacity-related expense is included as a customer charge or as a part of the initial block rate tariff.

Peak load pricing is achieved by charging higher rates for energy during periods of greatest demand. Simply stated, the objective is to modify customer consumption patterns by shifting consumption from periods of high demand to times of relatively low demand, thereby allowing the utility to use its generating capacity more efficiently. Peak load pricing, while readily accepted in the United States, is far more common in Europe. In France, for example, electricity is generated and distributed by a single, state-owned utility. The utility has both seasonal and time-of-day pricing schemes in place. The system has a winter seasonal peak rate, November to February, and a off-peak summer tariff that goes from April to September. Within each seasonal period, there are daily time-of-use rates as well.

B. Water Services

The typical method of charging for water service in urban areas is a two-part tariff, a flat-rate minimum monthly charge plus a usage charge for consumption in excess of the minimum. The volume usage portion of the tariff may be based on a declining level or rising block rate scheme. A declining block tariff attaches a high price to the initial block purchased and then reduced rates for additional blocks of consumption. In contrast, a rising block rate has higher charge for each additional block of consumption. The level block is simply a fixed charge per unit of consumption regardless of the amount consumed.

On efficiency grounds, the rising block rate is the preferred method of pricing; however, despite the clear-cut benefits of such a pricing system, with remarkable frequency

declining block rates are employed by cities, particularly in the United States and Canada.⁹ Constant per unit consumption charges are also quite common in the two countries. In general, the level and declining rate methods are popular where good water is easily accessed and relatively abundant. In areas where water is relatively scarce, like the Western States of the United States, rising block rates are customary.

Access fees remain a popular method of recovering the cost of connection. A flat charge related to the cost of installation is the most common. The fee often varies with the size of the installed meter, and the cost of connection. Development charges, while appropriate for an efficient tariff, are seldom used in practice. A variation of this concept is employed by cities, however, when estate developers are required to incorporate the water distribution system as part of the development project.

C. Sewerage Service

Although addressed separately, the provision of potable water and sewerage service are linked. Once a customer becomes connected to public water, there is the problem of how to responsibly dispose of the resulting wastewater. Simply put, to avoid the unsanitary disposal of wastewater and the predictable health problems which would surely arise, water and sewerage services must be jointly planned and expanded. Because of this linkage, the two

⁹Bird, R.M., *Charging for Public Services: A New Look at An Old Idea* (Toronto: Canadian Tax Foundation, 1976).

public services are often contained within the linkage, i.e. they are often contained within the same administrative organization. And, from a pricing policy standpoint, the close relationship between the two services implies that the price for providing sewerage service can be charged jointly with that of providing water. This is indeed the observed method of pricing residential sewerage service in most cities.

Similar to the structure of water charges, the most common practice for residential customers is a two-part tariff--a surcharge on water-use, plus a periodic charge unrelated to water consumption. A service connection fee is also generally required.¹⁰

The pricing of sewerage service to industrial customers parallels that of the residential category, with the exception that effluent charges may be imposed when pollutants are introduced into the system. Industrial customers that emit substantial quantities of effluent are subject to periodic sampling and the sewerage charge depends upon the volume and strength of the effluent. The cost of treating and disposing of the effluent is the important factor.

D. Solid Waste Removal

Before discussing the observed methods of pricing solid waste removal, it is important to consider first the basic cost elements of this service. Unlike the other three utility services,

¹⁰The financing of sewerage network through development charges is discussed in Julius, J.D. and Warford, J.J., "Economic Evaluation and Financing of Sewerage Projects," (Washington, D.C.: World Bank, Guideline Series, 3).

disposal costs consist primarily of the labor and capital cost of collecting refuse from residential, industrial and commercial locations. The collection is done with specially designed and built vehicles. The cost of collecting the refuse is directly related to the volume and weight of the waste collected, the frequency of pickup, the distance from the disposal site, but inversely related to the density of the community. Disposal costs, on the other hand, vary directly with the quantity and type of waste material, the selected method of disposal (sanitary landfill, composting or incinerating plants), and the land and capital input costs of the chosen method of disposal. Each of these cost elements must be carefully analyzed in order to properly affix rates for this service.

When setting user charges for refuse service, it is important to distinguish between residential, industrial and commercial type wastes. For residential refuse service, a charge directly linked to the volume or weight may be inappropriate. Users may seek to escape payment by illegally dumping trash on the streets or in isolated areas. If this occurs, the private cost to the individual is minimal, but the social cost to the community is very large. Hence, in the case of residential customers, it is desirable to keep the charge low and link the refuse charge to measures other than quantity or weight.

For social cost reasons, many cities elect not to levy a direct charge for residential refuse collection. For fiscal and equity reasons, however, this is not viewed as a desirable public policy. If collection costs vary with distance from the disposal location and inversely with customer density, a flat monthly charge could be imposed. In the interest of "fairness",

the fee may be varied by building estate area within the city and by the size of the residential building lot. Clearly, such a charging method does not avoid the problem of illegal dumping nor encourage presorting and recycling at the residential level; but it would encourage efficient land usage within the city.

Similar to the other public services, industrial and commercial customers should be monitored separately, and the charge imposed on them should reflect their cost of service. Besides the previous cost elements, quantity of refuse, disposal site distance and frequency of pickup, the type of solid waste is an additional factor to be considered in arriving at this cost. For example, some industrial waste materials may require special processing or treatment prior to disposal in order to avoid damage to the environment. When such extraordinary costs exist, they should be recaptured in the refuse charges collected from those imposing them.

V. Concluding Comments

A properly designed public service tariff structure generates sufficient revenues to cover all the authority's costs and makes some contribution to future expenditures. Or, if privately owned, total revenues cover all the utility's costs, including a normal fair return to its investors. In addition to the financial viability objective, the adopted structure should be fair, promote efficiency, and be administratively feasible. All four are important concerns and must be fully addressed in the pricing decision.

Local Government and Infrastructure Finance in Donetsk:

The Current Situation

By

**Michael Pabat
Head, Donetsk Oblast Financial Department**

Problems of Budget Formation and Use

Ladies and gentlemen, friends:

Finance plays a determining role in State or regional development, and, in this connection, State budget centralization and its use in for State interests has a decisive significance. Taking into account the important role of finance in State and regional economic and social development, one should be aware of the fact that regional management efficiency becomes real if finances are stable.

The Supreme Rada of Ukraine and the President's Cabinet of Ministers have adopted a number of legislative documents which define the procedure for forming, approval and use of regional budgets at different levels. Along with this a more comprehensive analysis of these and other legislative acts and their practice shows that they are far from perfect and fail to ensure conditions for regional independence.

What are the main problems and contradictions in forming and using budgets at different levels? Some of them need to be considered in detail.

A. One of the contradictions in local budget formation is that revenues are calculated according to expenditures, meaning that regions draft budget expenditure sections, which in turn differ from calculations made by a higher level authority. Later the fixed revenues of these regions are subtracted from the budget, and the amount of payments from State revenues and taxes is determined. This contradiction lies in the fact that, in accordance with the legislative acts mentioned above, local councils' budgets, while theoretically independent, depend in reality on the share of State taxes and revenues defined annually by objective and subjective circumstances.

Since standards do not exist for calculating per capita expenditures or other parameters for technological, ecological and other regional conditions, each citizen does not receive his due share of national income. Ukraine, as any civilized state, must to a certain extent redistribute national income between its regions in order to support the less economically and socially developed regions at the cost of the more developed ones; however, such there should be a standard for redistribution.

B. With a standard basis for determining specific local budget expenditures, it seems feasible that the amounts to be paid must be stable and long-term, i.e., they must be set for a period of three to five years instead of for one year. Long-term payment standards from State

taxes and revenues to local budgets would, together with acquiring a certain stability, eliminate the annual and often futile need to justify any increase or reduction in the amount of funds to be transferred.

