Work package 5

The Governance of Shrinkage in Donetsk and Makiivka (Ukraine): the Case of Local Government Finance

Research report

D10 Comparable research report

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1 – Introduction

This report details the results of research undertaken in Greater Donetsk (also known as the Donetsk-Makiivka Conurbation), Ukraine, for Work Package 5 (WP5) of the Shrink Smart project. At its core, WP5 is seeking to investigate the choices made by urban municipal administrations and national governments in responding to shrinkage. And, as it has long been argued elsewhere, there are many choices to be made. Chief among these is whether to accept shrinkage, and plan an area's land use, housing, and public services accordingly, or to battle against shrinkage, developing strategies which seek a return of residents.

The report addresses one of the key issues affecting Ukraine's third largest urban area. The prevalent view amongst scholars of Ukraine's urban and regional development has long been that – in the circumstances of urban shrinkage – the relative decision-making autonomy and efficacy of local government and municipal authorities is, for the most part, determined by the sufficiency of their financial resources. Local government finance in the form of municipal (city council) budgets, which concentrate financial resources of local authorities, has also been recognised as one of the key instruments through which the Ukrainian state conducts its social policy and has an impact on the social and economic development of regions, cities, and local communities. These notions have predetermined this report's rationale for the focus on the governance of Ukraine's public finance system and its impact on the ability of local governments to cope with urban shrinkage.

Focusing the study on local government finance and budget leads to two following key questions of WP5: Does urban shrinkage lead to or encourage any particular governance arrangements? What impacts do these arrangements have with respect to the ability of the governance system to cope with urban shrinkage? In order to study these questions this report focuses on a series of interrelated governance factors and mechanisms, including: a) identifying actors and their patterns of their interaction; b) structural conditions; and c) normative frameworks.

The research structure below broadly follows the guidance provided by the WP5 leaders in the background material. Most of the fieldwork research was carried out during the winter of 2010-2011, with additional interviews and consultations conducted throughout 2011. The method broadly used in this report is based around two major types of research techniques: i) secondary data analysis (strategies, statutes, legal and administrative documents, budgets, city development programmes, funds-related descriptions, academic literature, local, regional, and national mass media); and ii) primary face-to-face expert interviews and structured conversations with local government associations, the city of Donetsk and Makiivka councillors responsible for financial planning and budgeting, and Donetsk and Makiivka city executives.

2 – Local Government Finance in Europe and Beyond

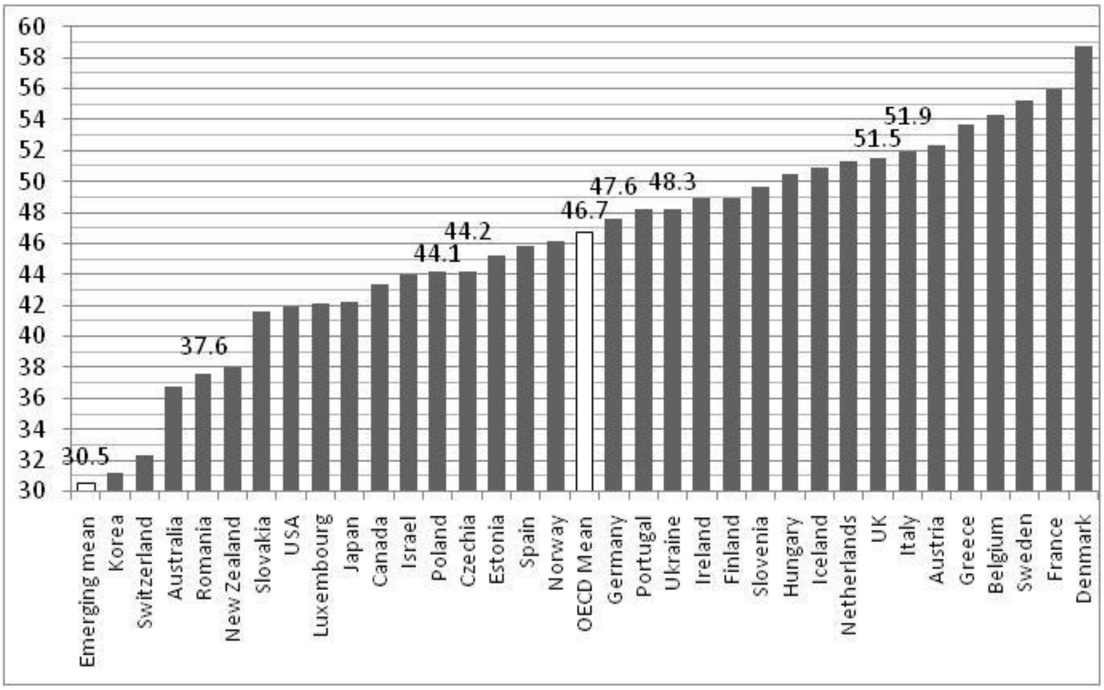
> Finance is at the heart of any fundamental debate about the role of local government ... It has two key dimensions – the relationship between local government and the state and the relationship between local government and the citizen.
>
> Janice Morphet, *Modern Local Government*

> Money does not buy happiness but it certainly helps. Neither does money necessarily buy power but it is a crucial factor in determining the effectiveness and independence of local government from central control.
>
> J. A. Chandler, *Local Government Today*

The modern state plays the crucial role in governing the capitalist space-economy. For centuries, the capitalist state has been intrinsically involved in complex, multi-dimensional, socio-spatial relations of production, distribution, exchange, and consumption (Arrighi, 2010, Jessop, 2002; Miliband, 2009 [1969]). One typical way of measuring the role of government is by fiscal criteria of taxation and public spending. In addition to regulation, the size and the scope of public finance indicate the extent of state involvement, or 'intervention', in the economy and society. In the mid-2000s, even after almost three decades of neo-liberalisation and 'rolling back' the frontiers of the state, about 40 per cent of gross domestic product (GDP) in a high-income 'advanced' economy was still spent by the state through the general government.

In 2009, at the peak of the Euro-Atlantic financial and economic crisis, the expansionary emergency demand-management measures undertaken by the governments in the countries involved pushed the public spending to GDP ratio to 46.7 per cent amongst the high-income advanced economies – member states of the Organisation for Economic Co-operation and Development (OECD) sector (see Birch and Mykhnenko, 2010; Mykhnenko and Birch, 2010). Within the seven countries this project is focused on, the size of government ranged from 37.6 per cent in Romania to 51.9 per cent in Italy. Notably, the size of the Ukrainian state on the expenditure basis (48.3 per cent of GDP) was not only above the high-income OECD average in 2009, but also unusually high by the standard of a middle-income, ‘emerging and developing’ economy (see Fig. 1). Yet similarly to the United Kingdom’s position, Ukraine’s historically high share of government spending was a direct result of the global financial-economic crisis and the state’s emergency intervention in the collapsing banking sector.

Figure 1. General government total outlays as a % of GDP: emerging and developing economies (average), high-income OECD countries, Romania, and Ukraine, 2009



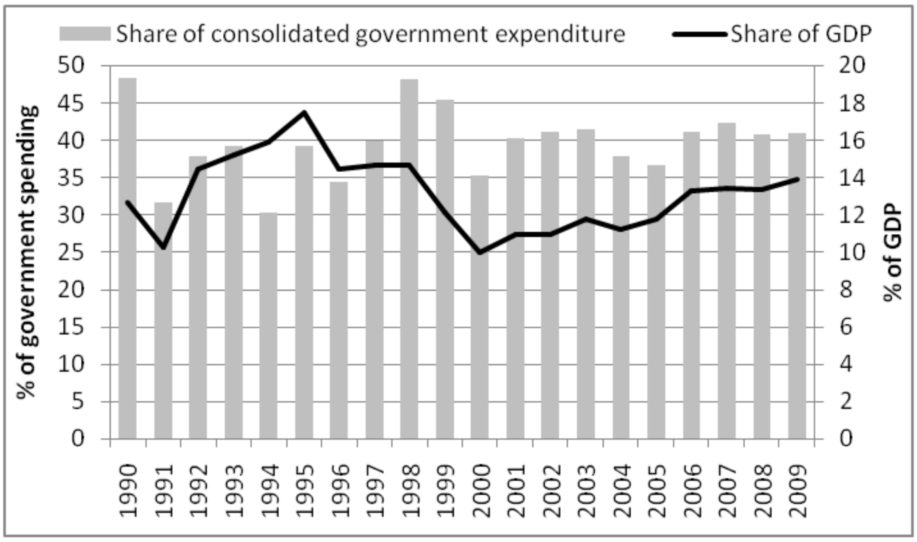
Source: compiled on the basis of IMF GFS Online 2011.

In a broader historical perspective, the size of the Ukrainian state has experienced a significant decline during the post-communist transformation in the 1990s and 2000s of around 10 percentage points, or one-fifth the size of the national economy. This process has also been reflected locally. The relative size of Ukraine’s sub-national (i.e., regional and local) government has also diminished under post-communism, when assessed through spending.[1] Between Ukraine’s independence in 1992 and the peak of its second post-communist economic depression in 2009, the local government’s relative spending (as share of GDP) dropped from 14.4 to 13.9 per cent. Ukraine’s local government spending allocation *within* the total general government expenditure at first declined between 1990 and 2000

[1] The term ‘local government’ refers in the Ukrainian legislative context to all the sub-national levels of the regional and local self-governance.

from 48.4 to 35.3 per cent, before recovering to 41.0 per cent by the end of the 2000s, signalling a reversal of centralising trends observed earlier (see Fig. 2). Thus, unlike in other countries undergoing radical state restructuring (see Duncan and Goodwin, 1988), the overall direction of Ukraine's local government finance during the past twenty years has been towards a gradual increase in the level of fiscal decentralisation, accompanied by decline in the overall size of public spending at all levels.

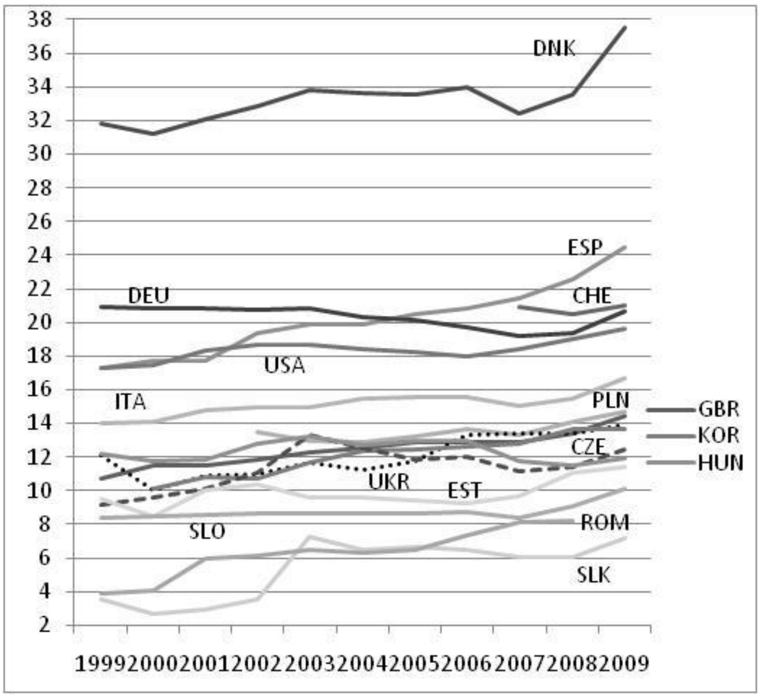
Figure 2. Local government expenditure as a % of consolidated (central + local) government expenditure and of GDP, Ukraine, 1990-2009



Source: authors' own calculations on the basis of SSSU Statystychnyi shchorichnyk Ukrainy (various years).

Local government is a significant direct provider of public goods in Europe and North America. In addition, from the late 1970s onwards, with a shift towards the 'New Public Management' paradigm of public policy implementation and public services delivery, local governments in many countries have also been 'empowered' to commission the provision of public services from the private- and the third- sector firms and organisations (Bovaird and Löffler, 2009; Osbourne, 2010). Thus, local government finance and local regulation have a fairly straightforward effect upon the conditions and quality of public services, and on the local authorities' capacity for meeting the needs of local residents. Generally, throughout Europe, North America, and East Asia, local government expenditure accounts for a significant proportion of GDP – between 7 per cent in Slovakia to almost 40 per cent in Denmark (see Fig. 3).

Figure 3. Local (regional + local) government expenditure as a % of GDP, selected high-income OECD countries, Romania, and Ukraine 1999-2009

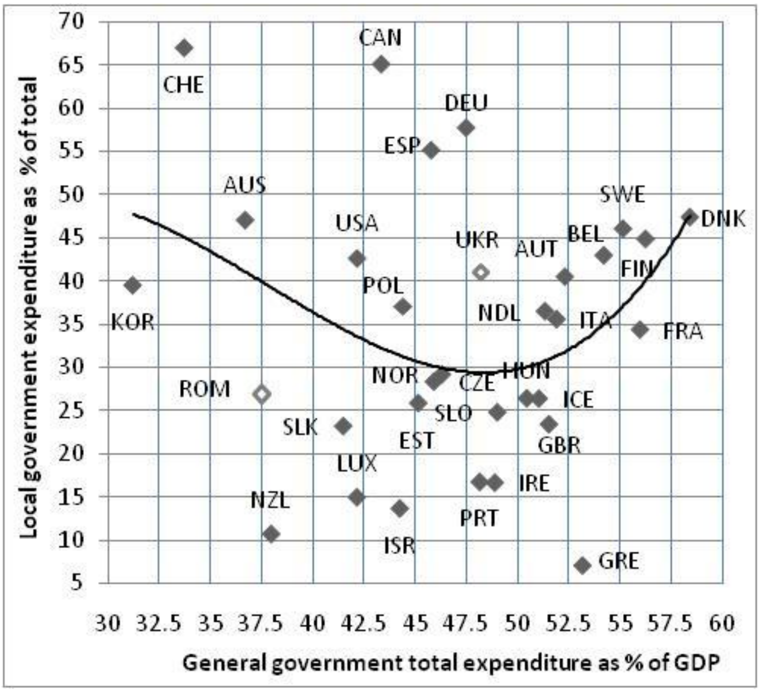


Source: authors' own calculations on the basis of INS Anuar statistic 2009; OECD.Stat Database 2011; SSSU Statystychnyi shchorichnyk Ukrainy (various years).

It is usually argued that larger-scale expenditure occurs in those countries, where local government has been put in charge of costly social services such as social security, non-tertiary education, health care, and public utilities (Anderson, 2010; Wilson and Game, 2011: chapter 12). Yet a more profound, growing worldwide trend towards de-concentration, devolution, and fiscal decentralisation across levels of government has been well-documented (Ter-Minassian, 1997; OECD, 1997). Figure 3 also provides evidence of a further strengthening of the financial muscle of major local government systems, with an increase of the average local public spending in the selected countries from 13.1 to 16.1 per cent of GDP between 1999 and 2009 alone. In particular, within this period, the size of local government in terms of expenditure increased by 4.3 percentage points in Romania (reaching 8.2 per cent of Romania's GDP), 3.7 percentage points in Great Britain (up to 14.4 per cent of GDP), 3.3 percentage points in Czech Republic (up to 12.4 per cent), 2.7 percentage points in Italy (up to 16.7 per cent), 1.8 percentage points in Ukraine (up to 13.9 per cent), and 1.2 percentage points in Poland (up to 14.7 per cent). Somewhat bucking the trend, sub-national authorities in Germany experienced a small – 0.2 percentage point – decline in their fiscal power to 20.7 per cent of GDP.

Further evidence suggests there is a complex non-linear relationship between the overall size of the state and local authorities' fiscal position within it. Figure 4 indicates that local government (state/regional + municipal authorities) is very likely either to have a very large slice of a very small cake or a fairly large slice of a very big cake of public spending, with the majority of cases falling somewhere in between.

Figure 4. Relationship between the size of the state (general government expenditure as a % of GDP) and the power of local (sub-national) government (as a % of total public spending after transfers), high-income OECD countries, Romania, and Ukraine, 2009

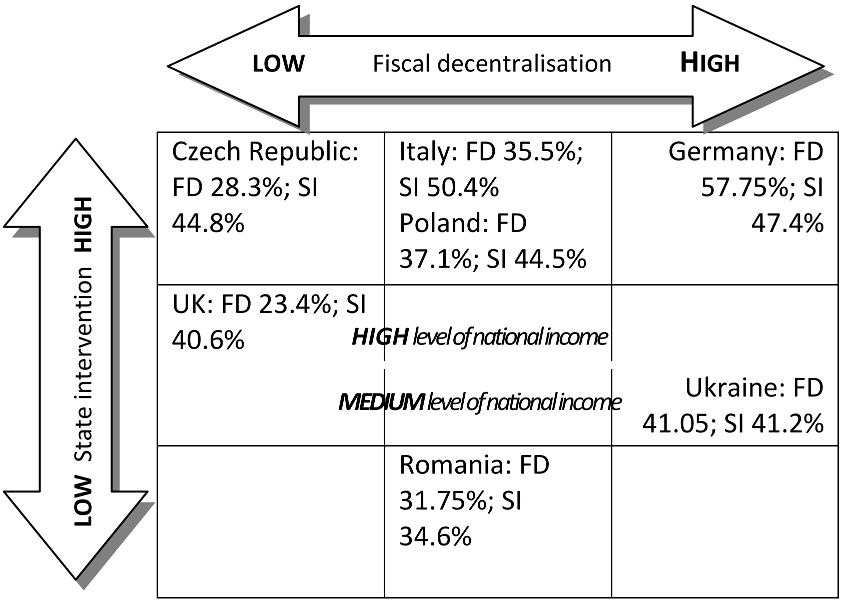


Note: the polynomial trend line reflects the relationship between the two variables within the high-income OECD group only; thus, it does not take into account the position of Romania and Ukraine on the chart.

Source: authors' own calculations on the basis of INS Anuar statistic 2009; OECD.Stat Database 2011; SSSU Statystychnyi shchorichnyk Ukrainy (various years).

This line of reasoning allows one to compare systematically particular national circumstances, which the ten case study cities of this project find themselves in. Similar to Wilson and Game (2011: chapter 12), we have positioned British, Czech, German, Italian, Polish, Romanian, and Ukrainian cities within three different groups of cases. First, vertically, the national cases are divided according to the overall 'size of the cake' into the low, medium, and high categories of state intervention, defined as the average total general government expenditure as a per cent of GDP over the 1990-2010 period, with the middle category falling within the range of +/-10 per cent of the advanced economies' historical average of 40.2 per cent of GDP. It is notable that Bytom, Halle, Genoa, Leipzig, Ostrava, and Sosnowiec are located in countries with historically high levels of state intervention. Donetsk, Liverpool, and Makiivka are located in countries with average levels of public spending, whereas Timisoara operates in an environment characterised by low levels of public spending.

Figure 5. Average levels of fiscal decentralisation and state involvement in the economy in Czech Republic, Germany, Italy, Poland, Romania, Ukraine, and the United Kingdom, 1990-2010



Note: FD is the level of fiscal decentralisation in 2009. SI is the extent of state intervention in the economy in 1990-2010. For analytical and comparative purposes, the ten cities are further divided according to 2010 gross national income (GNI) per capita, calculated using the World Bank Atlas method. According to the World Bank, Ukraine ($3,010) and Romania ($7,840) were located amongst middle-income (or developing) economies, whilst Poland ($12,420), Czech Republic ($17,870), Italy ($35,090), the United Kingdom ($38,540), and Germany ($43,330) belonged to high-income (or advanced) economies.