C. Both the present practice and normative acts regulating the formation of local budgets present problems in balancing budgets. Complications and difficulties in solving this problem develop when the revenues of a certain local budget exceed expenditures defined by a higher level executive body in accordance with fixed revenue sources, particularly citizen income taxes that, according to law, must be paid to jurisdictions where taxpayers reside.

Regional governments, to whose budgets 100% of the said revenue must be paid according to the *Law on Local Councils of People's Deputies and Local and Regional Self-Government* and the *Law on Income Tax on Citizens*, seem to be rightfully claiming the use of total payments, while in local budgets there is a lack of funds for planned actions - funds that were taken into account in calculating total expenditure amounts.

The current legislative documents set forth in a detailed and clear way methods of balancing local budgets when revenue sources are insufficient, i.e. transferring funds from higher level budgets in the form of subsidies and subventions.

The issue of approval and transfer of the calculated revenue surplus over expenditures from lower level budgets to higher level ones is not regulated by legislation, and budget

balancing in such cases is done by methods of local government "inventiveness", which is often censured by representatives of one of the interested sides.

Experience shows the need to adopt appropriate legislation to regulate the budget balancing procedure in which revenues exceed expenditures. This would ease tensions between staff in charge of the technical side of this issue and representatives of government officials and local council representatives.

D. It is possible and expedient to make the following changes in approaches to setting budget revenues, which would, to some extent, simplify technicalities of this issue, such as:

1. Define the list of federal taxes, retaining a value added tax as a revenue source for balancing regional budgets and the budget of the Crimean Republic.
2. In order to expand and strengthen the financial basis of local budgets, it is necessary to impose, in the form of a fixed revenue source, a profit tax on all self-sustained businesses, including state property businesses.
3. To grant regional councils of people's deputies and the Crimean Republic the right to define the list of regulating revenues for town and district budgets independently, with respect to their specifics. A similar right must be granted to town and district councils.

This means that decisions made on this issue must be obligatory for banking institutions, irrespective of their property status.

E. Establishment of various out-of-budget funds (out-of-budget funds of local councils, pension funds, environment funds, the financial regulation fund of the State Coal Committee of Ukraine, and others) quite often rules out the possibility of attracting the funds not currently used. It appears that liquidation of various out-of-budget funds and concentration of revenues from all the sources that form these funds would give the State an opportunity to use the funds that are being accumulated in a more flexible way, having preserved the targeted character of these funds.

Besides, in conditions of deepening economic crisis, pooling out-of-budget funds together would always allow the State to have information on full and timely payments to targeted funds and their use, and if necessary to make decisions on their rechanneling at the State level. Low efficiency of established out-of-budget funds and their separation from the interests of a region can be demonstrated by the example of the financial regulation fund of the State Coal Committee of Ukraine.

In 1992 and the first quarter of 1993, Donetsk region coal industry enterprises paid to this fund 50.9 billion Ukrainian coupons, of which 28.8 billion, or 56% of the total amount, were allocated back to the region. However, if income (profit) from coal industry enterprises went into the budget, then 30.3 billion would be paid to the State budget and 12.6 billion to

the regional budget. With actual payments from the target fund equal to targeted amounts and with payments from the coal industry financial regulation fund, the reserve of free funds not involved in State turnover was 22.4 billion Ukrainian coupons.

Of course one can say that these funds were used or could be used in the interests of the State Coal Committee of Ukraine, as decisions regarding spending of these funds were not agreed upon with regional government authorities. Besides, the Committee has control over the efficiency of use of this fund, which does not exclude the possibility that these monies can be used for subsidising machinery.

F. In inflationary conditions, indexing payments for use of natural resources such as water, land, environment etc., would be justified. The necessity of this is evident, since it would ensure rational use of natural resources and financing of actions required for restoration of these resources.

G. Taking into account serious changes in land rent and growth of this payment share in local budget revenues, it becomes clear that currently applicable payment terms (August 15 and October 15) do not satisfy neither budgets nor payers themselves. In the first half of the year, they have had to resort to loans in order to finance planned actions. For payers, especially individuals, it would be more convenient if the payment terms were not strict. Quarterly advance payments to be balanced at the end of the year would be mutually acceptable for both budgets and payers.

The significance of land rent payments to city and district budgets of the Donetsk region is demonstrated by the fact that 68 billion Ukrainian coupons, or 28.1 percent of the total budget, were due to be paid in 1993, and this entire amount was paid in the second half of the year.

Respected participants of the symposium!

In discussing the contradictions in the process for calculating local budget revenues, I have mentioned how they are related to budget expenditures. I would like to speak in detail on the problem of local budget expenditure formation. The solution of this problem is seen as follows:

A . At the State level it is necessary to have scientifically grounded and legislatively adopted standards of budget share per capita with comprehensive and clear methods of calculation. The said standards must be indexed with respect to territorial location, density of population, industrial potential, ecology, traditions, etc. Calculated by this method, budget expenditures must be objective; and, should there be a lack of financial resources for them, they can be reduced in all regions proportionately to the total amount lacking.

B. Regional councils of people's deputies must be informed of the said method and approaches to forming budget expenditures, and councils must develop and adopt similar amount of budget share per capita in regionally subordinate towns and districts.

C. Similar standards must be developed and adopted in towns and districts for their jurisdictions. The process of calculating budget expenditures must go from bottom to top; and, if they are not recognized or are changed by an executive body of a higher level, executive bodies of lower levels must be informed of this with a statement of the reasons for such actions.

D. The issue of budget share per capita seems not to be a new one; legislative acts that proved its necessity were adopted in 1990, and discussions about them started even earlier. But difficulties in determining budget expenditures still exist, and there are no adopted standards.

Difficulties in development of these standards are evident; however, the need is worth overcoming them [the difficulties]. Thoroughly developed, grounded, and adopted standards of budget share per capita will give assurances of regional independence, make the region the owner of its funds, stimulate local councils in facilitating increased efficiency of local businesses, and promote restructuring of the regional economy by developing efficient businesses and imposing limits on them or liquidation those that are inefficient.

During the transition to a market economy, with increasing prices and tariffs as well as growing inflation, State and local budgets to date are overburdened with expenditures for social protection of citizens. These expenditures could be lower if such protection were concretely targeted with respect to average aggregated income per capita and set at the State

level. For example, in 1992 the regional food processing industry received 8.4 billion Ukrainian coupons in subsidies for the production and sale of food products, which were actually allocated to cover losses. There is no doubt that these expenses would be less merely by paying them directly to product consumers. The level of reduction of these expenditures is in direct relation to population groups that the State undertakes to protect and for whom the ultimate responsibility is left for the higher State administrative structures.

Similarly, one could speak about expenditures financed from the social protection fund for other purposes, namely subsidies for medicines, public transportation, communal housing, construction at the cost of citizens, school lunches, and fuel for heating. Actual expenditures from regional budgets for the said purposes were 16.9 billion Ukrainian coupons, and expenditures forecast for the current year, considering the increase of prices and tariffs starting June 1 equals 349.7 billion coupons.

The following example indicates a number of paradoxical difficulties or confusion in the existing budget forming practice. The existing practice of forecasting subsidies for communal housing services (water, heat supply) by the Ministry of Finance - no offense meant - is done only for suppliers of the Ministry of Communal Housing of Ukraine; while many similar services provided to persons residing in communal property housing or enterprises of other ministries are not taken into account at all. Such an approach to the problem forces local councils to look for their own solutions when expenditures for said purposes are quite high. In 1992 in the Donetsk region they equalled about 5 billion Ukrainian coupons, and the expected

price increase in the current year will increase them to 20 billion.

Of course, if subsidies for these services were calculated per resident for local communal housing, the existing problem would have been already solved. A convincing proof for required development and adoption of budget expenditures standards per capita is the existing detrimental approach to planning for public education and cultural expenses. To date, the previous year's budget is used as a basis for budgeting, along with an assumed factor of price growth in the planned year calculated by the Ministry of Statistics.

This approach is detrimental since it does not take into account, to a significant degree, the specifics of network development (apart from actions undertaken at the State level). Therefore, subsidies to kindergartens that are transferred from ministries to public education were not taken into account at all. Besides, the applicable factor of price growth in the forthcoming year, calculated by the Ministry of Statistics for all of Ukraine, must be differentiated for each region, i.e., must be in accordance with their real stages of development.

Irrespective of the fact that the current year budget expenditures for health care were calculated per capita, the method of calculation is far from perfect, since the previous year's budget, together with a price increase factor - not the socially- and biologically-grounded standards per resident of a certain territory - was used as the basis for calculation, as in the case with public education and culture.

As has been already said, for cases of insufficient financing of local councils' budgets, allocation of subsidies or subventions from higher level budgets are being considered; but since there are no standard documents to define the difference between these types of financing, the said methods of budget balancing are used cautiously.

The facts submitted proving the necessity for further development of budgeting approaches are quite convincing; but I am not inclined to believe that, after this symposium, everything will be drastically changed because of propositions and comments made here. I am deeply convinced, however, of the need for further local budget development, and no doubt I acknowledge that all these issues require detailed and thorough discussions by scientists and specialists in this area.

Thank you for your attention.

Price Setting in Maintaining Public Services in Donetsk:

The Current State of Affairs

By

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The fact that public services are owned by the local councils predetermines in many respects the specific nature of their interrelationships with the budget. Conditionally, these relationships can be divided into three groups:

- Budget subsidies for business losses cause by low prices for services
- Financing for the maintenance of public services and amenities
- disbursement by enterprises of obligatory payments and taxes.

Public service enterprises incur losses because of unprofitable water and heat supply prices and for the city's electric passenger transportation. In accordance with the Cabinet of Ministers decisions, these losses must be reimbursed by the budget. In this case enterprises must be guaranteed the creation of optimal funds for economic stimulation which would ensure investments, solve social problems, and encourage workers financially. Unfortunately, nobody

has yet calculated this optimal level. There isn't even an analysis on this issue. The enterprise subsidies are established without any standards whatsoever. As we see it, such standards could be developed by our Committee's institutes. We believe that such compensation payments must not be lower than the average indices for the entire country.

Its [price setting's] importance also arises from the necessity to support enterprises' investment processes. Unfortunately, the general rise in the cost of basic public services assets considerably outstrips the development of their production bases.

Analyses have shown that enterprises, especially the small ones, will within a year be unable to acquire either machines or equipment or to renew their stock of machine tools. In the future we expect a worsening in public services delivery.

As a counter argument, someone might say that the money for developing the production base as well as for acquiring equipment and transportation vehicles can be provided from the budget. It would be difficult not to agree on this point. But in this case the enterprises turn into suppliers, with the chance that someone may or may not grant their requests. We, however, have in mind a guaranteed provision which would enable the enterprises to perform work on reconstruction, building, and acquisition of basic assets in an independent and purposeful way.

In the services covering housing facilities and public utilities, the question of pricing is

rather acute. The experience of shaping a pricing policy for these services throughout the country shows that it lacks a uniform approach. In spite of the fact that the questions of pricing policy have been transferred to the management of regional governments, we believe that a general conception on this issue must exist.

Unfortunately, it must be observed that in most of the country's regions, price setting authorities have been attacking the problem with a lot of zeal and introduced set prices for many public services, thereby crippling the enterprises' initiative and restricting their freedom. In this connection I would like to comment on how we deal with these problems in our region. First of all, we departed from the approach of dividing enterprises and organizations into those that operate by preferential and nonpreferential terms - what is called the second and third group of consumers. Our pricing principle is that a price must cover expenses and ensure an optimal earning capacity. As a result, the price of water for a factory and a hospital is the same. How do we achieve this? Above all, enterprises do not react painfully to the structural changes in the ratios of the volume of services they use.

We have completely discarded fixed prices for public services. All prices are regulated and free. Regulation is carried out not by restricting the upper limit of prices, but by establishing a maximum level of earning capacity. It amounts to 30 percent, while for water and heat supply it is 40 percent. In this case the pricing authorities and our workers exercise only control over the correctness of pricing. We believe such a price-setting system is the best, since it does not constrain the enterprises; it is flexible; and it makes it possible to react

promptly to the changes in the net cost of services.

Yet another issue of principle is the preferences applied to specific categories of consumers, both in relation to the population and to enterprises and organizations. Preferences are now established by everyone, beginning with the Supreme Rada and ending with a village council. But no one and no place, as far as I can remember, has ever solved the problem of compensating for income losses by the public service enterprises. As a consequence, the legally granted preferences are enjoyed at the expense of the enterprise workers.

I think that the government must not just grant preferences but address assistance to those it wants to help. In this respect, the first step has already been made, namely assistance for burials. Currently, the government is considering subsidizing the payments of public services by specific low-income categories of the population. Having looked into this matter as well, we came to the conclusion that such people must be given subsidies in the same way as is the case with burial services.

There is yet another issue to be solved after our conference is over. A decision of the Cabinet of Ministers of Ukraine has established that the prices for burial services must be declared. According to this declaration, the enterprise must submit a mass of forms to the regulating authorities. Now let us imagine a funeral home's task to bring all these declarations to the regional center every week. Who is supposed to be making them out, if a funeral home has only one accountant on its staff? We think that we must return to price regulation by

establishing a maximum earning capacity as far as burial services are concerned. If it is too high, it can be set, not at 30 percent, but at 15-20 percent.

In the pricing system we will in the long run arrive at the point when people will be paying for public services at profitable prices. But today such an end is impossible to achieve both for political and financial reasons. The transition to profitable prices means a considerable increase in the amount of money, wages and salaries, and the subsistence level. At the same time, however, this question is not of the distant future; it will arise with the privatization of housing facilities.

Yet another remark on the issue of price setting. It concerns the position of the Ministry of Finance and its local offices. The Ministry believes it possible and necessary to compensate for public services losses by establishing labor prices with high profitability - up to 1,000 and more. An immediate advantage is thereby created. Industrial enterprises react to this rise by decreasing water and heat consumption. The public services enterprises incur losses and are forced to raise prices for the rest of the consumers. This process looks very much like self-asphyxiation, with which it is difficult to agree. Each karbovanet by which we raise the price of water returns to us in a fivefold increase in materials costs.

It is difficult to dwell on the issue of financing all public services and amenities. Unfortunately, their financing has not been solved at all. For example, in 1993 in our region budget requirements for the maintenance of such services in the cities and settlements amount

to 21 billion karbovanets, while the budget provides only 7 billion karbovanets.

At the same time, there are a number of issues of a methodological nature which need to be reversed. In some cities financial entities continue the practice of subsidizing public services losses without any profit in mind. The enterprises in this case recover only their expenses without gaining profits. Non-budget funds built up by local councils are used inadequately to finance services.

The methods of developing budget resources for improving public services and utilities are in need of serious changes. Today the underlying basis of this method is based on the volume of work performed, such as the number of parkland plantings and the length of the roads.

With such an approach, the ecological situation in the regions is completely overlooked. It is obvious that you have to change a shirt much more frequently in the hot climate of Donetsk and Kriviy Rih than in Vinnitsia or Chernihiv. By the same reasoning you have to sweep the roads and sidewalks in the first two cities much more often, because there the level of hard waste fallout exceeds by many times the average throughout the entire Republic.

Taxation policy in relation to public services must ensure that enterprises have the opportunity to develop and increase the volume and quality of services. There seems to be

nothing new in this idea, since any taxation policy must be based on it. But as regards public services today this is most urgent. This year the Ministry of Finance changed the methods of accounting and reflecting subsidies received for compensating price differences. Now the enterprises must reflect the subsidy amounts in their income structure, thereby changing from unprofitable into profitable enterprises. As profitable enterprises, their incomes automatically become taxable.

The amount by which enterprises are being subsidized is 15 percent, and the payroll funds of the enterprises are huge. The tax on incomes, in this case, eats up all of the profit. Moreover, in our region there are organizations in which the amount of profit does not ensure even the budget payments determined from the income. In this case the enterprises are simply deprived of turnover resources which are insufficient as it is.