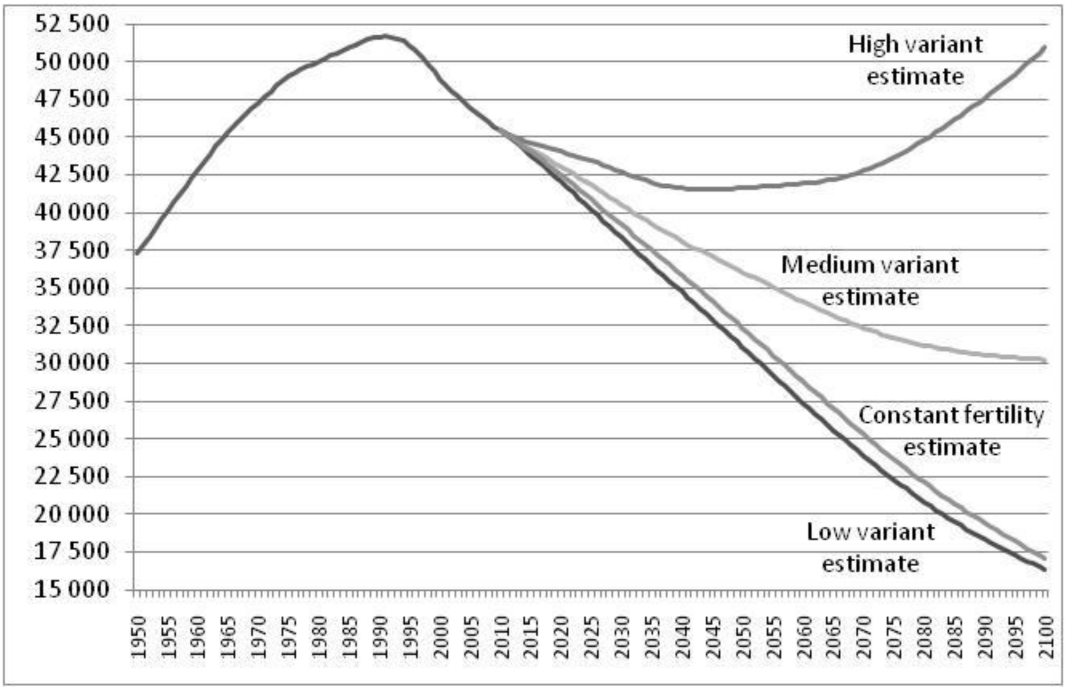
Source: authors' own calculations on the basis of IMF GFS Online 2011; INS Anuar statistic 2009; OECD.Stat Database 2011; SSSU Statystychnyi shchorichnyk Ukrainy (various years).

Horizontally, the ten cities are then divided according to the 'slice of the cake' into groups with low, medium, and high levels of fiscal decentralisation, defined as local (state/regional + municipal) government expenditure as a per cent of total general government expenditure in 2009 (the latest data available). The high-income OECD unweighted mean for local government's share of total public spending was 34.2 per cent in 2009; hence the medium degree of fiscal decentralisation in Figure 5 lies within +/-10 per cent of this figure. Accordingly, Donetsk, Halle, Leipzig, and Makiivka operate in highly devolved fiscal regimes, whereas Liverpool and Ostrava are located in highly centralised states, with Bytom, Genoa, Sosnowiec, and Timisoara located in the middle of the spectrum. In addition, one final distinction is made between the medium- and high-income groups of countries, according to their absolute levels of economic development defined as gross national income per capita in 2010 (cf. Wilson and Game, 2011: 230-232). Thus, unlike any other city within our sample, Donetsk and Makiivka have been allowed to have a large slice of an average cake, though in a lower middle-income economy context.

3 – Ukraine's Post-Communist Transformation, Shrinkage, and Public Finance Trajectories

Ukraine represents a prime example of the conceptual complexity involved in understanding the issue of shrinkage, of a fairly sluggish policy response and rather messy and emotive national politics of ethno-cultural 'extinction'. To start with, the country's population trends over the last twenty years have been truly astounding, with a loss of almost 7 million inhabitants under post-communism. Ukraine's demographic prospects for the following forty to ninety years appear to be particularly bleak, according to most of the demographic variant estimates. In particular, according to the United Nations' 'medium variant' estimate, Ukraine population is set to decline from around 52 million population in the early 1990s to 36 million in 2050 and further to just above 30 million in 210; thus, shrinking back to the population size *circa* 1900 (see Figure 6).

Figure 6. Ukraine's long-term population prospects: 1950-2100 (thousands)



Source: elaborated from *World Population Prospects 2010 Revision* (Population Division, 2010).

In the 1990s, during Ukraine's devastating post-communist transformation, the country had plunged to the bottom, reaching the world's worst human survival and development indicators (Mykhnenko, 2011). Over the entire 1990-2010 period, Ukraine's crude death rate fell behind that of the Sub-Saharan Africa (15.03 deaths per thousand people), whereas the country's total fertility and population growth rates were recorded to be amongst the historically lowest in the world. Moreover, in terms of natural population increase, during the past two decades Ukraine had been the *fastest* shrinking country on earth, well ahead of Bulgaria, Latvia, Russia, Hungary, Belarus, Estonia, Lithuania, Germany, and Romania (see Table 1).

Table 1. Contemporary demographic indicators: Czech Republic, Germany, Italy, Poland, Romania, Ukraine, and the United Kingdom, ranked by population growth rate, 1990-2010 averages

	Crude death rate **deaths per 1,000 population**	***Total fertility*** **children per woman**	***Rate of natural increase*** **per 1,000 population**	***Population growth rate*** **average % per year**
Ukraine	15.43	1.35	-5.72	-0.60
Romania	11.85	1.36	-1.34	-0.37
Poland	9.96	1.49	0.92	0.03
Czech Republic	10.82	1.36	-0.82	0.09
Germany	10.54	1.34	-1.38	0.20
Italy	9.81	1.28	-0.44	0.33
UK	10.44	1.75	1.85	0.42
Europe	11.39	1.49	-0.72	0.12
World	8.82	2.74	13.10	1.50

Note: according to the UN geographical definition, 'Europe' includes 48 countries and territories, whereas the 'World' covers all of 230 states, dependencies, and other territories.

Source: elaborated from *World Population Prospects 2010 Revision* (Population Division, 2010).

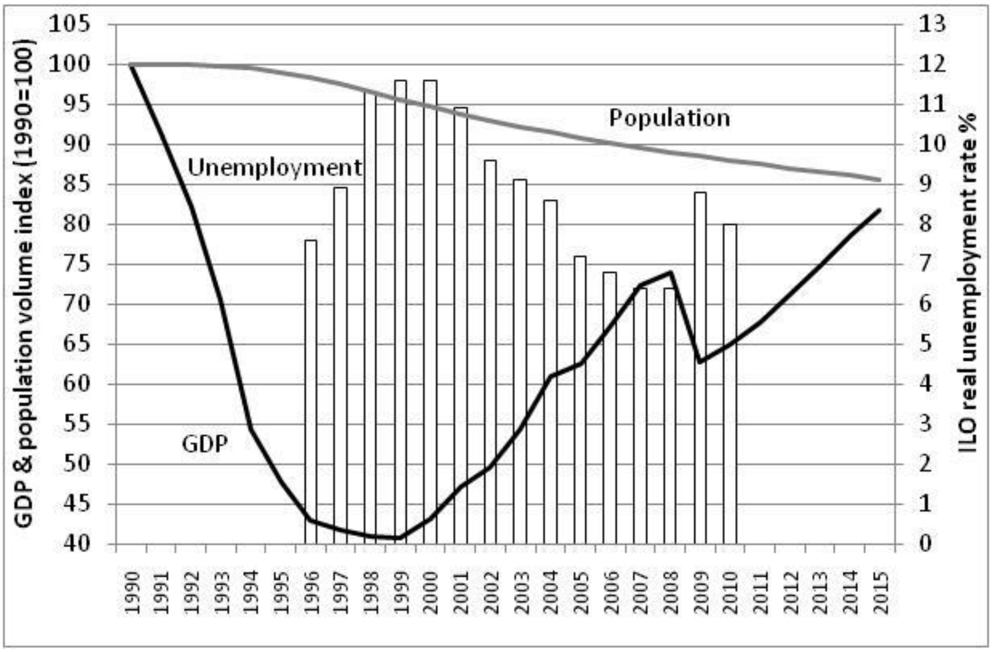
As a major societal problem, Ukraine's dramatic population loss was firmly put on the political agenda by the country's left-wing opposition in the mid-1990s. Natalia Vitrenko, the leader of Ukraine's Progressive Socialist Party and then member of the Ukrainian Parliament, along with Petro Symonenko, the long-standing leader of the Communist Party and an MP, used to attack regularly the United States and the international financial institutions-backed neoliberal transition in Ukraine as the major cause of Ukraine's economic crisis, frequently describing the country's rapid decline in population as an ongoing 'IMF genocide', a Western imperialist project aimed at destroying its former Cold War enemy by making east Slavonic nations 'extinct' (see Haran and Maiboroda, 2000). It had not been until Ukraine's tumultuous 2004 presidential elections that the country's conservative and nationalist politicians along with the extreme-right picked up the issues of low fertility, out-migration, and a 'national suicide' as a major rallying point.

In the much calmer sphere of expert discourse, the phenomenon of shrinkage (literally, *ubavli**a**nnia*) is commonly understood in Ukraine as a decrease (*skor**o**chennia* / *zm**e**nshennia*) or a decline (*zn**y**zhennia*) in population, and, concisely, as depopulation (*depopuli**a**tsiia)*. Thus, in terms of public policy, shrinkage has always been conceptualised and treated predominantly as a problem of Ukraine's demography – a 'demographic crisis' (*demohrafi**i**chna kr**y**za*) (e.g., see a recent roundtable discussion in the *Weekly Mirror* / *Dzerkalo tyzhnia* of Kyiv, as reported by Kotliar, 2010). Since the end of the 1990s, however, shrinkage as a public policy issue has been gradually spilling over from the sphere of social, family, and health care affairs into the labour market and, eventually, local and regional development policies. Nevertheless, it is only in 2010, after eighteen years of a continuous population loss, that one could have noticed an emergence in Ukraine of a more holistic, integral approach to shrinkage, even if still limited in scale.

Perhaps until very recently, the major feature of the shrinkage-related planning and policy debates in the country has been their rather disjointed nature. On the one hand, the central government and Kyiv-based academic experts have approached shrinkage as a national all-Ukrainian demographic problem, paying very little attention either to its spatial distribution across the country or its specific impact on local, urban, and regional development. At the same time, the state and its various agencies, local and regional governments, and the country's spatial economists, planners, and legal specialists have invested a far greater deal of effort into Ukraine's assisted areas and lagging behind regions, officially designated as 'depressed areas' and 'priority development territories' respectively.

Public policy attempts at tackling the country's 'demographic crisis' and depopulation have proceeded in parallel, but as an explicitly separate issue from local and regional development issues. The most obvious explanation for the lack of a joined-up approach to shrinkage, social and technical infrastructure, public services, housing, and employment from the public authorities has been Ukraine's precarious economy. In the 1990s, the country suffered *the* deepest and longest economic depression experienced by *any* of the post-communist transition economies not affected by war, losing 60 per cent of its gross domestic product (GDP) over the decade. The sheer magnitude of the economic collapse has simply dwarfed all other social concerns, including depopulation. Given that as late as 2010, Ukraine's economy was still one-third smaller its pre-transition level, whereas its population decline amounted to 12 per cent over the period, it is perhaps unsurprising that economic depression and high unemployment rates of almost 9 per cent on average have become the primary concerns of both the government and the public at large (see Figure 7).

Figure 7. Ukraine's present population and real GDP trajectories, 1990-2015, volume indices (1990 = 100), and ILO real unemployment rates, 1996-2010, per cent



Note: estimates start from 2010.

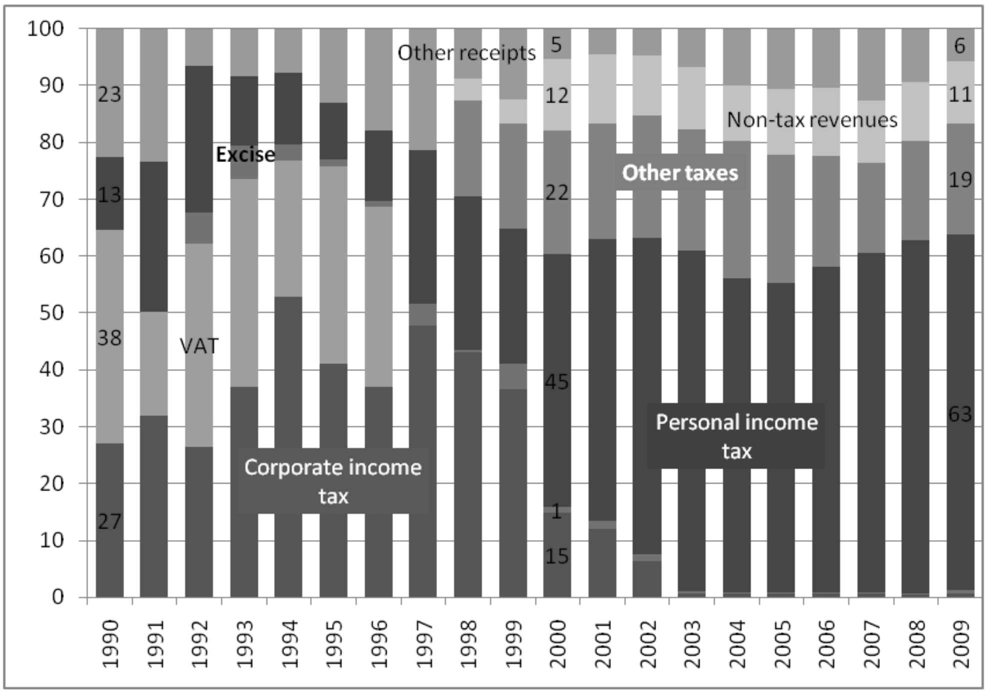
Source: elaborated from IMF *World Economic Outlook Database* (2011); *World Population Prospects 2010 Revision* (Population Division, 2010).

Chronologically, the issue of shrinkage was first officially problematised at the end of Leonid Kuchma's first presidential term. In a special Presidential Decree in October 1997 on 'The Basic Social Policy Guidelines, 1997-2000', the Kuchma administration declared ‘ensuring the demographic reproduction of the population’ to be one of the public social policy’s eight major strategic goals. The document fully acknowledged a ‘steady depopulation’ of the country ‘in recent years’ and suggested a number of measures aimed at overcoming ‘this demographic crisis’, attempting to boost fertility, decrease mortality, improve life expectancy, and suggesting some pro-family and pro-youth health care and employment policies (President, 1997).

Running for re-election in 1999 and facing a very strong opposition from Ukraine’s left-wing presidential candidates, including Symonenko of the Communist Party, Vitrenko of the Progressive Socialists, Moroz of the Socialists, and Tkachenko of the Village Party, Leonid Kuchma was forced to respond to fairly frequent accusations of being an enforcer of an ‘IMF genocide’ against his own people. In a new Presidential Decree in August 1999 on ‘The Guidelines for the Development of Labour Potential in Ukraine for the period until 2010’, the Kuchma administration emphasised the detrimental impact of ‘demographic peculiarities of the 1960s-1990s’, including a decline in birth rates, an increase in death rates, a drop in life expectancy, and the overall ageing of the population. To increase the ‘natural base of Ukraine’s labour potential’, the state was urged to create a family- and child-friendly policy environment, encouraging ‘extended reproduction’ of the population through better social protection, housing, health care, and employment opportunities. A spatial dimension was added at the sub-national scale, at the European National Unit of Territorial Statistics (NUTS) Level 2, by aiming at a more balanced inter-regional development across the nation (President of Ukraine, 1999). At the same time, in order to increase his support against Donetsk-based Petro Symonenko, Kuchma’s Communist party rival in the 1999 presidential run-off, the then president fast-tracked and singed an Act of Parliament to turn effectively the whole of Donetska *oblast*, including all of its coal-mining and steel-making urban centres and rural districts, into a free economic zone (Verkhovna Rada, 1999; see Mykhnenko, 2002).

Upon re-election, in his Presidential Address to the Ukrainian Parliament, Leonid Kuchma has referred again to an ‘aggravation of the demographic situation’ in the country. In a separate note, the address has reiterated the need to stimulate the social and economic development of ‘depressed’ areas, through the establishment of special (free) economic zones, ‘priority development’ investment regimes, and other measures. Given economic depression, the local authorities' hitherto reliance upon local firms and customers through the taxation of corporate income and sales of goods and services made the majority of them fiscally unsustainable. Faced with rapid deindustrialisation, an absolute impoverishment of local residents, and a regular 'tax blackmail' by the few solvent enterprises within its jurisdiction, the local government cried for a change in Ukraine's public finance system. A new Budget Code was enacted by the Verkhovna Rada of Ukraine in 2001, gradually shifting the bulk of local authorities' tax intake away from corporate and sales taxation and towards personal income taxes and non-tax revenues (see Figure 8).

Figure 8. Shifting patterns of Ukraine's local government revenue (excluding transfers), % of total, 1990-2009



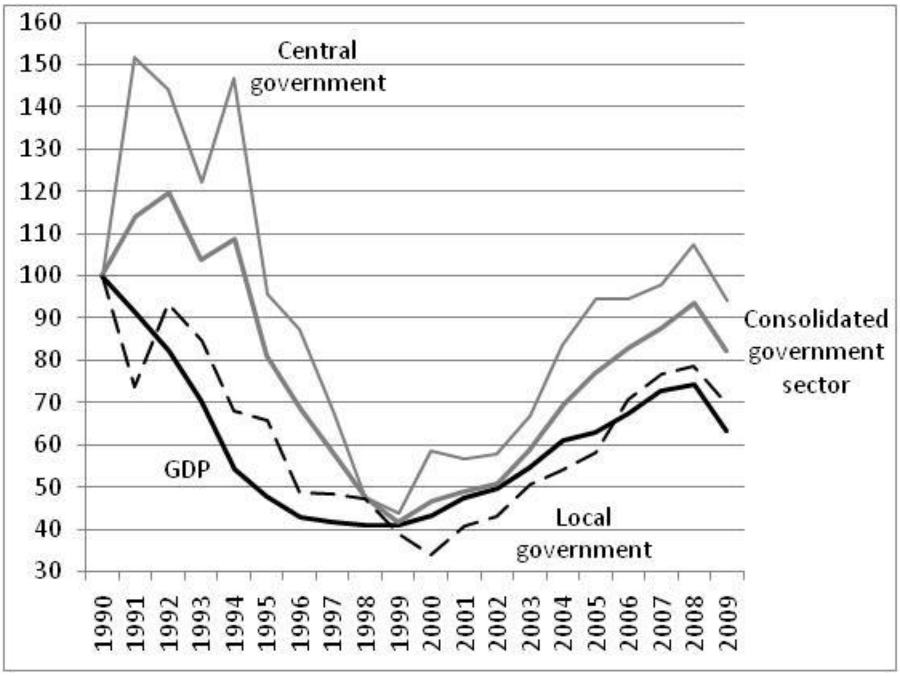
Source: authors' own calculations on the basis of SSSU Statystychnyi shchorichnyk Ukrainy (various years); World Bank (1999).

Ukraine's lagging behind areas were re-defined in economic *and* fiscal disparity terms such as differences in industrial output, income, and the amount of collected taxation per capita (President, 2000). Referring to the country's troubled public finances, Kuchma's advisors would typically blame the Communist past:

Ukraine maintains the communist overcentralization of state administration, and a rational division of power between the central state and regional and local governments is still to be found [...]. As in the old Soviet system, virtually all taxes go to the central treasure, and the Ministry of Finance determines the expenditures of regional authorities, but formal power and actual control do not coincide. The situation is untenable [...]. The extreme financial and political centralization paralyzed the whole Ukrainian state because regional authorities had few legal rights to do anything on their own [...]. If local governments were given charge of regional services, they would be more responsible. The logical conclusion was that taxes and expenditures should be clearly divided between the center, the regions, and the municipalities, while tax transfers should be minimized. Each level of government should be fully responsible for certain taxes with separate tax bases (Åslund, 2009: 243-44).