On the whole the picture is as follows - administratively we have curbed the profits of enterprises, but we expect to receive budget incomes from them punctually. This is a policy not of creation but of destruction.

The enterprises which artificially became profitable and receive subsidies from the budget must be exempt from taxes. The rates of the taxes for the remaining enterprises must be differentiated by the local councils depending on the actual level of profitability. For example, for an earning capacity of 30 percent or more, the rate must be 18 percent; for a 20 percent capacity, 9 percent; and for a 10 percent capacity, 2 - 3 percent. I think that is just.

A lot of the unsolved questions in the public services are the result of the flaws in the management system. The fact that the enterprises servicing housing facilities and public utilities are owned by the local councils leaves a certain imprint on their management system. There are numerous examples when local councils regard the public services enterprises as their own possession that they can order around without being responsible for the results of their activity. There is rude interference in their economic activity and financial matters at all administrative levels, from the highest manager to an ordinary government official. The decision of an ordinary clerk can at times undo the work of an entire enterprise.

The problem is that the local councils that own the enterprises servicing housing facilities and public utilities must recognize the latter as independent subjects of economic activity. The relations between them must be built around the principles of a business partnership which does not allow any interference in economic activity. These changes must occur precisely now, because the impending privatization of the public services enterprises does not in any way agree with current management methods.

Local Government and Infrastructure Finance in Lviv:

The Current Situation

By

**Vladimir Cherevko
Deputy Head, Lviv City Administration**

At the complicated time of the formation and consolidation of the State system of Ukraine, the city administration of Lviv faces problems connected with the socioeconomic development of the city in the period of transition to market economy, the period of embarking on the course of privatization.

The heritage of the preceding system left the city economy in a state of neglect. This argument is supported by the following data about the level of social protection of the city population:

- Per capita living space of 15 square meters, while the norm is 20.4 square meters
- Water consumption according to municipal services requirements - 376 liters
- Hospital provision - 73.3 percent

- Polyclinics - 43.7 percent

- Food shops - 47.9 percent

- Public catering establishments - 48.4 percent

- Public services establishments - 44.3 percent

Of 10,230 houses under the authority of local radas, 252 are dilapidated houses in a state of emergency. In addition, over 400 flats do not meet sanitary-technical standards and are recognized as uninhabitable. At present, the city population numbers more than 830,000 inhabitants, while the city infrastructure was intended for half of this population. Striving to raise the level of social protection of the city population to existing norms, the Lviv City Council adopted a decision in 1990 to stop building new enterprises and expanding existing ones. Housing construction in conjunction with municipal and social infrastructure projects became the top priority.

The main problem for Lviv's infrastructure development is providing land for city housing. Lviv has 192.4 sq.m. of city territory per capita, while Kiev has 316.6 square meters; Donetsk, 322.8 square meters; Krivy Rig, 588 square meters; and Prague, 420 square meters.

Now we need to withdraw 800 hectares of land from agricultural use for the construction of new residential districts. But the village radas are creating obstacles to the provision of land for housing construction (Zubra), sewage disposal system construction (villages of Bryukhovichi and Miklashiv), water distribution (Sasiv), and town dumps. The city administration suggests that the right to withdraw lands without the approval of village radas should be given to the regional rada, the Cabinet of Ministers, or the President.

The main direction of the city's economic development is spelled out in the General Plan, which was completed in October 1992 and implemented in the *Plan Strategy for Social and Economic Development for the City of Lviv for 1993*. It has already been two years since the city budget and the Plan-prognosis of Social and Economic Development were approved under conditions of investment and financial uncertainty, the latter caused by the economic crisis, inflation, and paralysis of economic ties between producers.

According to the Plan strategy, expenditures covered by the budget are set at 77 billion karbovanets. In actuality, the budget meets only 39.5 billion karbovanets., which constitutes 51.3 percent of the total need. It should be noted that Ukraine's State budget expenditures increased [in 1993] eight times over the 1992 level of 684,471.2 million karbovanets, while, with the assigned norms of State funding allocations to the city of Lviv for 1993, the budget volume increased by only 4.9 times over the previous year (37,018.2 million karbovanets in 1993 compared with 7,487.3 million karbovanets in 1992). This is a testimony to the drastic financial discrimination against both the Lviv region and the city of Lviv this year.

Allocations to the city budget from basic regulated State taxes and fees paid by city enterprises (enterprises and organizations revenues tax, value added tax, and excise duty) make up 14.9 billion karbovanets from a revenue total of 113.2 billion karbovanets, or only 13.2 percent. At the same time, allocations from these taxes to the regional budget constitute 35.9 billion karbovanets (31.7 percent) and to the State budget of Ukraine-62.3 billion karbovanets (55.1 percent).

One of the city's problems is financing capital construction. Housing construction is currently planned in six residential districts. In addition three schools with a 2,500-student capacity, other children's facilities at a capacity of 570, and polyclinics with a reception rate of 1,600 patients in one shift will be put into operation, even though the financial situation for capital construction of social infrastructure projects is very grave. The Plan strategy envisages capital investments over 14 billion karbovanets, while the city budget has approved only 1.8 billion karbovanets and has received centralized capital investments of 1.2 billion karbovanets.

The city administration is deeply concerned about the state of the city's transportation. Mobile stock of the tram-trolley bus park was reduced by 30 percent in 1989 (from 428 to 301). Formerly, mobile stock had been replenished through the centralized system (mainly Czechoslovakian electric transport); but, during the last three years, almost no funds have been allocated to meet this objective. The city budget is unable to provide transportation funds, although the administration plans to obtain 40 trolley-buses produced by the Lviv Bus Factory.

It would be reasonable to remember that Lviv is considered in the category of cities of class "A" historic heritage. Today in Lviv there are under State supervision more than 200 cultural monuments of national significance and 1,300 monuments of local significance. Among tactical and also strategic objectives are such projects as the restoration of the Lviv defense line, elaboration of the Lychakivsk graveyard plan, and emergency suspension of construction in the city's historic district.

But long-term plans in this direction can hardly be discussed, as they are not financed by the city budget; and the appropriate specialized production base is not available. For 1993 the Plan strategy estimated 211 million karbovanets' not covered by the city budget. From the State budget, only 23.5 million karbovanets was allocated for repair of the monuments of national significance.

There is a shortage of funds for completing construction of the exhibition hall of the Ukrainian Union of Artists, for repair of the M. Zankovetska state academic Ukrainian drama theater, and for repair of the city museums. A similar situation exists with the housing capital repair fund. The city development Plan strategy estimates repair and design work for more than 40 residential buildings, for which 1.1 billion karbovanets is allocated.

In conjunction with the restoration work and housing repair fund, we should consider the work on municipal maintenance projects. This should include repair of completely worn out roads (cobble-stone roads covered with asphalt), planting of greenery and improvement of

park maintenance, as well as repair of outdoor lighting. Organization of public services and amenities requires five municipal production bases, and the city budget is unable to provide funds of 1.3 billion karbovanets for this work.

It is important to note that the city with 1.5 percent of Ukraine's population, 4 percent of its industrial-productive potential, 2 percent of basic productive funds, 4 percent of Ukraine's total production volume, and over 20,000 specialists trained annually has stopped its development in this complicated period. The Government of Ukraine should consider the possibility of increasing the City of Lviv's budget eight times higher in accordance with the increase in Ukraine's budget.

The city administration proposes that over 80 percent of industrial enterprises (totalling 500) should become city municipal property, leaving the economically vital enterprises as State property. Taxes from those industrial enterprises that would pass into municipal possession would make it possible to consolidate revenue considerably, which must be formed at the lower levels and not imposed in a centralized manner. In this way we could do away with departmental and ministerial pressures, since within the city there will only be enterprises and organizations under the authority of the city administration.

It is absolutely inadmissible that a number of industries that are of vital importance to the city (like the bread factory, meat-packing plant, dairy, construction and transport organizations, and light industry enterprises) are not under the city administration's authority.

Pursuing the privatization policy, the city administration could privatize a portion of smaller enterprises, creating by this act conditions for economic competition between private and State industries. Moreover, it is necessary to define by law the right of local governments to determine prices for water and land resources, city transportation fees, local taxes and fees, and also obligatory payments and fines. Only under such conditions will Lviv, a city of European heritage, able to solve adequately its inner problems, and to create appropriate living conditions for its people.

**Financing the Local Government and
Development Kirovograd's Infrastructure**

By

**Vassily Mukhin
Chairman of Kirovograd City Rada of
the People's Deputies Executive Committee**

Assessment of Development Conditions

The city of Kirovograd cannot be regarded as one of the oldest Ukrainian cities, as it will only be 239 this year, which is quite a young age for a city. Kirovograd's founding is connected with the construction of the St. Elizabeth Fortress, which was started in 1754 at the same time as the history of the city began.

There were all kinds of disasters in the course of its formation and development: Tartar invasions, fires, famines and plagues. But the city has survived, and it is growing and gaining strength.

Presently the city has 289,000 inhabitants, or 22% of the region's total population. The population has been growing rapidly in recent years. From 1959 to 1992 the population growth rate reached 220%, while this figure averaged 180% for the group of Ukrainian towns having 100,000 - 250,000 inhabitants. At present the population growth is slowing down.

The State economic complex in Kirovograd, as in Ukraine in general, is characterized by the predominance of heavy industries (production group "A"). About 62% of the population working in industry is employed in the economic sectors that form the basis of the city. The main industries of our city are machine building, production of metal goods and construction materials, light industry, and agricultural products processing. Industry revenue makes up almost 40% of the city's budget.

Social Infrastructure and Housing Construction

According to its level of social infrastructure development, Kirovograd, as the regional administrative center, meets 60% of the recommended requirements for inter-regional service, thus ranking 17th among Ukraine's regional administrative centers.

The city cultural and public service spheres are also underdeveloped. The population is not sufficiently provided with sports and public-service facilities. The city housing stock comprises 4.6 million square meters of total living area. At present 67.5% of the housing stock (that comprises 3.1 million square meters) is held in the public sector, with the remaining 1.5 million square meters held privately.

We plan to build about 40% of the new houses within reconstruction areas after demolition of existing run-down buildings. Unfortunately, modern houses, which have recently appeared in our city, as well as in other cities of Ukraine, often evoke negative

reactions from their residents because of poor architecture and lack of individuality and originality. Even specialists consider such houses to be the result of some compositional and design errors. So the housing problem remains one of the most important in the town's economical and social life, notwithstanding the fact that the present housing situation is somewhat better than in previous years. There are 16.5 square meters of living area per capita in the city of Kirovograd. But at the same time almost 24,000 families have no apartments of their own.

Functional design and lay-out of apartments is being improved: rooms giving access into others have disappeared; kitchens have become more spacious; bathrooms have been separated from toilets; and all new apartments have hot-water, gas and central heating. Yet to the present day, about 10% of existing apartments situated mostly within the old historic territories have no modern technical facilities.

Today's speeding up of individual construction in our city is predetermined by the need for rapid growth of city housing stock. Definite measures are being undertaken to achieve the annual scope 50,000 square meters of individual construction. To accomplish this task we are using bank loans and assistance from the businesses where people involved in individual construction work.

Now we have to solve problems not only with the placement of individual construction sites (because there is fertile agricultural land around the town), but also with making

individual houses the kind of city dwellings that are protected against liquidation, constantly renewed and developed, and fully included in the city social, economic and architectural structures. All this is necessary to achieve both preservation and the maximum housing stock fit for habitation, as well as improvement of the city ecological situation, especially as it is located in a non-standard zone.

City Area Development

City area development is mainly carried out by combining its historical center and the adjoining settlements which are rapidly becoming suburban into a unified city system. This unity is achieved through the development of a roads network. City development has been restrained, however, because there are lands available for construction around it. The main city property is surrounded by fertile agricultural land as well as by a number of projects which, together with their indispensable sanitary zones, restrict the possibilities of city area development. Within the non-industrial construction zone are some enterprises which are situated in close vicinity to houses with no sanitary gaps and which require relocation to industrial zones.

The criteria for assessing the town's historical potential have been worked out in order to provide detailed estimation of the area and to solve specific tasks of preserving the town's cultural heritage. Having studied historical heritage plans formed at different stages of city development, we have discovered a considerable area that compromises the historical lay-out

and construction performed in 18th and 19th centuries.

Engineering support

Analysis of the further development of the city water resources shows the necessity of (1) progressive mastering of local resources and (2) additional investigation of water resources of adjoining areas and springs for drinking water located in the area including the Dnieper. City water resources are scarce. The city's sewage situation is also grave. Existing sewage purification systems cannot provide perfect water collection and purification.

Taking into account all these difficulties, the local authorities, with financial assistance from the Ukrainian Ministry of Construction and Architecture, worked out in 1992 a new city development plan. This plan specifies the idea of developing housing based on balanced city growth including social, demographic, economical and ecological development. this brings forward some prior social tasks, such as:

- Solving water supply and drainage problems for new main sources
- Organizing environmental protection measures including landscaping systems, water protection zones and industrial sanitary zones

- Solving the housing problem by means of increasing the housing stock
- Developing construction scopes and privatizing city housing stock
- Controlling the development of industries requiring large amounts of resources (especially water resources)
- Orienting industry to medium-sized and small businesses in areas with uneven population settlement
- Working out principles for dividing property into districts and inventing a new economical control system
- Increasing the efficiency of city property utilization
- Improving the population settlement pattern in historical and social areas with scarce resources
- Introducing property rent; privatizing housing stock; developing small businesses in areas of unemployment

- Improving the quality of social infrastructure
- Organizing city public centers according to their involvement in the structure of small businesses and privatized services
- Constructing mainly one-, two-, or three-story buildings in accordance with historical and architectural tradition
- Reconstructing buildings of architectural value in the central part of city
- Providing cottages with modern public services
- Taking major steps to increase traffic capacity of the city's central highways as well as the directions of the main labor connections
- Turning the existing radial system of main streets into a diametrical ring system, taking account convenient connections into the external road network

In this plan we make an attempt to look at the reasons and consequences of city building in Kirovograd from a new angle, to assess them, and to suggest some new methods of city development. It is done with attention to the new social and political situation and with

our desire to see the city as an organic whole united with its environment.

It goes without saying that, to solve all these problems, one needs adequate financial resources. At what cost are we solving these city infrastructure development problems today? With private ownership and construction rights initiatives being introduced, the State becomes dependent on the people to achieve its aims.

As the financial resources of individual owners are relatively independent and dispersed, any long-term planning is impossible here. In this situation the city rada Executive Committee's function is to regulate construction activity and coordinate its interests with those of the population. That is why the Executive Committee exercises control over the regulation of individual construction activity, including design layouts and decisions, credit accommodations, and start-up of projects.

It's commonly known that budget funds spent on infrastructure development are limited. Like other cities, we can hardly make both ends meet. Taking these facts into consideration, on January 28, 1993 the Executive Committee passed resolution #63 entitled *On the City Complex Construction*. According to this resolution, the enterprises working out technical terms for engineering support projects must determine the amount of their customers' resources that must be transferred to the city budget's special account for future spending on city infrastructure development.

**The Legal Framework for Local Government
and Infrastructure Finance in Ukraine**

By

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Problems of Legal Regulation of Local Budgets

Creating a rational model for developing and using local budgets as well as an exact and, at the same time, flexible mechanism for their legal regulation is a problem of urgent importance for Ukrainian State and local self-governments in particular.

Legal regulation of the financial activity of local councils as the main link in the system of local self-government has a great potential influence upon social relations that develop in this sphere, which, to a great extent, precondition the scale and importance of local self-government generally. As the French researcher P. Godme rightly said, the independence of local governments is mostly determined by their financial competence rather than by problem-solving or by their juridical status.