Nevertheless, even though the above description may contain a kernel of truth, just a glance at Ukraine's *post*-communist output trajectory could reveal a less fanciful, if mundane, explanation for the perilous state of the Ukrainian public finances in the 1990s, namely, the country's severe economic depression. As the economy collapsed, it had taken the nation's fiscal base down along with it, drying out the state's tax revenues.

Figure 9. Volume change in GDP and public expenditure (local, central, and consolidated government sectors), 1990-2009, volume indices (1990 = 100)



Source: authors' own calculations on the basis of IMF GFS Online 2011; SSSU Statystychnyi shchorichnyk Ukrainy (various years).

In the first stage of transition, Ukraine's central government had tried to mitigate the economic depression by a series of counter-cyclical spending measures. Yet since the late 1994, under President Kuchma, the country reversed to implementing the neo-liberal 'Washington Consensus' advice peddled by the international financial institutions and many foreign experts, including Anders Åslund (see Mykhnenko, 2009; Mykhnenko, 2011). The general government sector's expenditure was in effect slashed by 60 per cent during the 1990s and made to balance Ukraine's GDP by the end of the decade. Local government finance was particularly badly hit (see Figure 9). In 2000, at the very end of the drastic 'belt-tightening' exercise fully exacerbated by depression, the local government revenues dropped to just 27 per cent of the 1990 level, whilst spending declined to 34 per cent.

Concerning shrinkage, President Kuchma's major goal during his second five-year term has remained to be a decrease in mortality, active pro-family, children, women, and youth policies, and an 'encouragement' of in-migration (President, 2000). Consequently, Ukraine's government has adopted a 'Health of the Nation' programme as its first public policy measure aimed at addressing the country's demographic crisis directly (Cabinet, 2002). In his annual Presidential Address to the Ukrainian Parliament in April 2003, Kuchma expressed a 'serious concern about the demographic situation' and provided a grand historical narrative of Ukraine's shrinkage. According to the Kuchma administration, the most recent demographic challenges facing the country were firmly rooted in 'social catastrophes of the 1920s-1950s, two World Wars, three Holodomors [man-made famines] of 1921, 1932-1933, and 1947, the forced industrialisation, coercive collectivisation [of the agriculture] and mass repressions of the 1930s-1950s, the Chernobyl disaster, and a prolonged systemic crisis in the 1990s'. It was claimed that those historical calamities had resulted in 'around 16 million pre-mature deaths' and had seriously 'deformed the nation's demographic structure'. Along with a continuous decline in birth rates from the 1960s onwards, Ukraine's tragic 20th century history has eventually caused the country's rapid ageing and depopulation. It was noted that the negative demographic developments were particularly intense and detrimental in rural rather than urban areas. The country's depopulation 'at least until 2026' was recognised as 'inevitable', as Ukraine have 'practically exhausted its demographic growth potential'. The population policy was to be concentrated on improving the health care, decreasing mortality, pro-birth measures, active re-deployment of the elderly, and encouraging the in-migration and return of *ethnic Ukrainians*, with the overall emphasis 'on the qualitative rather than the quantitative demographic improvement' (President, 2003).

Following the speech, special Parliamentary hearings were held in May 2003 at the Verkhovna Rada on the 'Demographic Crisis in Ukraine, Its Causes and Consequences'. The members of parliament highlighted a decade-long decline in population of up to 4.5 million and declared the country's 'deep demographic crisis' to constitute 'a national security threat'. It was stated that none of the previous and then existing public policies and central government programmes aimed at dealing with the demographic crisis and its causes was properly implemented or had had a major effect (Verkhovna Rada, 2003a). Two weeks after the hearings, shrinkage was officially declared a 'national security threat' by the Parliament through the Law of Ukraine on the Foundations of Ukraine's National Security. The law has made it 'imperative' for the state to 'facilitate extended reproduction of the population' as one of its 10 national security priorities (Verkhovna Rada, 2003b).

In October 2004, almost seven years past the 1997 Presidential Decree on Social Policy, which was the first public announcement to put Ukraine's depopulation on the government agenda, the Cabinet of Ministers of Ukraine adopted a 'Demographic Development Approach, 2005-2015'. Instead of blaming Stalin and the Nazis for Ukraine's current demographic plight, the conceptual document emphasised the 'global low fertility trends' as well as 'the deep economic crisis of the 1990s', wide-spread impoverishment, poor health care provision, and an inadequate social safety net as major deterrents from human reproduction. The government policy paper signed by Prime Minister Viktor Yanukovych, an ex-governor of Donetska oblast, who was at the time struggling with his own presidential election campaign. That could account for a rather sudden 'spatial turn' in the Demographic Development Approach, which cited Donetska and Luhanska *oblasts* as the two areas with 'the most acute demographic situation', and Kyiv as 'the country's only region continuously receiving an inflow of net migration since 1995'. In order to halt the negative demographic trends as well as to balance the growing inter-regional population disparities, the government was set to introduce a 'two-child family' policy (Cabinet, 2004). As Ukraine's regular presidential elections were to be held later that month, shrinkage was to become a bitter electoral issue once again.

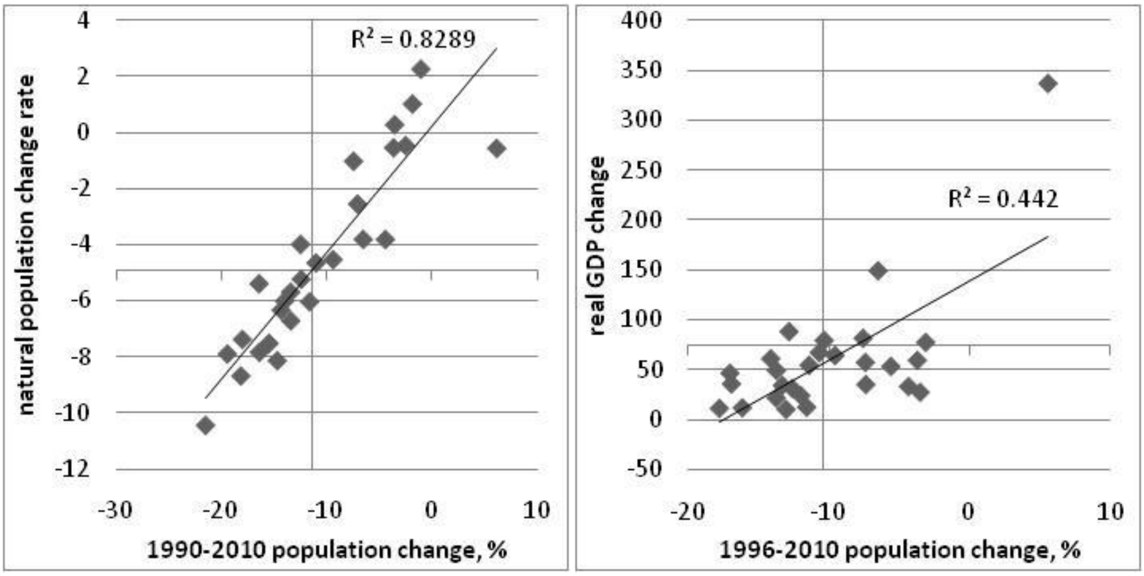
Viktor Yushchenko, the conservative-nationalist opposition candidate for presidency in 2004, has inserted a number of specific shrinkage-related promises in his electoral manifesto, including an introduction of single cash payments to families for every new-born first, second, and third child, as well as a creation of 5 million new jobs to halt the out-migration of Ukrainians abroad. Having delivered the first part of that electoral promise soon after his presidential election on 26 December 2004, Yushchenko continued to emphasise the political objective to see 'his nation grow'. In June 2006, Ukraine's Cabinet of Ministers announced a sudden decision to scrap Yanukovych's 'Demographic Development Approach', by adopting a new 'Demographic Development Strategy-2015' instead. In a rather dramatic turnaround from the previous government policy statement (and contradicting President Yushchenko's nation-building desires), the new Strategy explicitly dropped the emphasis on 'overcoming Ukraine's demographic crisis' and 'halting the country's depopulation'. Instead, the new liberal government of Prime Minister Yekhanurov suggested concentrating the efforts on bettering the living standards of the (remaining) population, and on preserving and 'maintaining its life and labour potential'. The 2015 Strategy also lost most of its predecessor's spatial awareness; all of the references to the country's internal, inter-regional demographic disparities were removed, apart from a brief mentioning of Kyiv as Ukraine's only attractive place for internal migrants (Cabinet, 2006a). In an attempt to placate the Head of State, a new government programme was introduced later on to improve the 'Reproductive Health of the Nation' (Cabinet, 2006c).

In the meantime, as a separate measure, a newly-enacted 'Law of Ukraine on Stimulating Regional Development' has provided an official, statutory definition of a 'depressed area' at the scale of regions (NUTS-2 level), industry- and agriculture-dependent districts or *raiony* (Local Authority Unit - 1), and cities of regional importance (LAU-1 level). 'Depressiveness' was classified according to an area's relative level of output, wages, and unemployment. Only in the case of rural, agricultural districts, was the Law to apply such spatial demography characteristics as population density and a natural rate of population change to be used amongst the many qualifying criteria for a depressed area status (Verkhovna Rada, 2005). To implement some of this act's provisions, in 2006 the government approved a Regional Development Strategy for a ten year period. The strategy document emphasised a protracted, 'demographic transition' towards small, often childless, families ‘evident in the advanced economies’ as a major explanatory factor for Ukraine’s decrease in population. The rural areas were specifically mentioned as those disproportionally badly hit by shrinkage. At the same time the large cities and conurbations (including Greater Donetsk) were highlighted as really existing growth poles, places attracting both job-migrants and capital investment. The Strategy acknowledged that depopulation would lead to a detrimental impact on labour market ‘in the future’; yet due to high levels of unemployment, all (but one) region had still been exporting ‘surplus labour’ abroad rather than feeling any labour shortages at home. By achieving its desired goal of full employment, the government was planning to mitigate (fully) the negative impact on the economy from shrinking population (Cabinet, 2006b).

President Yushchenko returned to the issue of shrinkage in his 2008 annual address, urging for ‘the most radical, truly life-saving, rescuing action’ to ‘halt this demographic crisis’ (President of Ukraine, 2008). During his ultimately unsuccessful re-election campaign at the end of 2009, President Yushchenko convened an emergency meeting of the Ukraine National Security and Defence Council to discuss the country’s ‘demographic crisis’ and ‘a steady acceleration of depopulation trends’ and use it as a public relations opportunity (President, 2009b). In his final annual address, President Viktor Yushchenko has praised his own and his followers’ efforts in successfully ‘halting the critical demographic processes’ and ‘stopping a mass outflow of the people abroad’. In a rather emotional appeal, the head of state rejoiced there were ‘84 thousand more Ukrainian babies born in 2008 than in 2004’, before adding: ‘And this, I trust, is just the beginning’ of the nation’s re-birth (President, 2009a). In a yet another bitter electoral battle, Yushchenko’s successor to the post was to go even further, declaring as his headline – ‘two presidential terms goal’ – an increase in Ukraine’s population of up to ‘50 million citizens by 2020’ (Yanukovych, 2009). Incidentally, such an ambitious target is 6 million inhabitants more of what is currently projected under the United Nations’ ‘*high variant*’ demographic prospects for Ukraine in 2020 (see Figure 6).

Four weeks before the decisive 2010 presidential run-off, Prime Minister Yuliia Tymoshenko, Viktor Yanukovych’s main rival in the campaign, signed a draft bill of Ukraine’s new law on ‘promising development territories’. The draft bill has problematised Ukraine’s ever-increasing regional disparities and the accelerated development of the country’s ‘eight to ten largest, competitive cities, especially Kyiv and Donetsk’ at the expense of monofunctional towns and mining settlements, small cities of less than 50,000 population, officially-designated depressed territories, mountainous settlements, and remote borderlands with high unemployment levels (Cabinet, 2010; cf. Mykhnenko and Swain, 2010). Indeed, our evidence indicates an emerging positive relationship between economic and population growth across the twenty-seven Ukrainian regions, even though the influence of natural population change (i.e. surplus of births over deaths) on total population growth remains paramount in the country as elsewhere (see Figures 10-11).

Figures 10-11. Relationship between natural population growth and total population growth, 1990-2010 (left), and economic growth and total population growth, 1996-2010 (right)



Source: authors' own calculations on the basis of SSSU Statystychnyi shchorichnyk Ukrainy (various years).

Thus, it is not surprising that since the presidential victory of Yanukovych in February 2010, Ukraine's regional policy and its demographic crisis have continued to pre-occupy the government and various public bodies (President, 2010). In 2010 alone, a number of local state administrations, central government agencies (e.g. State Social Services) and major Cabinet departments (primarily, Ministries of Families, Youth and Sport; Labour; and Health Care; but also Science and Education; Economy; Finance; and Justice) were kept busy implementing a number of national demography-related social and healthcare policies and programmes. At the same time, following the 2010 draft bill on regional policy, there has been some recognition of the complex intertwining of forces driving the overall local and regional economic development, especially, with regard to demographic change, employment, public finance, investment, and infrastructure. Ukraine's 2010 economic and social development plan has officially acknowledged 'a creeping tendency' for a growing concentration of finance, innovation, and labour resources - 'the economic life of this country' – in 'eight to ten largest, competitive cities' at the expense of underperforming areas and remote borderlands. Accordingly:

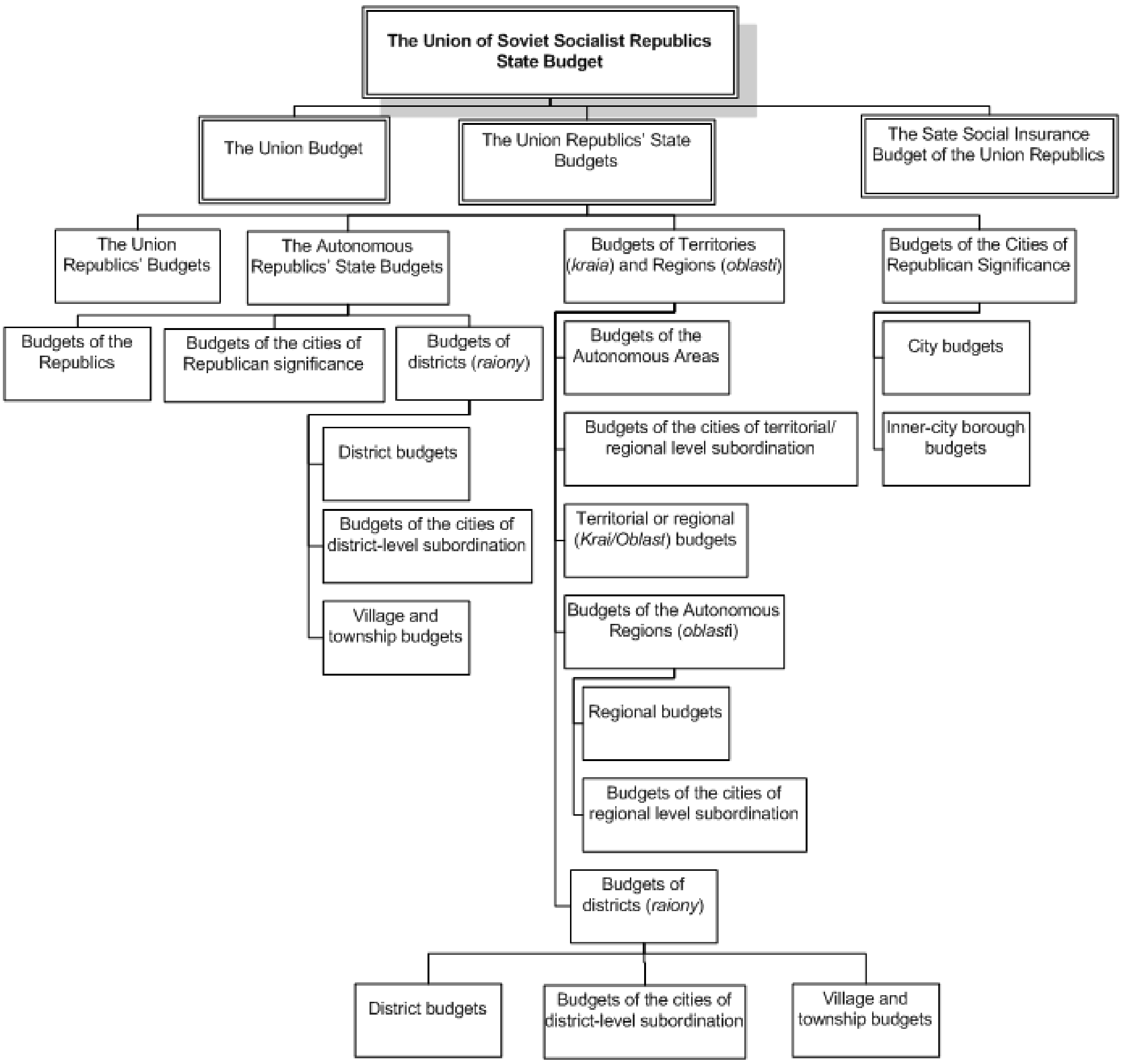
> The result is the ruination of local infrastructure, unemployment, an outflow of population, especially the youth, demographic problems, and social tensions in the community. The current state of regional and local development is characterised by weak material, financial, personnel, and other resources necessary for the performance of tasks and the authority of local self-government, as well as by a crisis of housing and municipal services, of the power-, fuel-, and water-supply systems, and of the social infrastructure' (Verkhovna Rada of Ukraine, 2010a: Section 6).

It is far too early to judge whether the above sentiment signifies the beginning of a truly integral, spatially-aware, joined-up government approach to the problem of shrinkage in Ukraine. Nevertheless, it ought to be interpreted as the culmination of the Ukrainian state's incremental progression regarding its policy on shrinkage since 1997.

4 – Local Government Finance in Ukraine: Evolving Governance Arrangements

From December 1922 and until its Act of Independence of 24 August 1991, Ukraine was one of the fifteen constituent units (*Union republics*) of the Union of Soviet Socialist Republics – a northern Eurasian federal state and the world's largest country by area, which occupied nearly one-sixth of the Earth's land surface. From the mid-1950s and until Ukraine's Declaration of State Sovereignty on 16 July 1990, the public finance system of the Ukrainian Soviet Socialist Republic was based around the Law on the USSR Budget and other statutory acts of the Moscow-based Supreme Soviet of the USSR as well as the auxiliary budgetary acts by the Ukrainian SSR Supreme Soviet.