During our State and society's profound economic crisis, it is feasible to combine the financial independence of local councils, without which it is impossible to find the way out of

the crisis, with distinct budget and financial discipline. A firm financial basis for local self-government through a regional citizens' organization for independent decision making on all issues of local life must be created through growth of initiative and the activity and entrepreneurship of local councils.

Local council budget and financial independence must be ensured by their sufficient authority to obtain and use revenues and by reliability of revenue sources, which are determined at legislative level. As of today, the existing legislation in Ukraine cannot ensure this. An active legislative process, reform of state management and local self-government have moved the situation from a standstill but have not yet solved these problems and have even evoked a number of other crucial factors in solving them.

The main legislative acts that regulate local budgets are the *Law of Local Councils of People's Deputies and Local and Regional Self-Government* and the *Law on the Budget System of Ukraine*. From the legislative point of view, it is incorrect that many articles of these laws duplicate one another. This does not improve these laws efficiency; this must be ensured by a detailed implementation mechanism, which is missing in both cases. Therefore, these laws do not carry out the principles stipulated in them to regulate local council budget and financial activity.

The list of tax earnings and revenues that are ensured for local councils by these laws is more comprehensive than the one that was specified in the *Law on the Budget Rights of Local*

Councils before. If previously the ensured revenues comprised 25-30% of local budgets, then today their share is slightly less than 50%, but it is still not determinative.

The following revenues are included in local budgets:

- Income tax on Ukrainian citizens, foreign citizens and persons without citizenship residing within the jurisdiction of a certain local council
- Tax on the State Farmers Wages Fund, State customs duty, and payments for individual business activity licenses
- Revenues from communal property leases
- Tax on vehicles
- Tax on land
- Payment for use of local natural resources
- Tax on business incomes governed by the local jurisdiction as well as JVs in accordance with the share of local governments in them

- Local taxes and duties

The following incomes, determined by tax laws, are paid to the local budgets:

- Value added tax (VAT)
- Excise duty
- Income tax from non-communal property businesses
- Payments for use of State-owned natural resources
- Other income specified by Ukrainian legislation

Article 10 of the *Law on Local Councils and Local and Regional Self-Government* stipulates that, within their competence, village, town, and city (except for Kiev and Sevastopol) Councils of People's deputies draw up, approve and use local budgets. Interference of State authorities in the process of drawing up, approving and use of local budgets is prohibited. A local government's budget is not included in other local budgets or in the State Budget of Ukraine. Thus, this Article ensures the independence of local councils in forming and use of their budgets.

But how is this principle being realized? A 1992 budget analysis of the town of Dniprodzerzhinsk in the Dnipropetrovsk Oblast (Region) shows a picture characteristic of most local budgets:

- Revenues: 163,738 thousand karbovanets
- Expenditures: 172,357 thousand karbovanets

- Budget deficit: 137,173 thousand karbovanets (5% of total budget)

- Main revenue sources:
 - Taxes on state-owned businesses income - 17.9%
 - Taxes on communal property businesses income - 13.7%
 - Citizens' income tax - 22.4%

Out of these revenue sources, the tax on communal property business income and citizens' income tax are totally allocated to the budget. In Ukrainian terminology they are called *fixed revenues*. Tax on state-owned business income is included in the group of so-called *regulating revenues*, the percent of payments from which local budgets are annually determined. Regulating revenues comprise 54.1 percent of the city budget, i.e., more than a half. Regulating revenues include:

- VAT (8.6 percent is retained in the local budget)

- Tax on state-owned business income (10 percent is retained in the local budget)

- Excise duty (50 percent is retained in the local budget)

Total breakdown of 90.2% of the local budget gives the following picture:

- Regulating revenues - 54.1 percent
- Citizens' income tax - 22.4 percent
- Tax on communal property business income - 13.7 percent

Other taxes and duties allocated to the local budget make up less than 10 percent.

Therefore, local budget stability directly depends on annually determined payments from regulating revenues, while less than half of it is determined by fixed revenues. This is a big obstacle for strengthening general financial independence of cities and local councils.

Practically any local council effort aimed at increasing budget revenues can be devalued to a great extent by a set percentage of payments from the main revenue sources. Apart from this, one cannot speak about non-involvement of the higher government authorities in the process of forming and using budgets when such annual involvement has a decisive importance.

The situation in Oblast (Regional) and Raion (District) local councils, who have practically no fixed revenues, looks even worse. If the Supreme Rada (Parliament) of Ukraine

sets the amount of state taxes, duties, and payments made to the regional budgets of Kiev and Sevastopol and the towns and cities of regional subordination, then part of the State taxes, duties and payments that are paid to the local budgets are set by Oblast (regional) Councils of People's Deputies. Here we have a case of double involvement.

In order to enforce the main principle of Article 10 of the *Law Regarding Independence of the Local Councils in Forming, Approval and Use of Their Budget* as well as to stimulate the efforts of local councils in obtaining budget revenues, regulating sources must set stable payment rates at first for a three- to five-year period, recognizing the economic instability in Ukraine today, and legislatively fixed stable rates in the future.

While doing so, it is also necessary to develop a detailed procedure for calculating rates of payments. This procedure must be distinct and exact and not just generally outlined, as is often the case in current Ukrainian legislation. Assistance to the local budgets should be provided not by redistribution of funds but by creating a legislatively-supported program for regional development and economic equalization by providing subsidies. In order to achieve this, a chapter that regulates the procedure and terms of such assistance must be added to the *Law on the Budget System*.

Today the issue of communal property, in accordance with the *Law of Local Councils and Local and Regional Self-Government*, constitutes the basis of the local economies. First of all, communal property businesses are often incurring losses, i.e., local budget expenditures

for them are higher than their incomes. Secondly, there are no scientifically grounded criteria for the transfer of these or other businesses to communal property or for their redistribution between certain local councils. This redistribution is done in a traditional way, i.e., the business remains the property of the previous owner or it is transferred to more influential owners (Very often these are regional councils as opposed to town and district ones) who take the most profitable businesses under their control.

Quite often local councils incur losses, while commercial structures reap high profits. According to the Dniprodzerzhinsk Community Property Fund, the profit and loss statements for trade and public food catering are as follows:

- Trade (industrial products): Profits - 10 percent; losses - 90 percent
- Public food catering : Profits - 34 percent; losses - 66 percent

In this connection, it is easy to understand the point of view of many economists and managers that privatization of communal property should occur as soon as possible in order to free the local councils from property control and the local budgets from an extra burden.

No doubt, the problem of loss-incurring businesses should be solved this way. But this must not be done with profitable businesses whose local budget conditions could be improved.

Each region has its own specific features, and this is difficult for the central government authorities to take into account. Therefore, the procedure for transfer of property to communal ownership must be developed at the legislative level, but this should not impose limits on the entrepreneurship and initiative of local councils. Advances must be made in any efforts to solve problems without outside help and limits must be set only in the form of permits for business activity to be issued to local entities. Favorable tax rates must be provided to communal property businesses and social infrastructure enterprises in particular.

Let me use Dniprodzerzhinsk as an example. A significant part of communal property consists of communal housing, social support organizations, health care, and public education. At the same time, social support is the most vulnerable financially. Local budget expenditures for social support equal 52.8% of the total budget or 1,448,559 thousand karbovanets. They are distributed as follows:

- | | |
|--|------------------------------|
| ■ Public education and professional training | 544,217 thousand karbovanets |
| ■ Subsidies to culture, arts, and the press | 52,509 thousand karbovanets |
| ■ Health care | 829,210 thousand karbovanets |
| ■ Sports and youth programs | 1.300 thousand karbovanets |

■ Social welfare

21,323 thousand karbovanets

Each of the social support divisions has its own variant for the development of paid public services that are mutually beneficial; people are provided with additional services, and organizations and other entities receive funds required for their development. To facilitate this process, it is necessary to lower tax rates applied to them by 30-50 percent, at least for the next two years.