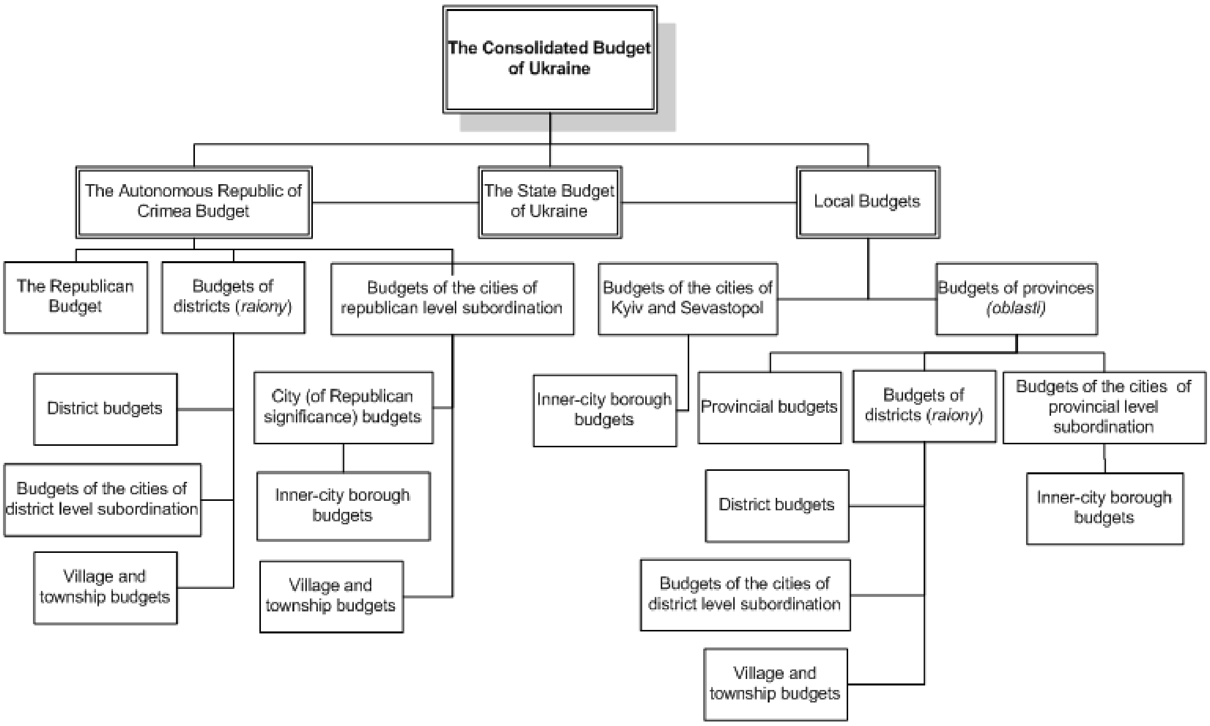
Figure 12. The Soviet Union's public finance hierarchy, c. 1955-1990



Under the Soviet rule, the bulk of Donetsk and Makiivka city councils' rough revenue and expenditure allocations were made in Moscow, within the state budget of the USSR, to be consequently adjusted in Kiev (now Kyiv) within the state budget of the Ukrainian SSR, as a part of the respective regional budget. Hierarchically, as both cities had a status of 'regional subordination', their budgets were finalised at the fourth step down the line, after the federal, republican, and oblast budgetary allocations. Later on, as the final step, Donetsk and Makiivka city council executive committees would divide the respective city budgets between inner-city borough council budgets. In addition to the city council budgets, a substantial share of local public infrastructure in Greater Donetsk (as well as in other large Soviet industrial conurbations), including roads, utilities, general medical practice surgeries, hospitals, kindergartens, dormitories, company housing estates, special shops, and sport and leisure facilities were financed directly by local state-owned enterprises from the federal (Union) funds through the respective Union-level (federal) ministries (see Figure 12). For example, a local coal mine in Makiivka would provide free housing for its employees and their families, kindergartens, and summer youth camps for their children, from the company funds distributed by the USSR Ministry of Coal from its respective Union Budget allocation.

Upon the formal dissolution of the USSR on 25 December 1991 by its three founding member-states (Belarus, Russia, and Ukraine), Ukraine's public finance structure was gradually altered according to the new reality of sovereign statehood. Firstly, within the overarching framework of a 'consolidated budget', reminiscent of the Ukrainian SSR Budget under the state socialism, three separate public finance headings were created to represent the central government's revenues and spending (the 'State Budget'), as well as public finances of Ukraine's newly established local government ('Local Budgets') and the Crimean autonomy (see Figure 13). During the first five to six years of Ukraine's independence, another major departure from the old Soviet public finance arrangements was the free transfer to the local government of social facilities and technical infrastructure, previously owned by local state firms. During the privatisation of state-owned enterprises (SOEs), the new owners were often allowed to obtain core commercial assets and off-load to a local council all of the former SOE's social 'liabilities' (e.g. kindergartens, sport and leisure centres, and hospitals). In many cases, cash-strapped local councils, including those in the Greater Donetsk area, had to sell, rent out, or close down such establishments which they were not able to fund.

Figure 13. Ukraine's local government finance arrangements, 1991-2001

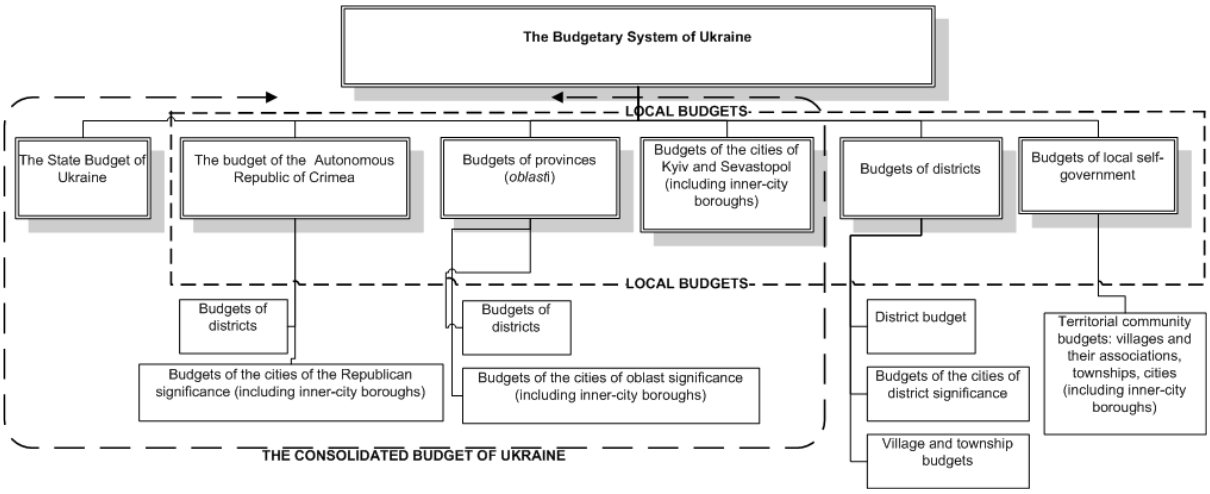


Despite the expansion of powers and responsibilities of Ukraine's local government bodies, they had had to rely on the hastily-altered Soviet Ukraine legislation well into the second half of the 1990s. It was not until the adoption of Ukraine's new Constitution on 26 June 1996 (Verkhovna Rada, 1996) that the authority of the central and the local government had been formally delineated (see Appendix 1). The Laws of Ukraine on Local Self-Government in Ukraine of 21 May 1997 (Verkhovna Rada, 1997a) and on Ratifying the European Charter of Local Self-Government of 15 July 1997 (Verkhovna Rada, 1997b) clarified the spatial division of powers more fully and provided a further impetus for the gradual expansion of the local government's exclusive competence and authority. The process of devolution and decentralisation, however, was tightly controlled by the central government in Kyiv and Ukraine's constitutional provisions for a centralised, 'unitary' state (see, e.g., Cabinet, 1997; Cabinet, 1999)

The Budget Code of Ukraine, the main body of the most relevant legislation, came into force on 1 January 2001 and truly revolutionised the governance of the country's system of public finance. According to its recently revised version in force from 1 January 2011

(Verkhovna Rada, 2010b), the budgetary system of Ukraine was further streamlined and decentralised to encompass the central government's State Budget of Ukraine alongside 12,213 local authority budgets, include 453 city budgets (see Figure 14).

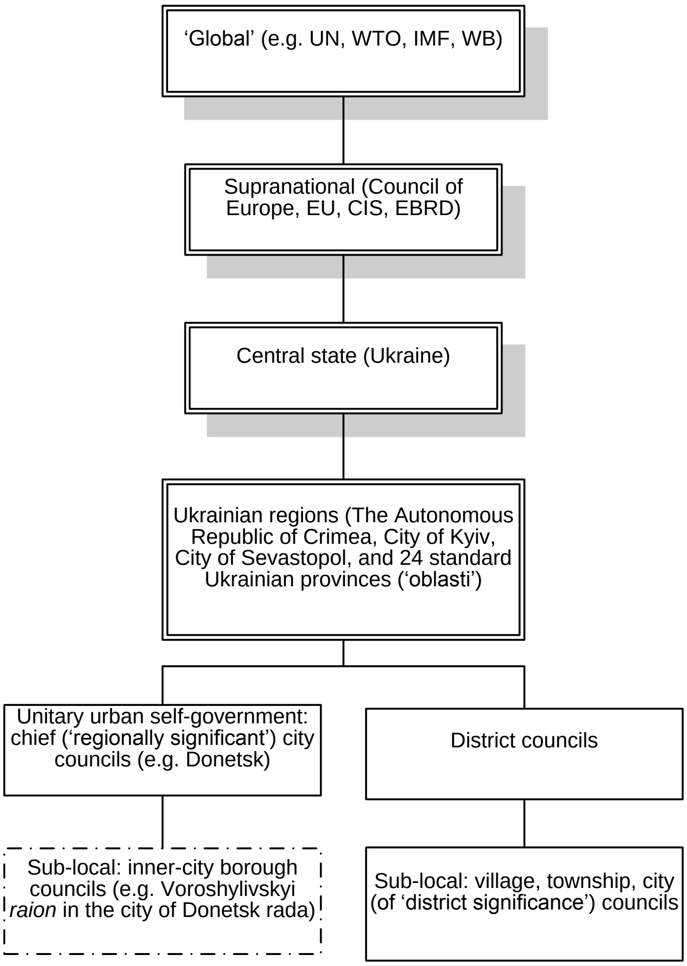
Figure 14. Ukraine's local government finance arrangements, 2001 onwards



Further radical local government reforms were contemplated in the late 2000s, including the Ministry of Regional Development and Construction's plans totally to re-draw Ukraine's administrative and territorial boundaries by creating a new multi-tier spatial system of governance based upon enlarged unitary authorities (Cabinet, 2009). The draft local government reorganisation strategy (officially described as an 'administrative and territorial reform') has originally envisaged an amalgamation of territorial communes to form a series of self-sufficient and contiguous unitary authorities or district council areas (similar to Eurostat's NUTS-3 regions). The enlarged local authorities were supposed to be part of upper-tier sub-national government regions (NUTS-2). The growing recognition of 'demographic challenges' and 'de-population' and their affect upon the fiscal sustainability of local government were the major reasons behind the proposed radical overhaul of the structure of Ukraine's sub-national government. Nevertheless, the reforms were officially postponed soon after the presidential poll of 2010 and the subsequent change of government.

By exploring Ukraine's territorial levels of *governance* – defined as 'binding decision-making in the public sphere' (Marks and Hooghe, 2004: 15) – one could attempt to locate the formal position of the cities of Donetsk and Makiivka within it. Ukraine's public finances belong to the conventional territorial public administration scheme of Marks and Hooghe's Type I multi-level governance (2004: 15-30) built around general-purpose jurisdictions, non-intersecting territorial memberships, limited number of jurisdictional levels, and system-wide, durable architecture, at least up to the national level. Formally, Donetsk and Makiivka are recognised as chief regional cities with the powers of a unitary city council area, one level below the provincial government of Donetska *oblast* (see Figure 15).

Figure 15. Territorial levels of decision-making and Ukrainian politics



Note: Inspired by Bache and Flinders, 2004: 98.

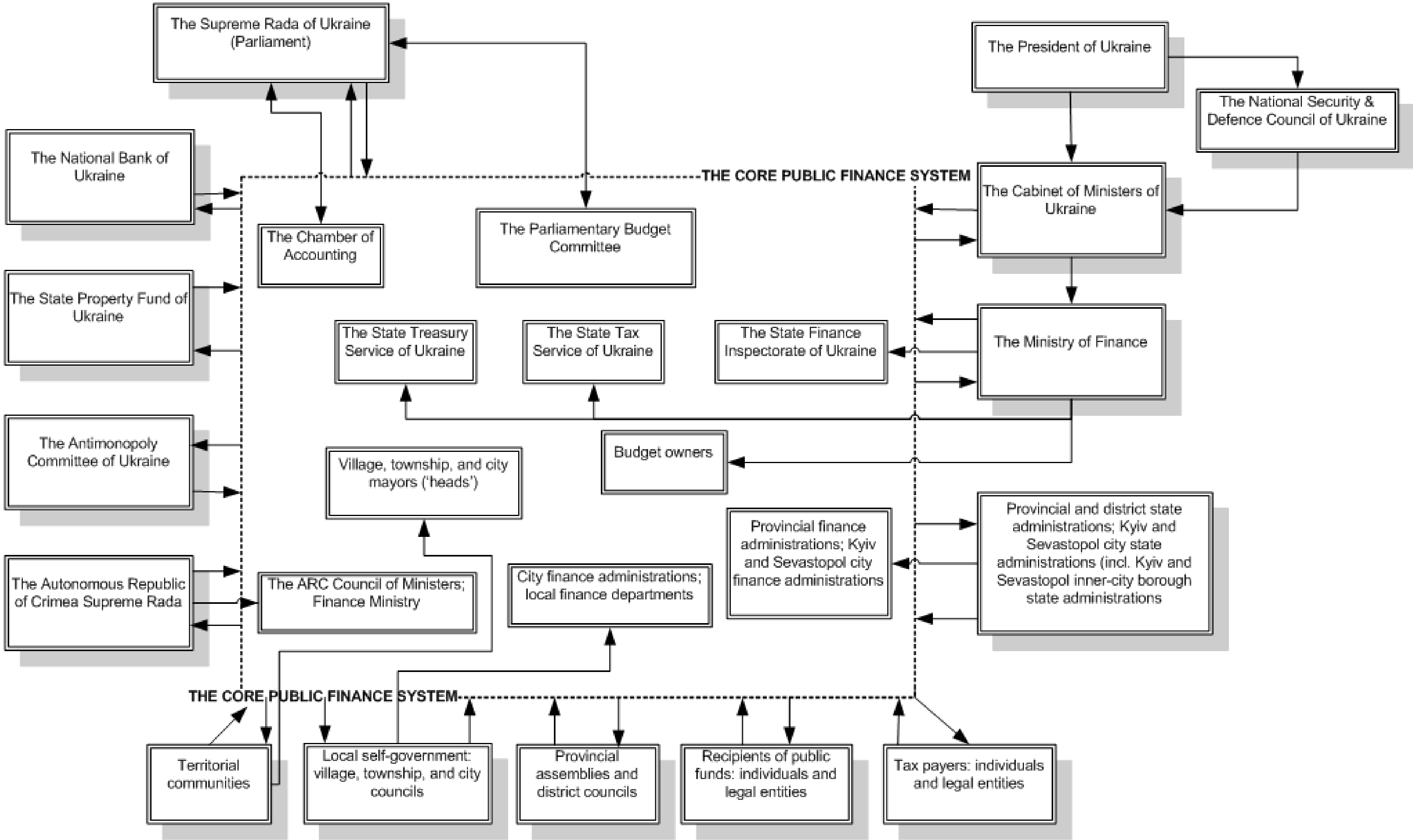
Nevertheless, the city of Donetsk hosts all of the three local branches of the state, with the provincial government, legislature, and judiciary bodies located around the city centre. In addition, Ukraine's and Donbas's largest companies and big private businesses have traditionally been headquartered in Donetsk, thus, adding further complexity to the web of formal and informal multi-level governance and funding arrangements.

5 – The Budgetary Policy Cycle and Fiscal Flows

There is a large number of core and auxiliary actors and agencies involved in the governance of Ukraine's public finances, ranging from the head of state to individual tax-payers and recipients of public funds. The nation's annual budgetary policy cycle involves an intense interaction across central, regional, and local levels of the state, and its public administration bodies. The core of the national public finance system is comprised of the Parliamentary Budget Committee of the *Verkhovna Rada* [Supreme Assembly] of Ukraine, the Chamber of Accounting (i.e. the national audit office), the Ministry of Finance and its three special agencies (the State Treasury Service, the State Tax service, and the State Finance Inspectorate), city mayors, budgetary committees of regional assemblies and city councils, finance departments of regional governments and city executives, and individual budget holders (see Figure 16). In accordance with the Budget Code, the multi-annual budgetary policy cycle begins early every year with the *agenda-setting* phase. The national agenda are set through long-term national development programmes approved by the Verkhovna Rada as well as policy announcements by the President of Ukraine. On the sub-national level, local and district councils, and regional assemblies set the agenda through (multi-)annual socio-economic and cultural development programmes for the respective territories. Ukraine's Ministry of Finance (alongside the National Bank) gathers the necessary public finance data from local and regional authorities and prepares an operating budget estimate for the following year. The agenda-setting phase lasts until the end of March (for full details, see Table 2).

During the *policy-formulation* phase (April-September), the central government (Ukraine's Cabinet of Ministers) approves Budget Policy Guidelines drafted by the Ministry of Finance for the following year and submits them before the Verkhovna Rada for scrutiny. Following the parliamentary approval, the Ministry of Finance drafts the Law on the State Budget of Ukraine. In the meantime, local authorities draft local budgets, design budgetary request descriptions, and provide estimates for relevant inter-budgetary (central-regional-local) transfers. By 20th September each year, the draft Law on the State Budget is submitted by the Cabinet to the Parliament and, subsequently, published in the central government newsletter.

Figure 16. Governance of Public Finances Interaction Snapshot, 2011



Note: Inspired by Feshchenko *et al*., 2008: 90.

Table 2. Public Finances of Ukraine: the Comprehensive Budgetary Policy Cycle

Policy cycle	The State Budget		Local Budgets	
	Primary actors	Timeline	Primary actors	Timeline
Agenda setting	VRU approves long-term national social and Economic Development Programmes as well as special-purpose programmes and projects concerning various arenas of public life, specific territories, industries, and other sectors of social and/or economic activity	Occasionally	Local (village, township, city level) and district councils, regional assemblies (i.e. Kyiv and Sevastopol city councils, provincial assemblies and VRARC) approve 'socio-economic and cultural development' programmes and other special-purposes projects for the respective territorial communities and local government areas	Occasionally
	President delivers his State of Ukraine at Home and Abroad Address to VRU	Annually		
	CMU submits its long-term programme of activities (action plan) to VRU for approval/consideration	Once in office		
	MinFin outlines a list of statistical indicators relevant for determining compensation factors and calculating Y1 inter-budgetary transfers, and collects the necessary public finance data and budgetary forecasts for Years -1 to 3 (within a five-year budgetary planning period)	February-March Y0	MinFin informs local council executives (village, township and city level), district and regional state administrations (including ARCCM) about specific features concerning the drafting of budgetary estimates for Y1	February Y0
	NBU collects relevant statistical data for budgetary indicators and submits to VRU and CMU a draft basic monetary and credit policy framework along with its operating budget estimate for Y1	By 15th March - 1st April Y0	Local council executives (village, township and city level), district and regional state administrations submit to MInFin and VRU Budget Committee statistical data necessary for determining compensation factors and calculating Y1 inter-budgetary transfers	March Y0
Policy formulation	CMU approves MinFin-drafted Budgetary Policy Guidelines for Y1	By 1st April Y0	Local council executives (village, township and city level), district and regional state administrations analyse statistical data and evaluate the local budget execution in Y0	April Y0
	VRU conducts parliamentary hearings on the state of public finances in Y0 and Y1 budgetary forecast, scrutinises the draft Budgetary Policy Guidelines (including public finance priorities for Y1) delivered by PM (or Finance Minister), and	3rd April - 1st June Y0	Local council executives (village, township and city level), district and regional state administrations prepare and submit to the respective local councils and assemblies (including VRARC) first quarterly Y0 budget execution reports, analyse the current state of local government finances, assess fiscal	May Y0

	approves the Budgetary Policy Guidelines for Y1		needs of the respective territorial communities and local government areas, determine spending priorities for Y1, design budgetary aims and develop Y1 fiscal policy for the respective region	
			Local council executives (village, township and city level), district and regional state administrations elaborate and approve necessary steps towards formulating the draft local budgets for Y1 according to the CMU-approved Budgetary Policy Guidelines	June Y0
	MinFin requests and collates budget requests from chief BOs and outlines a rough draft LSBU for Y1	July Y0	Local/regional finance departments/administrations (within local council executives, district and regional state administrations, including ARCMinFin) design budget request descriptions for Y1	July Y0
	MinFin submits the draft LSBU for Y1 to CMU	August Y0	Local/regional finance departments/administrations collaborate with MinFin on developing guidelines for Y1 inter-budgetary relations	August Y0
	CMU forwards to NSDC defence and security budget estimates for Y1, approves the draft LSBU, and sends the document with all the accompanying materials to VRU and President	By 15th September Y0	Local/regional finance departments/administrations process and compute estimate inter-budgetary transfers and other budgetary indicators for Y1 according to a CMU-approved methodology, and elaborate the MinFin-designed template of a draft local budget resolution	September Y0
	Official submission of the draft LSBU for Y1 by CMU to a VRU plenary meeting for consideration	By 20th September Y0		
	Official publication of the draft LSBU for Y1 in the government's daily newspaper (Uriadovyi Kurier)	By 22nd September Y0		
Decision-making	VRU parliamentary committees, parliamentary parties, and groups of independent NDs scrutinise the draft LSBU for Y1 and submit suggestions to the parliamentary Budget Committee	By 1st October Y0	Local/regional finance departments/administrations submit to MinFin their proposals and computations regarding the amount of inter-budgetary transfers and other budgetary indicators for Y1	October Y0
	VRU Budget Committee along with designated CMU representatives scrutinises the draft LSBU for Y1, prepares its findings, and submits an official opinion on the draft to the parliament	By 15th October Y0	Chief local BOs prepare local budget requests in accordance with pre-approved forms and instructions	October Y0

	VRU gives and adopts the draft LSBU for Y1 at the first reading	By 20th October Y0		
	CMU improves the draft LSBU for Y1 on the basis of the Budget Committee findings	By 3rd November Y0	Local/regional finance departments/administrations scrutinise the budget requests and decide on their inclusion into the draft local budget for Y1	November Y0
	VRU Budget Committee prepares its findings for giving the draft LSBU for Y1 its second reading	3-6th November Y0		
	VRU gives and adopts the draft LSBU for Y1 at the second reading	By 20th November Y0	Local/regional finance departments/administrations draft their respective local budgets and outlines local budget resolutions according to the second reading provisions of the draft LSBU for Y1	By 27th November Y0
	VRU gives and adopts the draft LSBU for Y1 at the third reading	By 25th November Y0		
	VRU adopts the Law on the State Budget of Ukraine for Y1	By 1st December Y0	Local council executives (village, township and city level), district and regional state administrations adopt their draft local budget resolutions for Y1	December Y0
	MinFin makes the Law on the State Budget of Ukraine for Y1 public	December Y0	Councils of cities (of provincial significance) and districts, and regional assemblies approve their respective budgets for Y1 in accordance with inter-budgetary transfer provisions of the LSBU	By 14th December Y0
			Councils of villages, townships, cities (of district significance), and inner-city boroughs approve their respective budgets for Y1 in accordance with upper-tier budgets (district and city respectively)	By 28th December Y0
			Local budget resolutions are made public via local newspapers	By 24th December Y0 – 8th January Y1
Implementation	MinFin approves detailed State Budget assignments for Y1	January Y1	Local (village, township and city) finance departments, district and regional chief finance administrations approve detailed local budget revenue and expenditure assignments and operating budgets of public-sector entities for the respective territorial communities and local government areas	January Y1
	CMU ensures the State Budget execution	On a	Village mayors, local council executives (township and city	On a permanent

		permanent basis	level), district and regional state administrations ensure local/regional budgets' execution	basis
	MinFin provides overall coordination of the budgetary process and the execution of the State Budget	On a permanent basis	Local (village, township and city) finance departments, district and regional chief finance administrations provide overall coordination of the local budgetary process	On a permanent basis
	Chief BOs utilise public funds according to the approved budgetary allocations, control budget liabilities and factual expenditure, and execute the budget	On an operating basis	Chief BOs utilise public funds according to the approved budgetary allocations, control budget liabilities and factual expenditure, and execute the budget	On an operating basis
	DKS administers and services all budgetary funds via a specially-designated budget banking account with NBU	On a permanent basis	DKS territorial offices administer and service local budgetary funds	On a permanent basis
	DPS monitors the tax-paying base and ensures the implementation of the revenue side of the State Budget	On a permanent basis	DPS local administrations maintain a complete list of local tax-payers, monitor the tax-paying base, and ensure the implementation of the revenue side of local budgets	On a permanent basis
Evaluation	CMU submits to VRU an annual report on the implementation of the State Budget for YO	By 1st May Y1	Local council executives (village, township and city level), district and regional state administrations submit to the respective councils/assemblies quarterly/final annual budget execution reports for Y0	Every four months/February Y1
	The Chamber of Accounting audits the final Y0 budget report and reports its findings to VRU	By 14th May Y1	Budgetary commissions of local councils, regional assemblies, and the VRARC Chamber of Accounting scrutinise the respective quarterly/annual reports before local councils and regional assemblies make a decision on the final annual reports	Every four months / February Y1
	VRU scrutinises the final Y0 budget report	May Y1		
	The Chamber of Accounting audits the State Budget revenue and expenditure	On a permanent basis		
	CMU and managers of BOs internally monitor and audit the budget execution performance of their subordinate institutions and personnel	On a permanent basis		
	MinFin regulates auditing and accounting assessment of the budgetary process, and coordinates DSK budget auditing activities	On a permanent basis	MinFin regulates auditing and accounting assessment of the budgetary process, and coordinates DSK budget auditing activities	On a permanent basis
	DKS submits regular budget progress reports to	Monthly,	DKS local offices submit regular budget progress reports to	Monthly,

VRU, President, CMU, the Chamber of Accounting, and MinFin, and provides online reporting on the quarterly and annual execution of the State Budget of Ukraine	quarterly, annually	local (village, township and city) finance departments, district and regional chief finance administrations	quarterly, annually
Finance officers of chief BOs provide regular budget execution updates and operating reports	Monthly, quarterly, annually	Finance officers of local BOs provide regular budget execution updates and operating reports	Monthly, quarterly, annually
DFI functions as a public-sector controller and auditor and submit monthly inspection report summaries to VRU and MinFin	On a permanent basis	DFI local controlling and auditing offices monitors budget performance of public-sector entities and perform random annual inspections of BOs	On a permanent basis

Note: ARCCM – The Autonomous Republic of Crimea Council of Ministers (government of the autonomy); ARCMinFin – The Autonomous Republic of Crimea Ministry of Finance; BOs – budget owners (public sector institutions and other legal entities using public funds); CMU – The Cabinet of Ministers of Ukraine (national government); DFI – The State Finance Inspectorate of Ukraine; DKS – The State Treasury Service of Ukraine; DPS – The State Tax Service of Ukraine; LSBU – The Law on the State Budget of Ukraine (annual central government budget); MinFin – The Ministry of Finance of Ukraine; NBU – The National Bank of Ukraine (central bank); NDs – National Deputies of Ukraine (members of parliament); NSDC – The National Security and Defence Council of Ukraine (the Head of State's own security and foreign policy apparatus); PM – The Prime Minister of Ukraine; VRARC - The Supreme Assembly (Verkhovna Rada) of the Autonomous Republic of Crimea (legislature of the autonomy); VRU – The Supreme Assembly (Verkhovna Rada) of Ukraine (national parliament); Y-1 – 'year minus one': the previous financial/calendar year; Y0 – 'year zero': the current financial/calendar year; Y1,2,3 – 'year one, two, three': the following financial/calendar year, the year after the following financial year, etc.
Source: authors' own construction on the basis of Blysniuk *et al.* (2007); Chala *et al*. (2010); Chvaliuk (2011);Kaminska (2010); Karin (2008a; 2008b); Priieshkina (2004); Suntsova (2010); Verkhovna Rada of Ukraine (2010b).

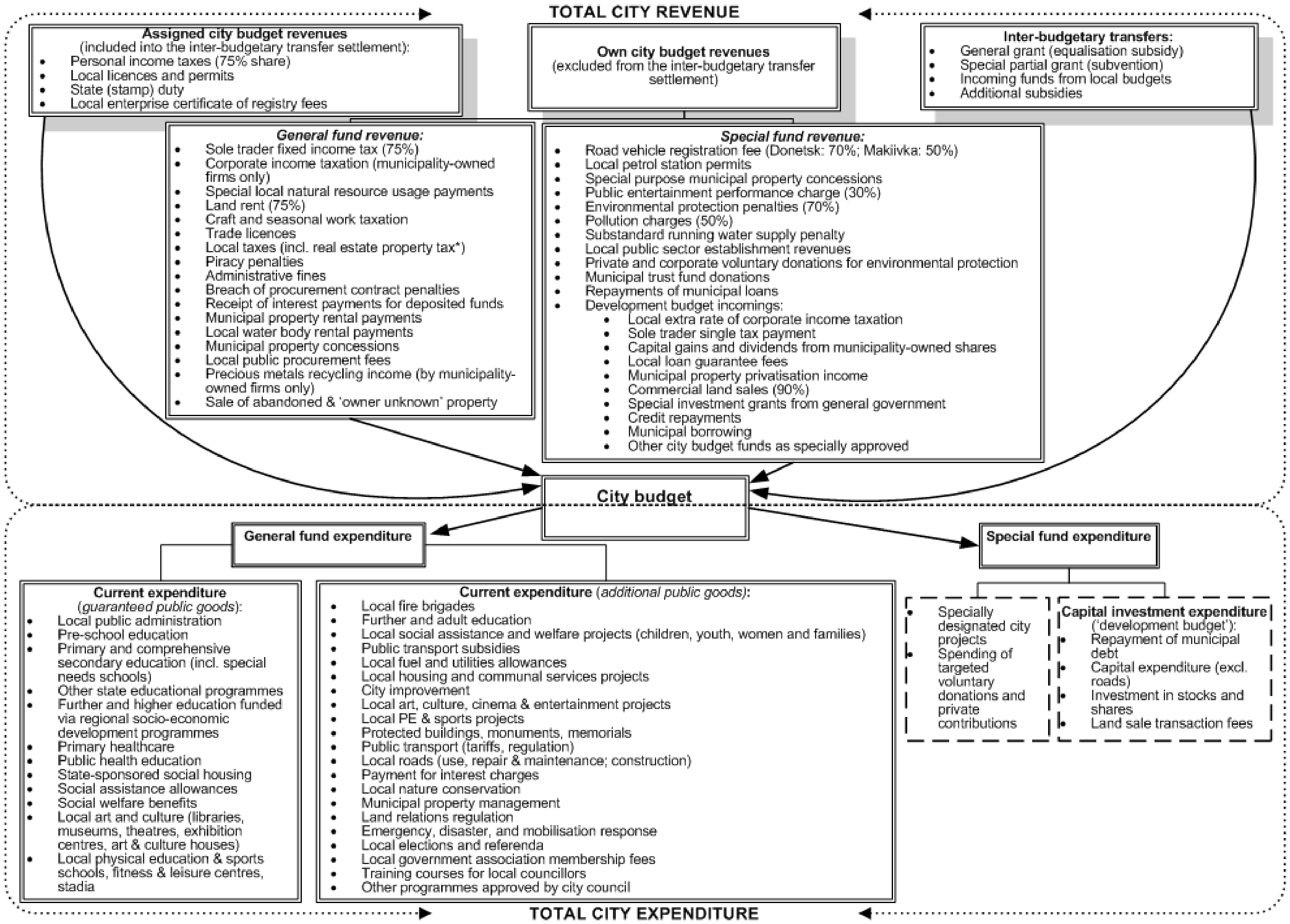
In the course of the *decision-making* phase of the budgetary policy cycle (September-December), the Verkhovna Rada scrutinises and alters the budget bill through a series of readings in the legislature. The Law on the State Budget of Ukraine shall be enacted by the Parliament by 1st December each year. Sub-nationally, during this period, local government finance departments liaison with chief local budget holders ('owners'), collates local budget requests for the following year, and compute the necessary amount of inter-budgetary transfers. After the second parliamentary hearing on the State Budget, local authorities draft their budget resolutions and submit draft local budgets before local councils and regional assemblies for approval. Upper-tier local authority and regional budgets for the following year shall be enacted by 14th December. Lower-tier local authority budgets shall be approved by 28th December. Local budget resolutions are consequently published in local newspapers.

The *implementation* stage of the overall budgetary cycle lasts from 1st January until 31st December, both for various local and State (i.e. central government) budgets. The State Budget is executed throughout the financial year by the Cabinet of Ministers through public expenditure by chief budget owners (i.e. public sector organisations and state-owned enterprises), with the Finance Ministry providing the overall co-ordination. On the sub-national level, finance departments of local councils and chief finance offices of district and regional governments co-ordinate the implementation of local budgets by local budget holders on an operating basis. All public finance transactions by central and local governments are administered by the State Treasury Service (and its territorial offices) via specially-designated budget bank accounts with the National Bank of Ukraine. Similar to other public finance systems, all public expenditure transactions by budget holders in Ukraine are administered via special budgetary codes of economic classification. On the revenue side, the execution of central and local government budgets is ensured by the State Tax Service (and its local administrations), which monitors tax payers, converses with tax avoiders, and prevents tax evasion on a permanent basis.

The *evaluation* of the budgetary process is conducted on a permanent basis though regular intervals (monthly, quarterly, and annually). On the central government level, by 1st May the Cabinet of Ministers submits to the Verkhovna Rada its annual final report on the implementation of the State Budget during the previous year. The report is, consequently, audited by the Chamber of Accounting, and scrutinised in the parliament within 30 days of its submission. The evaluation phase involves a host of actors, ranging from chief finance and managing officers of budget owners, the State Treasury Service, the State Finance Inspectorate, the Finance Ministry, the Cabinet, the President, and the Parliament. On the local government level, local government executives regularly report to the respective local councils and regional assemblies about the execution of local budgets. Budgetary commissions and local councillors scrutinise the final budget reports, whilst the Finance Ministry and the State Treasury Service provides their auditing and accounting assessment. Irregularities in the budgetary process are investigated by the State Finance Inspectorate and its local controlling and auditing officers.

The Budget Code of Ukraine (Verkhovna Rada, 2010b), fully revised in 2010, describes in great bureaucratic detail the phases and actors of the budgetary policy process, as well as the timeline and character of local-central government budgetary relations. This statutory act also provides the exclusive list of potential revenue sources and expenditure allocations of the central and local government budgets. At least since the mid-1950s, due to large population size, both Donetsk and Makiivka have been officially recognised as cities of 'regional significance'. The two local authorities have the power of upper-tier (unitary) urban self-government (see Figure 15), in addition to Donetsk being the administrative provincial centre, hosting all of the major public institutions in Donetska oblast. On the revenue side, Donetsk and Makiivka city budgets consist of the following three types of incomings: i) centrally *assigned* city budget revenues, ii) the city councils' *own* budget revenues, and inter-budgetary *transfers* (see Figure 17). At the most rudimentary level, the first grouping covers shared national taxes, whereas the second revenue source groups various local taxes, fees, and the entrepreneurial income earned by the two city councils. (Fiscal transfers will be further discussed as a separate issue).

Figure 17: Donetsk and Makiivka City Budgets: Fiscal Flows, 2011



In particular, in accordance with Article 9 of Ukraine's Budget Code, revenues of local budgets are composed of the following groups of revenues:

1) Tax revenue;

2) Non-tax revenue;

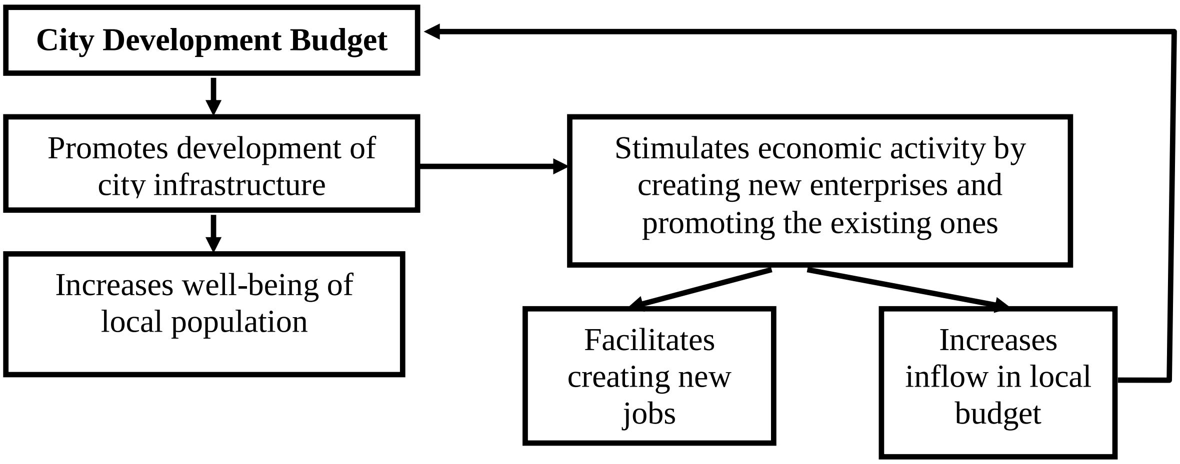
3) Revenue and interest payments from capital operations/deposited funds;

4) Transfers.

According to the Budget Code, revenues of local budgets fall in two categories: revenues that are assigned to local government budgets and taken into account during the calculation of inter-budgetary transfers; and city's own revenues, which are not considered for establishing the necessary amount of inter-budgetary transfers. Revenues necessary for the exercise of the executive authority by the corresponding organs form a separate part in the revenue of local budgets.

The local budget is divided into current budget and development budget. Current budget includes spending on the current maintenance and repairs of local housing and communal services buildings, healthcare, and social provision establishments, sports and physical education centres, local culture and educational facilities, and other expenses that do not belong to the development budget (see Figure 18). The development budget includes spending on financing innovation and investment activities that are related to capital investment in socio-economic development and other expenses on the extended reproduction of capital.

Figure 18. The Impact of local development budget on territorial socio-economic development.



The data describing the development budget of Donetsk is presented in Table 3. They show that the financial and economic crisis of 2008-2009 has had an acute effect on the development budget of Donetsk, which was more than halved. However, with the return of positive growth dynamics in the economy, there has been a slight recovery recently of the development budget, which started to grow again. By contrast, in Makiivka, the share of the development budget makes up less than 1 per cent in the total budget of the city. Hence, the investment part of Makiivka's city finances exists only nominally, leaving no room for the intensive development of the city and its future capital reproduction. This also means that the structure of Makiivka's budget, on the one hand, is determined by the processes of shrinkage of the city, but, on the other hand, it has contributed to the intensification shrinkage processes themselves.

Table 3. Development budget of Donetsk, 2007, in constant hryvnia

Years / Indicators	2005	2006	2007	2008	2009	2010
Development budget, UAH thousands	162,307	115,104	312,204	266,749	130,733	142,551
Share of development budget in total budget	25.0%	13.7%	19.2%	15.0%	8.5%	9.1%
Development budget funds per capita	160	150	310	270	130	150

From the moment when Ukraine had gained independence until the present day city budgets of Donetsk and Makiivka have been approved annually at the budgetary committee sessions of the two city councils. According to local councillors, in the Soviet period city budgets were in fact presented to the cities as directives for execution by the higher level administrations. Currently, public hearings dedicated to the budgetary process are a regular occurrence in the city council; they have to be conducted openly and any local resident has a right to take part in them. However, these hearings do not appear to raise much interest and attention from public.

In Donetsk, local taxes, user fees, and rental payments remain the main source of budget revenue. Subsidies and subventions from the central budget to the budget of Donetsk comprise only 19.4 per cent of its total revenue, whereas in Makiivka they account for 52.4 per cent of the city's total revenue. The fact that there is a discrepancy between the common trend towards the increasing share of central government transfers in Ukraine’s local government budgets, and, and the same time, a fairly small share of transfers in the budget of Donetsk, the administrative centre of the country’s one of the most economically developed regions, demonstrates a fairly excessive degree of centralisation and a growing redistribution of revenues from the more developed territories to the less developed ones. Consequently, the divergence of local financial fortunes of two neighbouring cities, which form one continuously built-up urban area, highlights the complexity of sometimes over-simplistic claims about ‘generous’ eastern Ukrainians ‘subsidising’ or simply ‘keeping’ the ‘undeserving’ western parts of the country.