A real, although not large reserve for this is the redistribution of already available funds in these divisions. The social welfare division could be improved organizationally and qualitatively if the 10 million karbovanets the Ministry of Social Welfare pays to the Ministry of Communications for delivery of pensions were channelled to setting up small businesses that provide social services. Pension delivery is unreliable and unsatisfactory, not only in Dniprodzerzhinsk. Here we are dealing with the case where one ministry improves its financial situation at the cost of another ministry and does not fulfil the undertaken commitments. Provided the above-mentioned small businesses are set up, social welfare departments and executive committees of local councils would provide these services. Favorable tax rates must be applied to these small businesses, since, with the growth of the nonworking population, the need for their services will increase. Besides, such businesses could provide paid services, which, with favorable tax rates, can be cheaper than those provided by traditional companies.

Public education also can have additional earnings, but only with the reduction of its income tax, at least for the period of development of activities targeted at the generation of additional income (small businesses, clubs, and leases). The income of the Young Sailors Club in June 1992 was 62 thousand karbovanets, and income tax alone was 18 percent. It would be more reasonable to spend these earnings for development, since clubs of this kind will be financed from the budget anyway. Besides, the incomes generated in the public education system do not play a significant role in the total amount of tax revenues. The lease of space owned by public education institutions is also worth mentioning, when, out of each 100 karbovanets earned, 75 karbovanets are paid in taxes. The other limited but real possibility to improve the financial situation of public education institutions is the rational use of available funds. Local budgets pay for lunches for junior school children. It would be more reasonable if school principals had the authority to use these monies, under the supervision of public education and financial inspection authorities, of course. Since not all school children eat at school, the school administration would know better how to use these monies. The same problems exist in health care and culture.

A possible source of additional revenue could be the participation of local councils on a share basis in banking, insurance, and [business] partnerships. Of course, this participation must be thoroughly thought over, partners must be reliable, and, most importantly, standards to regulate such activity must be enacted. One cannot risk the budget while doing so, but the local councils have the right to establish targeted and out-of-budget funds, and this right must be used actively and reasonably.

While developing standards for local councils' business activity, one should extensively rely on the Western experience with regulation, while, of course, taking into account complex local conditions. In the West, this activity is distinctly regulated and is mostly aimed at establishing various services. Local governments own banks, insurance companies and other financial institutions; and they offer various types of securities. This must also be introduced into the activity of Ukrainian local councils.

The issue of out-of-budget funds is also important. Out-of-budget funds, along with the funds accumulated in the local budgets and hard currency funds, constitute resources that are the financial basis of local and regional self-government. Of great importance is the stipulation in the *Law on Local Councils of People's Deputies and Local and Regional Self-Government* of the right of the local councils to establish and use out-of-budget funds and the definition of their legal status. First of all, in transitioning to the most economical management methods, the active search for additional non-budgetary sources to finance regional social and economic development plays a great role.

Of no less importance is the expansion of local and regional government rights in realizing their financial activity, which must stimulate their initiative. The legal standard is the initial impulse for the development of relations in the process of the application of the law. It's aim is to influence actively the conduct of legal relations.

Local councils could have obtained out-of-budget funds earlier, but the conditions of

their acquisition and use did not allow them to become a sufficient means of solving financial problems. At the same time, the mechanism to regulate out-of-budget funds had positive aspects which were not taken into account in the new legislation.

Legal standards for the establishment and use of out-of-budget funds are still not distinct and final; forms of accountability have not been provided, and the sources of these funds need to be clearly defined. One should bear in mind that the main fund ensuring the authority of local and regional governments is the budget. Its legal status allows it to be a means to ensure financial discipline as the exact procedure with which all citizens and organizations comply with the rules of State and local activity. The budget, as a normative act, has regulative, organizational and disciplinary functions simultaneously.

Revenues obtained by local and regional governments through additional measures that are not their direct responsibility, except for local loans, must go to out-of-budget funds. Local loans have an exclusive character and significant effects, since they bind local and regional governments with serious obligations. It is absolutely correct that taking local loans is within exclusive competence of representative entities of local and regional governments. Disregarding the voluntary character of loans for citizens, local and regional governments acquire obligations due to legal relations that develop in this case, and fulfillment of these obligations is guaranteed by the influence of the State. This requires a strict legal regulation for these funds, which fully insure the budget.

Revenues, which are difficult to calculate or forecast and which, at the same time, do not have the character of legal and individual obligations before local and regional governments, must be paid to out-of-budget funds. Payment of these revenues is not stipulated by the State as an imperative, as a result of which the fulfillment or non-fulfillment of one's obligations, taxes, various non-tax payments, or penalty payments are either a means or result of the execution of State functions. Their payment is ensured by legal and organizational actions, including sanctions, as a means of penalty and compulsion; therefore, all these [obligations] must be paid to the budget. Revenues from lotteries, auction sales, charity and target funds, donations of citizens entities, etc., must also go to out-of-budget funds. Proceeding from the above, Articles 11 and 13 of the *Law on Councils of People's Deputies and Local and Regional Self-Government* need to be modified appropriately.

The issue of local budget control needs to be mentioned. If today the control over budget use is generally clearly organized, the same cannot be said about the control over the revenue part of local budgets. In 1990 tax inspections were separated from [the control of] financial boards. It is hard to make judgments now whether or not this was untimely, taking into account the financial instability and the difficulty of forecasting entrepreneurial development and individual business activity under conditions of economic crisis. At the same time, the issue of control over their activity is a very urgent one.

Today tax inspection authorities are no longer subordinated to financial boards; they are financial boards themselves, financed from the State budget but not accountable to local

councils, which is not the case with the latter. This complicates control over timely and full revenue payments in general and to the local budgets in particular. The total amount of payments due in Dniprodzerzhinsk as of August 1, 1992 was 250 million karbovanets. If these payments were promptly mobilized to the State and local budgets and channelled for financing social support, it would have a perceptible effect on the cities' economies. Standing committees on planning, budget and finance have the right to request the necessary information on local revenue payments to the budget, and in their turn, must systematically inform the local council during its sessions. Since this right is not directly provided by the law, we are referring here to its possible use. This must become the right and obligation of the standing committee in relation to tax inspection authorities, and it would be expedient to stipulate this in the *Law on Local Councils and Local and Regional Self-Government*.

Speaking of local budget problems, one needs to mention the issue of the budget organization process and its normative regulation. With the complex financial and budget problems at the present stage, discussion of draft budgets by local council deputies takes an inadmissibly long time when the budget is not approved for three to six months. In order to alleviate this problem somehow, to solve the most complex and painful issues and not to bring the matter to a conflict at the council session during discussion and approval of the budget, it would be worthwhile to study all proposals by the council standing committees in the draft budget, that would be prepared and resubmitted to them by executive authorities prior to its approval. This additional budget process stage could be provided for in a clause on the procedure for forming, use and approval of budgets, which can be adopted by the local council

under current legislation.

At the same time, the recent experience of local councils does not give confidence that, with the introduction of such an additional budget preparation stage, the budgets will be approved on time. It is quite possible that the new fiscal year could start without an approved budget. Therefore, with essential contradictions during budget discussion, it is necessary to approve at least the major revenues and expenditures in order to enable payments to be made legally.

As in an extreme case, when it is impossible to come to mutual understanding, monthly financing of expenditures must be made in the amount of half of the previous year's budget expenditures, and these expenditures must be recorded in the current year's budget; but this period must be limited to 3 months.