Nevertheless, the existing system of inter-budgetary transfers in Ukraine totally ignores substantial problems faced by the Donbas and its major cities, which were caused by the long term restructuring of the region’s industrial base, the historical legacy of environmental degradation, a public health crisis, and various structural deficiencies exacerbated by shrinkage. This conclusion, first registered by our research team in the Work Package 2 report, has been widely acknowledged by the local political elites and regional governments in the Donbas, which continue to express a high level of dissatisfaction with the existing system of territorial income redistribution.

6 – Urban Shrinkage in Greater Donetsk: Fiscal Stress and Governance Response

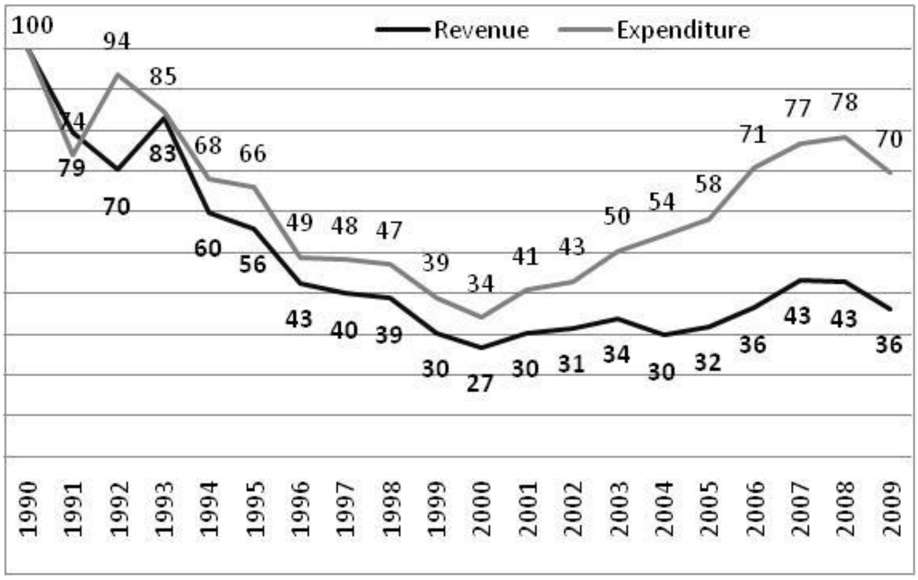
In the 2000s, local government finance has become intrinsically linked to the process of urban shrinkage, as a series of fundamental changes occurred with regard to the income raised by the elected branch of local authorities. In addition to the reported increase in Ukraine's central government intervention and the territorial redistribution of income within the country, the composition of local taxation revenues has been dramatically altered. Whilst at the beginning of the post-communist transformation, Ukraine's local government finance was principally based upon sales, VAT, and corporate income taxes, by the end of the 2000s, 98.9 per cent of local taxation came from a single source of revenue – personal income tax (for further details, see Figure 8 on page 15).

A gradual increase in the municipal budget expenditure has been occurring since the mid-2000s, partly as a reflection of the growing importance of local government in the functioning of the local economy, as well as gradual devolution to the communities and municipalities of responsibilities for the maintenance of housing, healthcare, social and cultural infrastructure, social welfare functions, and environmental protection. Even so, on average, Ukraine's central government still continues to account for about 60% of public spending.

The gradual appropriation of the corporate income-, value-added, and excises taxes by the central government has significantly reduced a tax resource base available for the local government. City dwellers themselves have become a principal source of finance for municipalities through personal income taxation and local service user charges, in addition to other local sources, such as land and rental income, loan capital funding, and private financial partnerships. Fiscal stress, the growing pressures of urban shrinkage, and dwindling numbers of taxpayers have all placed the issues of local government finance in the forefront of the current public agenda.

The Budget Code of Ukraine provides a complex formula aimed at ensuring that approximately the same amount of public expenditure per capita is carried out in different localities, cities, towns, and villages. The pivotal principle of 'territorial justice', on which the system of Ukraine's general government sector finance is implicitly based, allows the central government legitimately to 'seize' the revenue of local authorities in economically active and relatively prosperous areas and re-direct them towards the lagging, less developed territories. The degree of relative prosperity and, thus, the potential for the territorial redistribution of income is measured simply by the locality's GVA/GDP per capita in relation to the Ukraine's average figure. This approach to the formation of local government finance has attracted an enormous amount of criticism from local politicians, policy and academic circles in Ukraine's largest, industry-dependent urban areas (primarily in the east of the country). In addition to ever-increasing fiscal imbalances between the relatively high- and low-income areas, there has been a growing gap between the level of public spending commitments (declared by the central government) and the available fiscal resources (provided by the central government), leading to a shortfall in funding for social and other programmes (see Figure 19).

Figure 19. Local government finance: revenue and expenditure trajectories, 1990-2009, volume indices (1990 = 100)



Source: authors' own calculations on the basis of SSSU Statystychnyi shchorichnyk Ukrainy (various years).

The impact of shrinkage on local government finance

As it has been established in Work Package 1, urban shrinkage is a complex aggregate of socio-economic, demographic, ecological, and other processes, which occur as the result of a decline in urban population. The process of urban shrinkage also realise themselves in numerous policy arenas in the locality undergoing shrinkage. In particular, the processes of shrinkage are fully reflected in such a complex entity as the budget of the corresponding local authority. Being a balanced aggregate of revenues and expenditures, which are mobilised and spent in a certain area, the city council budget provides a fairly comprehensive description of the city's development trajectory. The city budget is taken as a basis for planning the city's socio-economic development and presents one of the main management levers and governance mechanisms available to the local authority. Tables 4 and 5 provide some basic features of Donetsk and Makiivka city budgets throughout the 2000s.

Table 4. The city of Donetsk budget, 2001-2010 (in constant 2007 prices)

	2001	2004	2005	2006	2007	2008	2009	2010
Total city budget, million UAH	429.8	554.1	649.4	838.7	1,631.2	1,777.4	1,529.7	1,572.0
Total city budget, UAH per capita	420	550	640	830	1,640	1,780	1,550	1,590

Table 5. The city of Makiivka budget, 2005-2010 (in constant 2007 prices)

	2005	2006	2007	2008	2009	2010
Total city budget, million UAH	279.1	347.3	409.5	440.7	447.7	480.1
Total city budget, UAH per capita	680	850	1,000	1,090	1,120	1,200

The data evidently indicate an absolute expansion of municipal budgetary funds in both Donetsk and Makiivka in the 2000s. In Donetsk, the high upward trajectory of local government finance was interrupted in 2009, as the aftermath of the global financial-economic crisis, which had a devastating impact upon the Ukrainian economy. Nevertheless, already in 2010, the budgetary dynamics in Donetsk showed a sign of improvement. Presumably, the recovery of the Donetsk city budget continued in 2011 as well. In accordance with the plan approved by the city of Donetsk council, the size of the municipal budget in 2011 in constant prices was projected to be around 1,937.6 million hryvnia, indicating a 23.2 per cent increase from 2010.

It is notable that the quantitative indicators of the two municipal budgets were increasing in both absolute numbers as well as in the amount of funds available per local resident. Despite the superficial similarity, however, the reasons behind the increase in the two municipal budgets were fundamentally different. Whereas the expansion of the Donetsk city budget might be explained by positive economic developments in the urban economy, the growth in size of the municipal budget of Makiivka was primarily the result of ever-growing fiscal needs (and entitlements) of the city with respect to its acute social and economic difficulties generated during the period of shrinkage.

According to one of the leading officials of the Makiivka city council executive, following a drastic period of restructuring in the 1990s, further nine coal mines were shut down in the city in the 2000s, leading to lay-offs of more than 9,000 workers. At the same time, the scale of operations at the Makiivka Kirov Steel Works was abruptly downsized in 2009 in the wake of economic recession, causing a loss of 6,000 more jobs; business operations of another large (glass and porcelain) factory were stopped too, following bankruptcy procedures. The dramatic decline of the city's major business actors has put a strain on Makiivka's budget.

Another issue refers to the structure of the local economy: the large numbers of workers in the overall employment structure of Makiivka are employed in coal mining and this has a profound effect on the state of the city's fiscal health. As emphasised by the city executive officials, due to the availability of early retirement benefits (at the age of 50) for coal miners, the city is faced with an 'ever-growing' 'welfare burden' and a high ratio of non-economically active residents. Additional pressures on the Makiivka city budget was applied in the late 2000s as the result of new social welfare entitlement programmes such as 'the children of war' benefit recipients, which have offset the natural reduction in the number of the older group of beneficiaries, i.e. the World War II veterans. The Law of Ukraine 'On the social protection of the children of war' was passed under Yulia Tymoshenko as an electoral gimmick, without any proper policy evaluation with regard to its affordability. It appears the city authorities in Makiivka (and elsewhere) has successfully attempted to minimise the number of eligible recipients of 'war children' benefits through further complicating an already lengthy and cumbersome bureaucratic process of acquiring and preparing the necessary paperwork.

Overall, in accordance with the Budget Code changes that came into force on 1 January 2011, Ukraine's local authorities were delegated with a variety of new functions and responsibilities, mostly without an adequate financial mechanism of support. As a result, many social programmes designed in Kyiv have suffered from severe under-funding on the local level. In Makiivka, this situation has resulted in a shortage of city's own and assigned revenues to cover the (new) social spending and a sharp increase in the share of official transfers from the central government to the city budget.

Table 6. Donetsk and Makiivka: own and assigned budget revenues, 2005-2010 (in 2007 constant prices)

	2001	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Own and assigned budget revenues in Donetsk, million hryvnia	247.0	332.3	385.5	411.7	1212.4	1421.2	1119.4	1119.8
Own and assigned budget revenues per capita in Donetsk	240	330	380	410	1,820	1,430	1,130	1,140
Own and assigned budget revenues in Makiivka, million hryvnia	n/d	n/d	171.9	196.5	186.6	227.8	222.0	205.9
Own and assigned budget revenues per capita in Makiivka, thousand hryvnia	n/d	n/d	420	480	460	570	550	540

Centrally legislated increases in spending on support payments for single mothers, low-income families, people with disabilities, housing benefits, and concessions for utility payments (including electricity, gas, water, sewage), combined with the reported decline in the city's own and assigned budget revenues, have led to a marked increase in the share of (social protection) subventions and equalisation ('levelling') grants received from the central government by Makiivka. Whereas in 2005 this figure stood at 38.7 per cent of total revenues, in 2008 it grew to 50.4 per cent, and in 2010 reached 54.2 per cent of the city budget. At the same time, the share of central government transfers in the total budget of Donetska oblast was 25.1 per cent, whereas in Ukraine on average this figured reached 46.7 per cent. Hence, the amount of subventions and equalisation subsidies received by the local authorities in Makiivka was higher than Ukraine's average by 16 per cent, and more than double (2.2 times) the average in the region. For comparison, the share of grants and subventions in the city budget revenues of Donetsk in the same period has oscillated between 20 and 28 per cent of total. Thus, the absolute increase in the size of Makiivka's city budget was not a consequence of some positive socio-economic shift and has only increased the financial dependence of the city administration (for details on Donetsk and Makiivka revenue sources, see Table 6).

Table 6 shows that the city's own and assigned budget revenues in Donetsk were continuously increasing in the 2000s, with the exception in 2009, when the total amount went down under the influence of economic crisis, and went back up again in 2010. In accordance with the plan approved by Donetsk city council, in 2011, the city's own and assigned budget funds (in real terms) would amount to 1,304.8 million UAH, projecting an annual increase of 16.5 per cent. At the same time, until 2008, Makiivka had experienced certain growth in the city's own and assigned revenues; followed by a steady decline in the aftermath of the financial and economic crisis. As a result, the amount of the city's own and assigned budget revenues per capita in Makiivka in 2010 was 2.1 times lower than that in Donetsk (after having being 11% higher just five years previously!).

It is important to note that in the period between 2005 and 2008, the amount of the city's own and assigned funds in the budget of Makiivka has gone up 1.33 times (by 8.25 per cent per year on average), the size of budget has grown 1.57 times (by 14.25 per cent per year on average), and the amount of grants and subventions from the budgets of higher levels increased 2.1 times (by 36.6 per cent per year on average). Between 2007 and 2010, an increase in the amount of grants and subventions received by Makiivka from the budgets of higher levels was going down by 7.6 per cent per year on average (or 4.8 times). This led to a reduction in the rate of increase of the size of the city budget in 2008-2010 to 4.45 per cent per year (or 3.2 times), and in the amount of the city's own and assigned revenues to 4.85 per cent per year. Henceforth, the increase of the city's own and assigned budget revenues was a result of the transformation of transfer payments from central and regional government budgets into the city's 'own' and assigned revenues.

The structure of city budgets has had a significant impact on the formation of their revenue streams. In general, from the beginning of 2000s, the main source of the city's own and assigned revenues in Ukraine has been the personal income tax. The dynamics of personal income tax inflows into the budgets of Donetsk and Makiivka are presented in Table 7.

Table 7. Inflow of personal income tax into Donetsk and Makiivka city budgets (in constant 2007 prices)

	2001	2004	2005	2006	**2007**	2008	2009	2010
Inflow of personal income tax to the budget of Donetsk, million hryvnia	129.194	189.257	222.696	265.534	**953.438**	981.613	811.295	811.254
Inflow of personal income tax to the budget of Donetsk per capita, hryvnia	126.5	186.1	220.5	264.2	**956.3**	990.5	822	825.7
Inflow of personal income tax to the budgets of Makiivka, million hryvnia	-	-	117.864	140.711	**136.560**	176.814	152.158	142.375
Inflow of personal income tax to the budgets of Makiivka per capita, hryvnia	-	-	285.4	344	**336.6**	442.5	389.7	373.4

The most significant part of the personal income taxation in Ukraine is the employee income tax. Besides that, according to the legislation, personal income taxation includes the following sections:

- personal income tax for those involved in entrepreneurial activity
- personal income tax on dividends and royalties
- sole trader fixed income tax
- individual tax on prises and wins
- personal income tax for non-residents
- personal income tax on renting and selling property
- inheritance tax
- personal income tax on other activities

The most striking element shown in Table 7 is the reportedly sharp increase in the inflow of revenues from personal income taxation in Donetsk budget in 2007. This factor alone has led to more than doubling of the size of the Donetsk city budget in 2007. The inflow of personal income tax to the city budget that year in constant prices increased 3.6 times in comparison with 2006. This expansion of the city revenues was driven by the four following factors:

1) An increase in average real wages in Donetsk in 2007 by 6.1 per cent compared with 2006;

2) An increase of the rate of income tax in Ukraine from 13 per cent in 2006 to 15 per cent in 2007;

3) An increase in the number of employees in Donetsk in this period by 2.7 per cent of total number of employed; and

4) Changes in the structure of personal income tax inflows into Donetsk's budget.

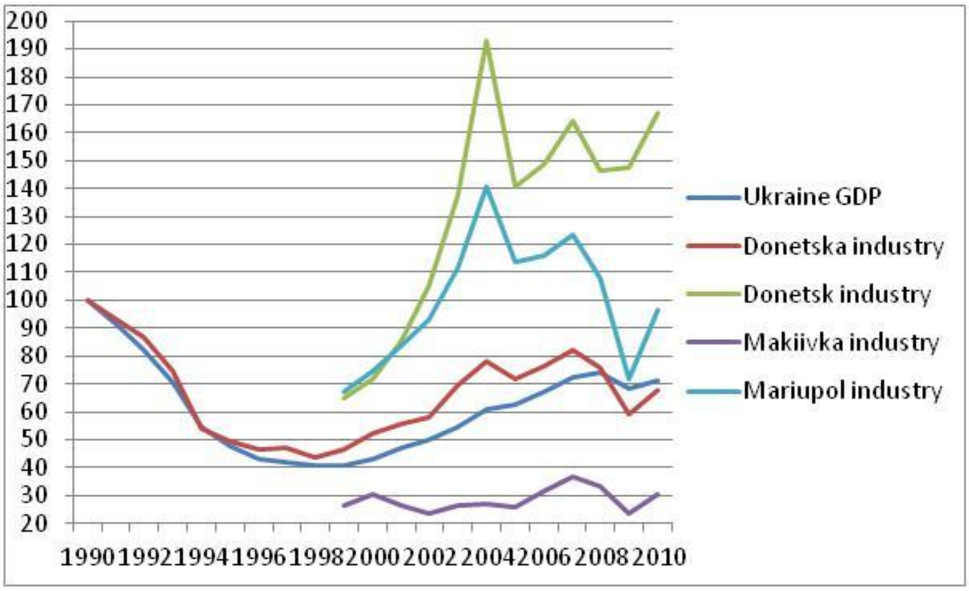
The first three of these factors are directly correlated with the inflow of income tax into the budget, thus, causing an increase of personal income tax inflows by 11.1 per cent through a growing number of taxable employee income. Hence, a structural change in (the collection) of personal income taxation in Donetsk in 2007 resulted in the increase of these payments by 348.9 per cent. To some extent, such a change in the structure of tax inflows can also be explained by a real boom of financial results (pre-tax profits) experienced by Donetsk firms in 2007 (see Table 8).

Table 8. Pre-tax profits of local enterprises (in constant 2007 prices), million hryvnia

	2001	2004	2005	2006	2007	2008	2009
In Donetsk	-78	11045.7	7980	7843.5	32984.9	1660.3	340.3
In Makiivka	-406.1	-2718.8	-219.3	-268	-149.1	-171.5	-1504.1
In Donetska oblast, excluding Donetsk	2791.3	9409	8365	5632.7	7499.3	6559.2	-5769.3
In Ukraine	42976.4	78175	90888.8	93868	135897.9	6962.8	-29007.8

The data in Table 8 demonstrates that the financial result of usual activity of economic entities in Donetsk before tax in 2007 grew more than 4 times, which provided for the increase in individual incomes, although predominantly from 'dividends and royalties', and for the increase in the inflow of personal income taxation into the city revenues. Taking into account that similar economic growth was not observed in Donetska oblast, the Donbas, or Ukraine as a whole (cf. Figure 20), one can only explain such a significant increase in tax payments to the local authorities in Donetsk, first of all, by a radical improvement in the effectiveness of Donetsk tax collection officials, who managed to reduced the amount of tax avoidance and tax evasion in the city.

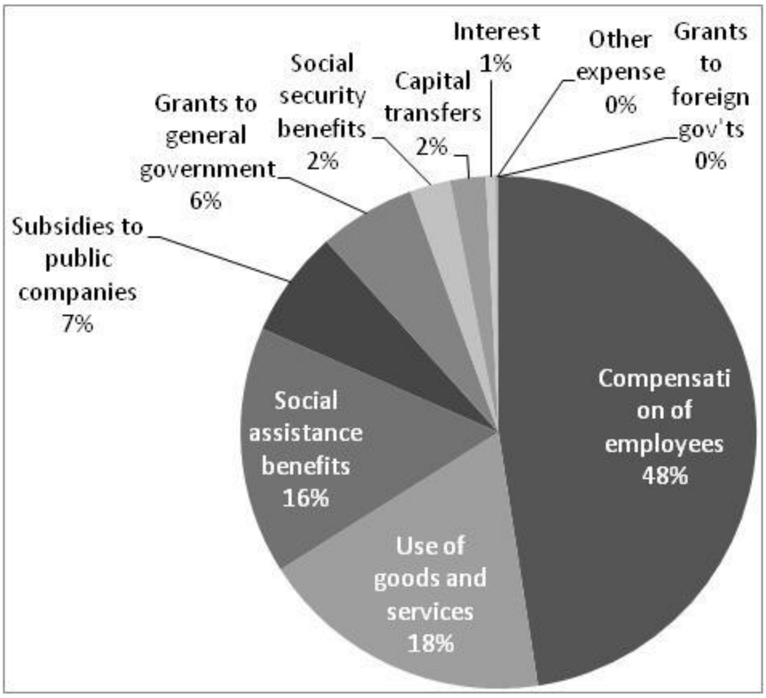
Figure 20. Comparative output trajectories: Ukraine (total output), Donetska oblast (industrial output), Donetsk (industrial output), Makiivka (industrial output), and Mariupol (industrial output), volume indexes (1990 = 100), 1990-2010



Henceforth, the inflow of employee income tax into the Donetsk city budget in 2007 amounted to about 31 per cent of total personal income taxation, whereas 69 per cent of personal taxation payments were attributed to other income sources. In general, in the structure of the city's own and assigned revenues, these 'other' payments amounted to 36 per cent, and to 26 per cent in the total structure of budget revenues. Accordingly, the employee income tax's share of the city's own and assigned budget revenues amounted to 16 per cent, and to 12 per cent in the total structure of budget revenues. Considering these facts, it can be stated that shrinkage, which in Donetsk is attributed first of all to depopulation and the ageing of residents, has not had (so far) a significant detrimental impact on the revenue part of the city budget. In Donetsk, the effect of depopulation has been counterbalanced by the growth of the urban economy and the consequent rise in real wages. The major effect of shrinkage on local government finance in Donetsk has been in the field of budget expenditure. In Makiivka, the processes of urban shrinkage have had an impact on both the budget revenues and public spending.

Overall, the structure of expenditure of local budgets in Ukraine is presented on Figure 21. The analysis of the spending structure shows that in 2009 64 per cent of Ukraine's local government spending was directed towards increasing the level of income of local resident through the payment of salaries of public sector employees and social welfare benefits. In its turn, this has led to an increase in the amount of collected income and other local taxes, further propelling the local government's own and assigned budget revenues. In this way, the central government transfers spent on public services locally are being partially transformed into the local authorities' own and assigned revenues, which is exactly what was happening in Makiivka in the 2000s.

Figure 21. The structure of expenditure of local budgets in Ukraine in 2009, by economic type (%)



To further illustrate this point, Table 9 presents the shares of spending on wages and salaries in the total budget fund of Donetsk and Makiivka respectively. The data presented in this table shows that the mechanism for transforming the local budget's transfer revenues into their own and assigned revenues has been more characteristic to Makiivka's fiscal position; it has been much less pronounced in Donetsk. In addition, Table 9 allows one to conclude that the expected level of capital expenditure in the Donetsk city budget has been much higher than in Makiivka, helping the former to more effectively maintain and build up urban infrastructure.

Table 9: Donetsk and Makiivka: spending on wages and salaries, % of total city budgets

	2001	2004	2005	2006	2007	2008	2009	2010
Donetsk	10.2	9.4	8.7	10.1	5.2	4.9	5.4	5.3
Makiivka	n/d	n/d	43.2	45.3	36.1	38.9	40.4	39.1

As a consequence of the economic crisis experienced by the Ukrainian economy after the collapse of the world's largest financial institutions in 2008 and the resultant recession, the amount of personal income taxes collected by the local authorities has significantly declined, leading to a drastic reduction in local budget revenues. Makiivka's fiscal outlook has also been detrimentally affected by a reduction in the amount of central and regional government grants and subventions. Whereas, since 2010, Donetsk has been able to restore its positive growth trajectory, Makiivka's economy and its local government finance has continued to suffer from the recession and the decline in taxable personal income.

Governance response to the challenge of shrinking budgets.

Ukraine's public policy-makers have been fairly slow in responding to the multifaceted manifestations of urban and regional shrinkage. Amongst the first set of policies, according to the 2005 Law of Ukraine 'On Stimulating Regional Development', the public authorities' main concern has long been with 'depressed territories'. Economically depressed areas are sub-divided into three groups: entire regions, industrially-dependent districts, in which the number of people employed in industry exceeds the number of those employed in agriculture, and provincial centres. A territory is given the status of being 'depressed' in order to enable the creation of legal, economic and administrative support mechanisms for undertaking emergency measures to stimulate the economic development of such territories by the public administration bodies, and local and regional authorities. In particular, depressed areas may cover:

- poor regions (oblasti), in which the average gross value added per capita in the last 5 years was amongst the lowest in Ukraine;

- industrial districts (raiony), which in the last three years suffered from very high levels of unemployment, lowest levels of industrial output per capita, and lowest average wages across the country;
- provincial centres with the highest unemployment levels during the last three years, in particular the long-term unemployment, and lowest average wages in Ukraine.

In order to stimulate the development of depressed areas, the Law provides for i) bringing forward significant public capital investment targeted on industrial and social infrastructure, transport and communications; ii) the provision of state support, including financial support, to small enterprises, and assistance in fostering entrepreneurial activities (e.g. business centres, business incubators, centres for innovation and consulting, venture funds); iii) the re-direction of international technical assistance towards solving topical socio-economic and environmental problems of such areas; iv) active labour market policies, including the provision of targeted funding for retraining and professional development of the unemployed; v) other types of public support for the development of such territories. Yet, despite this host of assistance potential, neither Donetsk nor Makiivka (nor Donetska oblast as a whole) could ever qualify for the 'depressed area' status, given their relatively low levels of unemployment and above the average wages.

The second type of Ukraine's public policy measures dealing with depopulation in the 2000s was aimed at stimulating fertility. The policy measures have primarily included the introduction of a child benefit paid after childbirth at a progressively higher rate (from the first to the third child, flat-lining afterwards). Yet, despite a substantial increase in fertility in the late 2000s, natural population growth in Ukraine as a whole, and in Donetsk and Makiivka in particular, has remained stubbornly negative. As it was mentioned earlier, the amount of the city's own resources in the budgets of Donetsk and Makiivka has not provided the two local authorities with enough resources for planning and implementing their own specific programmes to tackle and manage urban shrinkage; in Makiivka, the city authorities are left with virtually no funds for maintaining the local social, technical, and transport infrastructure.

Thirdly, one of the main objectives of the local authorities in maintaining social cohesion under shrinkage has been to control the timely and full payment of wages and salaries by local firms and public sector establishments, given that any wage arrears would directly impact upon the personal income tax inflows into the city budget. This task has been complicated by large shadow economy activities in the region and Ukraine as a whole; in particular, referring to the entrenched habit by some private sector employers to hand over the bulk of salaries and wages to employees in cash-stuffed envelopes to avoid the full payment of payroll taxes, social insurance, and pension fund contributions. Currently, the total burden on the payroll taxation stands at around 56.6 per cent of total salary costs, of which the employee pays only 3.6 per cent and the employer contributes further 38 per cent. In addition to unemployment and pension fund contributions, the employee pays directly a personal income tax at the rate of 15 per cent of the total income. According o some studies, around 60 per cent of all employees in Ukraine receive their 'wages in envelopes', amounting to around 20 per cent of the total salary fund. For example, Ukrainian recruitment agencies reported the average nominal wage in Donetsk in 2010 to be 3,344 hryvnia, whereas, according to the official statistics, the wage level in the city stood at 2,650 hryvnia, indicating that in Donetsk the total real wage might exceed the official level by at least 26 per cent.

In Donetsk and Makiivka, the Department for Work and Social Protection of the respective city executive has become the main agent of the struggle against the shadow urban economy. In addition, in Donetsk, one of the deputy city mayors personally chairs a special standing 'committee for insuring the timely and in-full payment of taxes, and the repayment of outstanding arrears of wages, pensions, student maintenance grants, and other social assistance payments'. This city executive committee has also worked towards increasing official wages, especially amongst the employers located in the least economically developed inner-city boroughs of Donetsk. In the case of wage arrears, the committee typically takes the schedule of repayment of arrears under its control and monitors the repayment. The committee also monitors the repayment of wage arrears across the city on a monthly basis and analyses the operative data weekly. If the repayment schedule is not met, the committee prepares a submission to the city prosecution office to initiate legal proceedings. Thus, employees, who did not receive their wages (in full), have been provided with legal support by the city authorities.

Fourthly, the city authorities have been trying to address the deteriorating financial condition of local businesses caused by the ongoing economic crisis (resulting in massive lay-offs, a shift to part-time employment, and accumulating wage arrears) and the fact that some local employers have ignored the minimum wage guarantees and special wage premiums stipulated in the General and Regional tri-partite social agreements. The two local authorities have also tackled the incorrect salary/wage grading of employees with a higher level of skills and qualifications, and the labour code infringements related to the length of working hours for part-time workers, and the involuntary unpaid leave.

According to the Law of Ukraine 'On setting the subsistence minimum and minimum wage No. 646-VI of 20 October 2009 and 'On the State Budget of Ukraine for 2010' No. 154-VI of 27 April 2010 (Articles 52 and 53), the subsistence minimum and minimum wage for people able to work at the end of 2010 were set at 922 hryvnia per month (around 90 Euro). At the same time, according to the Regional tri-partite agreement of 5 Mach 2009 (with alterations of 24 February 2010) between the regional government of Donetska oblast, regional trade unions, and local employers' organisations, all firms and organisations in the region (irrespective of the type of ownership and economic activity) have agreed to work towards the resumption of the system of skills tariffs as the basis of new pay scales and salary grades for workers with different qualifications, experience, and positions. In particular, the following conditions were agreed to be fulfilled:

- a monthly wage tariff for unskilled workers must be established at the level or above the subsistence minimum for a person able to work, in accordance with the legislation of Ukraine;
- for skilled workers, a monthly wage tariff of the first category worker should not be lower than 120 per cent of the subsistence minimum;
- a regional coefficient of 1.15 shall be applied to all wages and salaries to account for the higher subsistence minimum (and the regional price level) in Donetska oblast, in comparison with Ukraine's average.

Thus, the minimum wage for most employees in Makiivka and Donetsk in 2010 was set at 1,272 hryvnia per month (equivalent to 120 Euro), making it 38 per cent higher than the nationwide minimum wage. A number of firms and organisation across the Donetsk-Makiivka conurbation have commonly violated the regional pay indexation mechanism. When conducting a pay review, some employers refer to a difficult financial situation they are in, which allows them, according to the Ukrainian legislation, not take the regional coefficients into account for a period up to six months. In each such case, the actual financial circumstances of these employers are now vigorously and routinely investigated by the relevant department of the city administrations.

Furthermore, another major consequence of shrinkage (and post-communism generally) in Greater Donetsk has been a stark increase in the unevenness of development between different inner-city boroughs. One of the manifestations of inner-city territorial divergence can be observed in the level of wages paid in different inner-city boroughs (see Table 10).

Table 10. Average monthly wage in Donetsk inner city boroughs in 2008

Donetsk city boroughs	Amount of average monthly wage, hryvnia	Ratio between average monthly wage in the district and in the city, %
Budionivskyi	1976.04	86%
Voroshylivskyi	3075.07	**134%**
Kalininskyi	1930.37	84%
Kyivskyi	2413.85	105%
Kirovskyi	1823.1	79%
Kuibyshevskyi	1826.28	80%
Leninskyi	1864.22	81%
Petrovskyi	1779.88	77%
Proletarskyi	1611.81	**70%**
Donetsk average	*2296.26*	*100%*

According to a deputy city mayor of Donetsk, in order to tackle the growing development gap, a differentiated rate of land rents was set to stimulate the business activity in poorer or lagging behind inner-city areas by attracting firms to the periphery through concessionary land rents. Additionally, according to the 'Methods for calculating rents for the use of property of the territorial community of Donetsk' enacted by the city council executive on 16 August 2006 (Resolution No. 430), the rental payment for non-residential premises rented out by public housing maintenance firms of all types of ownership, and public sector establishments and organizations, is to be charged by the local authority in the following preferential manner:

- in Voroshylivskyi, Kyivskyi and Kalininskyi boroughs (the city centre): 40% of the rental payment is reimbursed into accounts of the leaseholder, with 60% going into the city budget;

- in Leninskyi, Kuibyshevskyi, Kirovskyi and Budionivskyi boroughs: 50% of the rental payment is reimbursed, with 50% going into to the city budget; and

- in Petrovskyi and Proletarskyi boroughs (the most peripheral areas): 60% is reimbursed, with only 40% charged into the city budget.

In this way, the city executive has supported the development of lagging urban districts by facilitating the existing and fostering the establishment of new firms in those areas. For example, in 2010 alone, local firms and organisations received around Euro 17 million from this source of fiscal stimulation.

Finally, the processes of shrinkage has led to an increased pressure upon the 'assigned' (centrally determined) revenue streams in the budgets of cities, forcing the local authorities to take austerity measures and cut spending on certain activities. In Makiivka, these processes have revealed themselves most distinctly. In 2001, Makiivka was the first city in Ukraine to abolish inner-city borough councils, accumulating all the funds in the city budget. Consequently, the city authorities have managed to reduce administrative overheads, and simplify and streamline the local authority structure. One has to emphasise, that the 'Makiivka model' was later followed by a large number of Ukrainian cities, including the capital city of Kyiv, where the number of inner-city borough councils was drastically reduced in the late 2000s. The city of Makiivka executive has continued to seek further efficiency savings, with the share of spending on 'public administration' declining from 5.9 per cent of total in 2005, to 5.4 per cent in 2007, and to 5.0 per cent in 2010. In Donetsk, the city authorities seem to have started chasing additional efficiency savings only in the aftermath of the global financial-economic crisis: the city's expenditure on public administration increased from 2.1 per cent of the total spending in 2005 to 2.7 per cent in 2007, before declining significantly in 2010 to just 1.3 per cent. Furthermore, according to the deputy mayor of Makiivka, one of the blocks of the city central hospital was shut down in the late 2000s for the purpose of saving the dwindling budget resources; the hospital patients were relocated to other blocks or transferred to a day-care centre.

School closures have been another significant measure adopted by the city of Makiivka executive, despite vocal protests from the affected parents (see Table 11). Table 11 indicates, however, that there is still more than enough spare capacity in educational establishments across the shrinking city. Eight more schools were planned for closure in Makiivka in 2011-12. School closures were accompanied with setting up of special school bus routes for bringing pupils to the newly-merged secondary schools.

Table 11. Primary and secondary education in Makiivka

Indicators	Years					
	1996	2002	2005	2006	2007	2008
Number of schools	108	100	95	94	92	89
Number of students, thousand people	61.9	52.7	41.8	36.9	35.6	32.3
School size, students per school	573	527	440	393	387	363

By contrast, despite a dramatic reduction in the number of children of school age, almost no closures of schools have taken place in Donetsk in the past 20 years, leading to a marked decline in class sizes across the city. According to a representative of Donetsk local authorities of Donetsk, currently schools in Donetsk function at 50 per cent of their capacity. Regardless, the total education expenditure in the city budget has remained practically stable. Between 2005 and 2010, the real term spending on education had actually increased in Donetsk by 8 per cent, from 28,896,000 to 31,205,000 hryvnia.

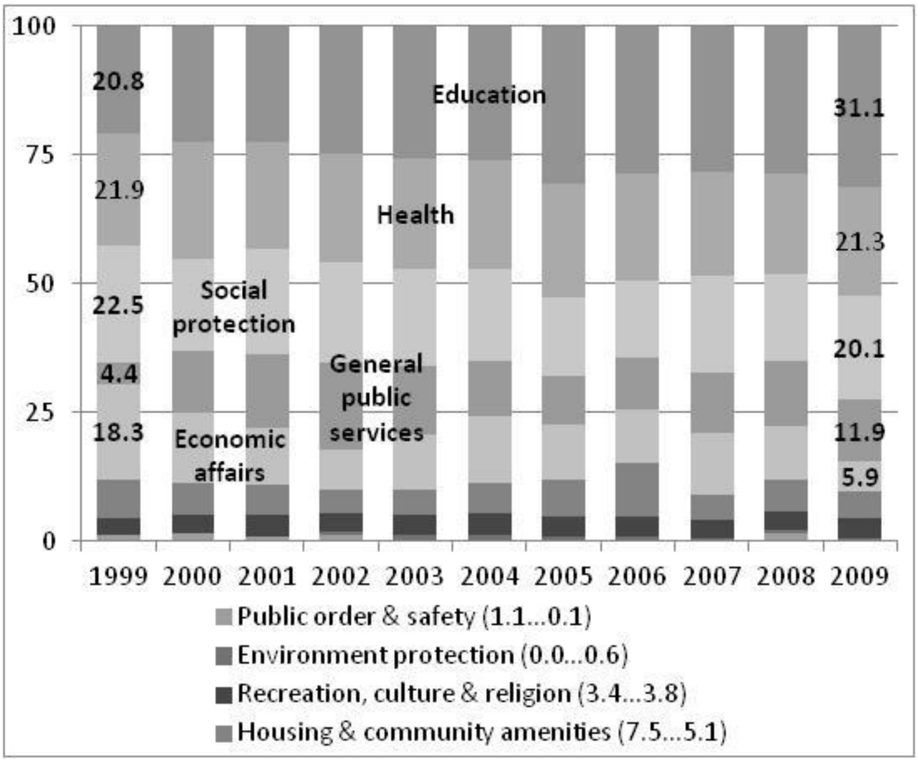
7 – Policy Outcomes: Achievements and Failures

There has been an official recognition by the state of civil society's increased role in agenda-setting and policy-formulation in the field of local government finance. It has revealed itself in a recently established dialogue between the local, regional, and central branches of Ukraine's government and the non-governmental organisations and advocacy coalitions, such as the Association of Ukrainian Cities, the Ukrainian Association of Local and Regional Authorities, and the Alliance of Local and Regional Government Leaders. These public fora have at times been devoted to the open debate about depopulation, and the nation's demographic and economic crises. Nevertheless, the local authorities remain unable to create and channel funding towards specific shrinkage-related issues, apart from performing the delegated authority functions (i.e. funding state schools, public hospitals, public utilities, and maintaining the inherited housing stock) and some profit-making investment. The lack of a real incentive to increase the budgetary income of territorial communes and the resultant loss of interest on behalf of the local authorities in improving their performance is often cited as major drawbacks of the current public finance system (see Blysniuk *et al.*, 2007; Chala *et al*., 2010; Chvaliuk, 2011; Kaminska, 2010; Karin, 2008a; 2008b; Priieshkina, 2004; Suntsova, 2010).

Most of the emphasis in public discussions of the country's demographic challenges and labour migration issues has appeared to be on tackling shrinkage in the countryside and small towns, whilst large cities such as Donetsk and Makiivka are typically described as current or potential 'growth poles': best performers, attracting migrants, capital, and creating jobs. Such a sweeping generalisation, though, is fairly crude. Throughout the 1990s and 2000s, Donetsk has continued to perform a 'donor' function, where the bulk of locally-generated income has been transferred to the central state budget and re-distributed as a subsidy to the least-developed regions; whereas Makiivka has gradually become to a large extent a net recipient of the central government grants. Although, in the late 2000s, Donetsk has experienced some increase in public investment related to improving the city's status as a host of the UEFA European 2012 Football Championship, targeted primarily on the (re-)construction of motorways, an underground transport system, and an international airport terminal, Makiivka has not seen any direct benefits of this sort. This section will detail the measures taken by local governments to tackle existing problems and evaluate the specifics of their implementation and effectiveness.

The analysis of the local budgetary expenditure can shed light on the change of priorities in financing certain budgetary outlays over time in difficult circumstances of re-structuring the budget revenue streams. The structure of Ukraine's local government spending during the 1999-2009 period is provided in Figure 22 (see also Appendix Table 2).

Figure 22. Outlays by functions of local governments in Ukraine, 1999-2009, % of total



During the 2000s, Ukraine's local and regional authorities most significantly increased their expenditure on education and general public services. At the same time, the financing of economic affairs of localities was reduced the most, from comprising 18.3 per cent of the total budget expenditure in 1999 to only 5.9 per cent in 2009. The shares of outlays on social protection and housing and community amenities were fluctuating the most during this period, experiencing a slight decrease by 2009.

Locally, the processes of shrinkage in Makiivka were accompanied by the change in the amount of public spending on the maintenance of social and technical infrastructure in the city. Between 2006 and 2010, its share had reduced from 81.7 per cent to 61.3 per cent of total. Respectively, one can observe a gradual increase in the city budgetary spending on the social protection and social assistance. The social welfare spending was carried out predominantly from the subventions, coming from the central government budget.