Payment for Land and Ways to Improve It

By

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One of Ukraine's greatest sources of wealth is its land. Ukraine occupies a territory of 60,400,000 hectares. Its area under forests and shrubs is about 10 million hectares or 17 percent, while in Belarus it is 35 percent; in Bulgaria, 30 percent; in Poland, 28 percent; and in Romania, 26 percent. But the land has not always fed our people as we would have liked. Inadequate economic management is one reason. Thus, the area of agricultural land in Ukraine is 42 million hectares, including 33.4 million hectares of arable land or 80 percent of plowed-up land. In Belarus it is 58 percent; in France, 52 percent; while in the Cherkassy, Kirovograd and Kherson regions, it is about 90 percent. In 25 years the content of humus in the soil has decreased from 3.5 percent to 3.2 percent. There is a serious onslaught of erosion. Within the same period the area of water-eroded plowland increased by 26 percent and reached 10 million hectares, or one third of the arable land. For this reason crop losses exceed 8-9 million tons of grain.

It is believed that gratuitous use of land is the main reason for agricultural exploitation; this also holds true for the large amount of land in city planning and building and in industry. Naturally, such a state of affairs cannot prevail under a developing market mechanism. That

is why, from 1992 on, Ukrainian legislation has set rates for paying for land use.

Enacted in 1992, the Ukrainian *Law On Payment for Land* regulates payments for agricultural and nonagricultural land, including the land of inhabited localities, industry and transportation. The law establishes that land utilization is effected by levying a land tax and lease payments. The tax is determined by the quality and location of the land plot based on the land cadastre assessment. The basis for land payment is an owned or rented land plot. The payer is an owner of the land or a lessee.

The land tax rate is established by the Supreme Rada of Ukraine and specified during changes of the land cadastre assessments. The rates are determined for both agricultural and nonagricultural lands. The agricultural land rates are established in karbovanets per hectare of arable land and perennial plantings as well as of hay fields and pastures in the Republic of Crimea, the regions, the cities of Kiev and Sevastopol and on the territory under the jurisdiction of the Sevastopol City Council of People's Deputies. The Supreme Rada of the Republic of Crimea, the regional, Kiev and Sevastopol City Councils of People's Deputies establish land tax rates by soil groups, proceeding from the average tax rates and land cadastre assessments. The minimal tax rate is 20 karbovanets per one hectare of agricultural land. If a cadastre assessment of specific land plots is lacking, the tax rates are determined in the same way as for the plots adjoining them, and they will have the same assessment. The procedures for determining land tax rates by groups of soils and within the boundaries of an inhabited locality are established by the Government of Ukraine.

Payment for nonagricultural land is established in the following way:

- The tax for agricultural land plots used for their end application under agricultural enterprise economic structures and located within the boundaries of inhabited localities is levied at the same rate as agricultural lands.

- The tax for land plots occupied by housing facilities, garage-buildings, dacha-buildings and gardening cooperatives, as well as by individual garages and dachas, is levied at three percent of the land tax rates established for land plots in karbovanets per one square meter, depending on the groups of inhabited localities. Provisions have been made for 11 such groups based on the number of inhabitants, at rates from 0.5 to 7 karbovanets per square meter, and in six groups at rates of 1.2 to 3 karbovanets per square meter.

The tax on plots beyond the inhabited localities allocated for industry, transportation, communications, defense and other purposes is levied at 1 karbovanet per one square meter, while the tax for plots beyond inhabited localities on the land for natural conservation, health-building, recreation and historical-cultural purposes is levied at 5 karbovanets per one square meter.

There are some distinctive features in payment for land with woodland and water

resources. For plots beyond the boundaries of inhabited localities and within the lands of woodland resources and occupied by buildings and installations, a tax is levied at three times the amount of the established rates of the tax on arable lands and perennial plantings. A similar amount of the tax is levied on land plots within the water resource areas.

Legislation provides land payment preferences. Taxes are not levied on the following:

- Preserves (parks, national, archeological and zoological)

- Botanical gardens

- Reserves (except for game reserves)

- Experimental farms, including scientific research establishments and educational agricultural establishments, state variety test stations and variety sections, as well as the lands of state farms used for testing agricultural crops

- Establishments of culture, science, education, public health, and social security

- Special sanatoriums for rehabilitating patients as listed by the Ministry of Public Health of Ukraine

- Children's sanatory-resort and health-building establishments
- Educational-production establishments
- Enterprises and organizations of the Society of the Blind and Deaf
- Public organizations of invalids and their associations
- Establishments of physical culture and sport, except for cooperative and private charity foundations
- Invalids of groups I and II
- Second World War invalids and persons equated with them
- Widows of servicemen who died in the performance of State duties
- Pensioners
- Citizens who were affected by the Chornobyl catastrophe and their public associations

Also exempt from taxation are radioactive and chemically polluted agricultural lands, in which agricultural work is restricted, as well as the lands of cemeteries. The newly established peasant (farmer) enterprises are exempt from land taxes for three years from the time the land plot has been transferred to their ownership or utilization.

The Supreme Rada of the Republic of Crimea and the regional, Kiev and Sevastopol City Councils of People's Deputies can establish preferences for land taxes: partial exemption for a specific term, deferment of payment, or reduction of the rate of the land tax.

The data of the State land cadastre serves as the basis for calculating the land tax. Legal authorities independently calculate the amount of the land tax and annually furnish the data to corresponding tax inspectorates not later than July 15. Citizens are charged the land tax by state tax inspectorates which, by July 15 of the current year, issue taxpayers notices. Taxpayer records and the land tax charges are carried out every year as of May 1st. The tax is paid in equal shares on August 15 and November 15.

The amount, terms and dates of regular payments for land are established by agreement of the parties in the lease contract. The amount of this payment cannot be less than the tax amount, and for agricultural lands it cannot exceed this tax.

The land tax payments are placed in special budget account for village, settlement, and

city councils of people's deputies on the territory where the land plots are located. For the centralized fulfillment of the work on the development and implementation of the *Program on Increasing Soil Fertility, Land Improvement, Development of the Infrastructure of Inhabited Localities, and Recovery of Losses of Land Owners Utilizing Lands of Poorer Quality*, 30 percent of the resources from the land tax payments, placed in a special local council budget account, are centralized in a special Ukraine budget account, while 10 percent is placed in special accounts of the Republic of Crimea and the regions.

The notion of standardized land prices is used for the economic regulation of land during the transfer to ownership as an inheritance, gift, or for receiving bank credit against security of the land plot. The standard price for a land plot is established as a hundredfold amount of the land tax on it.

There are a series of questions which need to be solved about the year in which owners pay for land they use.

- The Government of Ukraine established that the land tax is calculated on the basis of the tax rates approved by the Supreme Rada of the Republic of Crimea as well as by the regional, Kiev and Sevastopol City Councils of People's Deputies. But since the cadastral survey had not been carried out and there were shortcomings in cadastral assessment, the Councils have been deprived of the opportunity to determine more fully

the said rates. That is why the land tax rates, in accordance with the Government's decision, are determined according to the average rates established by the Law and increased 30 times this year. (In Kiev this work has been completed and there are now definite rates depending on the economic assessment and location of the land plots).

- Quite a few issues have appeared about preferences. For instance, the lands of the Ministry of Defense and State agencies, the lands under railroads, pipelines, motorways of general use and the like require a different taxation approach and granting of preferences. In addition questions are raised about granting the local councils the rights of preferential terms on this tax.

Taking this into consideration, we believe that the following should be undertaken:

- Finish land valuation, make the land cadastre more precise, and determine the rates characterizing the objective price for land. There are many reasons to do this, especially since the resources for this purpose (420 million karbovanets) are provided in the budget.
- It is expedient to introduce changes and specifications to the *Law On Payment for Land*. In particular, in order to decrease the counter flow of money, the agencies and military units maintained at the expense of budget appropriations and the resources of trade unions must be exempt from the tax.

The tax on land under railroads and motorways, pipelines, electric power grids, communication lines and the like has to be made uniform throughout the entire country, and the land used under the standard specification of their functions must be exempt from taxation.

It would be expedient to grant the right to extend preferential terms by a list of the regional councils and the councils of other levels, including the basic level of sums placed in a corresponding budget. In this year's *Law On the State Budget for 1993*, the entire sum of the land tax has been placed at the disposal of local budgets, and that is why the mentioned extension of the rights of local councils will make it possible to use the received resources more effectively.