Table 12. Makiivka city spending on public services, housing, and infrastructure, 2006 and 2010, % of total

	Share in total city budget expenditure, %, 2006	**Share in total city budget expenditure, %, 2010**
Education	34.6	28.1
Healthcare	32.1	25.6
Art and culture	3.4	3.6
Sports	0.6	0.5
Housing construction and maintenance	9.2	1.6
Transport, roads and communications	1.8	1.9
Other expenditures	18.3	38.7

In absolute numbers, the city spending on the maintenance of social and technical infrastructure in Makiivka grew in real terms from 255,911,000 UAH in 2006 to 294,731,800 UAH in 2010, or by 15.1 per cent. In the same period, the size of the Makiivka city budget expanded by 38.3 per cent. A certain increase in the absolute expenditure on Makiivka's social and technical infrastructure was driven by growing real wages of public sector employees. The actual growth was also driven by growing grants and subventions from the central government budget, since these expenditure outlays (e.g. wages) belong to the 'assigned' (centrally directed) part of the city budget. At the same time, in Donetsk, public spending on the maintenance of social and technical infrastructure has remained stable, oscillating around 24-26 per cent of the total city budgetary expenditure.

Thus, one is unable to detect an articulate reaction on behalf of the local authorities with regard to specific financing and budgeting initiatives brought about by shrinkage. This can be partly explained by a fairly limited possibility that the local governments have to influence the national budgetary process. In particular, in terms of regulating of the revenue part of budget, the local authorities are able to exercise mostly controlling functions. The global financial and economic crisis of 2007-2010 has made its impact on the shifting patterns of governance of the city of Donetsk budget with the implementation of two distinct sets of urban policies: a policy aimed at reducing the (public investment) development budget, and a policy of levelling the development of inner-city areas through land rent zoning, although the effect of the latter policy has so far been fairly limited. In addition, the local authorities have orchestrated an increase in tax collection and instituted land lease-holding auctions, which raised the share of the city's own entrepreneurial revenue in the city budget.

Table 13: Inflow of land rent payments into Donetsk and Makiivka city budgets (in constant 2007 prices), million hryvnia

	2001	***2005***	***2006***	***2007***	***2008***	***2009***	***2010***
Donetsk	46.269	38.903	39.139	117.747	98.412	169.431	204.238
Makiivka	n/d	22.097	22.106	18.421	16.096	21.630	27.790

In particular, in 2007, the Donetsk city executive introduced mandatory auctions of land lease-holds in the city, almost trebling the land rent intake as a result (see Table 13). By contrast, in Makiivka, a typical reaction to shrinkage has been various 'optimisation' programmes, which, in fact, has referred to cuts in (the funding for) the social and technical infrastructure. The described approach has allowed considerably to increase the amount of the city's own funds in Donetsk even during the acute economic crisis of 2008-2010. The amount of the land lease rental payments in Makiivka during this period has remained fairly stagnant.

Consequences of governance repose to shrinkage

Firstly, a number of legislative initiative to tackle and (potentially) reverse Ukraine's depopulation have been instituted nationally, including the provision of a range of benefits and payments to families with 3 or more children, special payments to women during pregnancy, at the birth of a child, the introduction of childcare benefits for the 3 years after childbirth, and the targeted material assistance to low income families. In addition, during the 2000s, large families with 3 or more children have been provide with utilities and rent payment allowances, concessionary fares in public transport, and additional educational opportunities. Large families with 3 or more children have also been given tax rebates on their wages and salaries. However, as it has been mentioned earlier, these benefits have not provided an incentive large enough to improve significantly the nation's average fertility rate to compensate the high mortality level. Neither Donetsk, nor Makiivka has experienced a sustained baby boom as a result.

Secondly, another major policy field that influences the processes of shrinkage and is regulated nationally is the labour market. In particular, the country's minimum wage and subsistence minimum legislation has been introduced to prescribe the pre-determined amount of wages for simple unskilled work, below which a monthly remuneration rate cannot be set. Subsistence minimum has been defined a cost estimate of a consumer basket, including a minimum set of food products and non-food goods and services necessary for maintaining individual's health and vital functions (see the Law of Ukraine 'On the subsistence minimum' No. 966-XIV of 15 July 1999). The nominal value of both the subsistence minimum and the minimum wage are set annually through a special Law of Ukraine No. 1646-VI 'On determining the subsistence minimum and the minimum wage'. Additionally, in Donetska oblast, the labour market is further regulated through the following corporatist tri-partite arrangements: 'The general agreement between the Cabinet of Ministers of Ukraine, the Ukrainian organisations of employers and entrepreneurs, and the Ukrainian trades and labour unions' and 'The regional agreement between Donetska oblast state administration, the labour unions of Donetska oblast, and the regional employers' association'. In accordance with the General agreement, the tariff rate for a skilled worker of the first category is determined by the current national minimum wage multiplied by 1.2.

Table 14. A comparison of subsistence minimum and minimum wages in Ukraine and in Donetska oblast, hryvnia

	2005	***2006***	***2007***	***2008***	***2009***	***2010***
Ukraine's subsistence minimum (nominal)	423	472	532	607	**701**	**875**
Ukraine's minimum wage (nominal)	332	375	460	545	**744**	**922**
Donetska oblast's Regional Agreement minimum wage (nominal)	398	450	552	654	893	1106
Donetska oblast's Regional Agreement minimum wage (in constant prices)	562	516	552	531	564	614

Furthermore, the regional tri-partite agreement makes provisions for the increased tariff grades (pay scales), which compensate for the higher living costs in Donetska oblast, given that the actual subsistence minimum in the region is well above Ukraine's average. In 2005, this coefficient was set at 1.06, in 2006-2007 it stood at 1.08, and in 2008-2010 it increased to 1.15. Consequently, the inflated employee income tax contributions have boosted the revenue of the city budgets in both Donetsk and Makiivka.

Table 14 above compares Ukraine's average subsistence minimum and the national minimum wage with those established through the Regional tri-partite agreement in Donetska oblast. Firstly, it shows that between 2005 and 2008, the minimum wage in Ukraine did not provide for the existing subsistence minimum. The regional minimum wage first matched the subsistence minimum in 2007 only. The real minimum wage in the region in the 2005-2009 period had remained stable, however, which did not correspond with the overall economic growth registered in the Donbas and Ukraine as a whole. Therefore, the Labour Code of Ukraine has proved ineffective in stimulating the growth of wages and salaries in the structure of the Ukrainian GDP by income categories, being effectively 'on the employer's side', and substantially reducing in turn the fiscal capacity of the local authorities (the phenomenon first observed in Mykhnenko, 2011). In other words, during the period in question, the Ukrainian state has stimulated the growth opportunities of private business owners and fostered the central state budget (through corporate income taxation) at the cost of the workers and local budgets (highly dependent on personal income taxation). The real wage values in Donetsk and Makiivka are presented in Table 15. It shows that until 2008, the level of average wages in Donetsk and in Makiivka had generally corresponded to the rate of economic growth in the region, which in significant part was the result of a close interaction between the local authorities and the cities' major employers. From 2009 onwards the real wages began to fall down in the aftermath of the economic crisis.

Table 15. Real average monthly wages in Donetsk and Makiivka, 1999-2010, hryvnia (in constant 2007 prices)

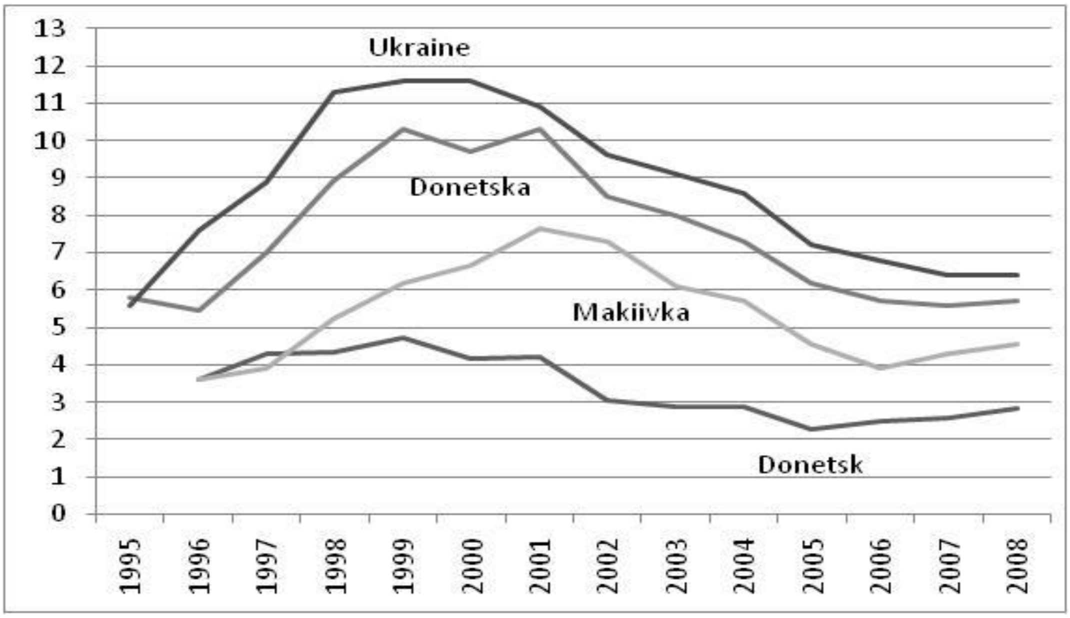
	1999	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Donetsk	746	917	917	941	1116	1278	1423	1570	1666	1715	1578	1550
Makiivka	660	650	706	837	965	1089	1231	1273	1459	1546	1502	1494

In addition to wages and salaries, close attention needs to be given to the employment dynamics in Donetsk and Makiivka during the past decade. Table 16 shows a steady pace recovery and a further job creation generated by Donetsk's buoyant private sector throughout the 2000s. By contrast, Makiivka has only experienced a slight labour market recovery on the late 2000s. One has to emphasise that the level of real (ILO) unemployment in Donetsk remained fairly low during the 2000s (see Figure 23), while the average annual number of employees increased by 15.9 per cent. In Makiivka, the level of unemployment had declined steeply between 2001 and 2006, whereas the average annual number of employees increased by 4 per cent.

Table 16: Average annual number of employees in Donetsk and Makiivka, 1998-2008 (thousands)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Donetsk	330.9	**320.0**	317.8	345.5	307.8	310.8	317.9	330.3	339.8	349.3	**353.6**
As % of previous year		*96.7*	*99.3*	*108.7*	*89.1*	*101*	*102.3*	*103.9*	*102.9*	*102.8*	*101.2*
Makiivka	127.1	**118.4**	107.9	96.5	91.0	87.0	83.0	83.3	84	85	**86.3**
As % of previous year		*93.2*	*91.1*	*89.4*	*94.3*	*95.6*	*95.4*	*100.4*	*100.8*	*101.2*	*101.5*

Figure 23. Average annual unemployment rates (ILO methodology), 1995-2008



In the situation of depopulation and the general ageing of local residents, the marked labour market improvements reported above were driven by the gradual decrease in the number of shadow employment in the two urban economies and the return of workers into official employment. This positive development has been fostered by increasingly effective leverage by the city authorities over the local employers. Subsequently, the growth in official employment has boosted the city budget revenues.

8 – Urban restructuring in Greater Donetsk: Was There a Lack of Capacity?

The gradual development of Ukraine's local self-government under post-communism has provided the cities of Donetsk and Makiivka with a growing capacity in the sphere of municipal finance. Nevertheless, the cities' statutory, institutional, financial, and other capacities continue to be in the process of permanent evolution. Public finance system reforms are currently being rolled out, with the Budget Code of Ukraine that came into full force on 1 January 2011, followed by the introduction of a new Tax Code of Ukraine in 2012. The possible overhaul of Ukraine's administrative-territorial system in the early 2010s, including a revolutionary re-drawing of boundaries of local authorities, undoubtedly adds further complexity and uncertainty.

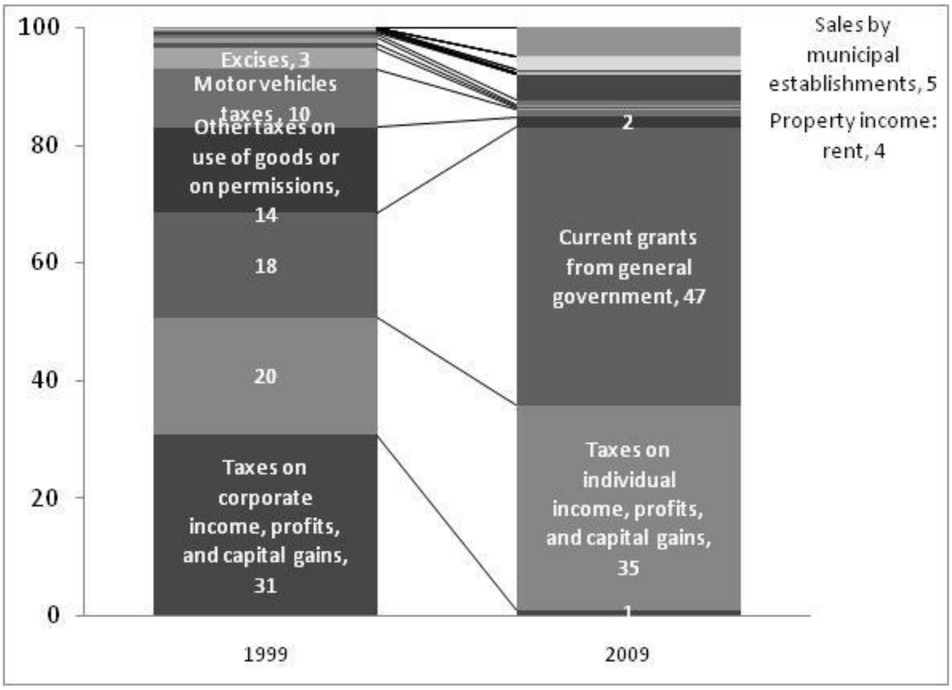
The two cities have developed a formal lobbying capacity through their membership in the Association of Ukrainian Cities (Donetsk is a member city since 2002; Makiivka is a founding city member since 1992) and the Association of the Donbas Mining Cities (both Donetsk and Makiivka are founding member cities since 1992). Amongst other things, the two associations have advocated for an increase in cities' ability to retain most of their revenues. In this context, with both city councils and directly elected mayors controlled by the Party of Regions since the early 2000s, the political affinity of Donetsk and Makiivka voters (usually characterised as the Party of Regions strongholds) has provided an additional informal facility for lobbying during the 'good' electoral cycles of 1999-2004 and 2010 onwards. In 'bad' years, however, the cities' close links with the main opposition force was deemed to be a liability, as various Orange governments in the late 2000s back-pedalled on finance public investment projects in the region.

Following a series of legislative changes, the civil society has gradually been allowed to take a direct part in municipal finance decisions: it has become mandatory to have a public hearing of the draft city budget during the formulation of revenue and expenditure priorities. Usually, such events do not appear to be exercises in 'participatory budgeting', but rather depend on situational participation by the representatives of selected civil organisations, seeking to inform the local authority representatives about the essence of the problems they face, and by opportunistic representatives of the big business, lobbying to influence the city's decision on real estate development and infrastructure investment.

Formally, the city executive's department for the large taxpayers continues to be in direct contact with all the major businesses in the city during the budgetary process to prevent them from aggressive tax avoidance and tax evasion.

The ability of city administrations to leverage more influence over the city budget revenue streams is very limited, however. As it has already been mentioned, form the early 1990s and until the mid-2000s, the share of local taxes (over which the local government had had some influence) in the total revenue of local budgets has significantly shrank. In general, the structure of tax inflows into the local budgets in Ukraine has undergone a series of radical changes. Figure 24 illustrates the end result of these structural changes in the composition of local budgetary revenues between 1999 and 2009 (for more details, see also Appendix Table 2).

Figure 24. Ukrainian local government revenues by source, shifting patterns, 1999-2009, % of total



Source: Appendix Table 1.

Figure 24 shows that the share of the corporate income taxation (i.e. taxes on income, profits, and capital gains by enterprises) in the revenue of Ukraine's local budgets had gone down very significantly in the 2000s, declining by almost 95 per cent, from being the main source of local government finance to becoming virtually irrelevant. The revenue shares such sources like excise duties (down by 85.3 per cent), motor vehicle duties (down by 77.8 per cent) and other taxes on the use of goods or on permission to perform activities (down by 77.2 per cent) have fallen almost as sharply as corporate taxation. On the other hand, personal income taxes (on individual income, profits and capital gains) dramatically increased to make almost 35 per cent of the total revenue of local budgets in 2009. Income from property rent also increased from 0.5 per cent of the total in 1999 to 4.2 per cent in 2009. The amount of grants and subventions received from the central state budget has also increased very significantly. Indeed, this particular source of local government revenue saw the highest increase over time, with its share in the total local budgetary revenue becoming the largest and comprising on average 47.3 per cent of the total in the late 2000s.

This shift towards the primary composition of local budgets from personal income taxes and transfers from the central government has coincided with the general reduction in the share of tax intake by Ukraine's local government. As a result, the financial independence of the local government has been drastically reduced; whereas the shares of (centrally) 'assigned' sources of budget revenues and of central government transfers have increased. Locally, the main city's own inflow into the budgets of Donetsk and Makiivka has tended to come from land rental payments, which comprised around 85 per cent of the total 'own' revenues. Also, local taxes and user charges have been the second most important revenue source, comprising around 10 per cent of the cities' own revenues. Table 17 shows the dynamics of the cities' own budgetary inflows.

Table 17: Inflow of city own (entrepreneurial) revenues into Donetsk and Makiivka municipal budgets, % of total revenue

	2005	2006	2007	2008	2009	2010
Donetsk	2.7	4.1	9.2	12.2	14.2	15.3
Makiivka	9.5	7.3	6.0	4.4	6	6.7

The analysis of the data from Table 18 allows to conclude that throughout the 2000s the local authorities in Donetsk were actively seeking to increase the share of their own revenues in the city budget, and correspondingly trying to have a greater control over the budgetary revenue streams. This process was especially evident in the late 2000s. With the land lease-hold auctions increasing the rental payments by more than 3 times in real terms, the amount of local taxes and user charges has increased in the same period by 2.9 times (in constant prices).

One has to stress that the possibilities for managing the budgetary revenue side by the city of Makiivka council have remained to be very limited. The city has become almost totally dependent upon central government transfers, including social welfare subvention and equalisation grants. The legislative basis of the equalisation subsidy from the central state budget to local budgets in Ukraine is worth exploring. The calculation of this payment is done according to the following formula:

$$\mathbf{Te = ai\ (Vi - Dizak\ )}, \qquad (1)$$

In the formula,

"Te" is the amount of the equalisation subsidy from the state budget to a local budget (or of the transfer from a local budget into the state budget);

"Vi" is the amount of centrally assigned expenditure in the respective local budget;

"Dizak" is the amount of centrally assigned revenue in the respective local budget;

"ai" is the levelling coefficient.

Thus, in case when the amount of the assigned spending in the respective local budget exceeds the amount of its revenues (Vi > Dizak), the value of "ai" is set as 1. In other words, the central state budget guarantees to cover all of the expenditure centrally assigned in the respective local budget. In case when, on the contrary, the amount of the assigned revenue in the respective local budget exceeds the amount of its expenditure (Dizak > Vi), the value of ai is set as less than 1 (for the cities of regional significance the coefficient stands at 0.6); that is up to 40% of the local government revenue might be legally 'donated' or transferred away from the respective city to the central government.

The calculation of the assigned revenues and expenditures is conducted according to the following parameters:

1. financial norms of budget security and correcting coefficient for them;
2. number of inhabitants and number of consumers of social services;
3. index of relative solvency of a corresponding city or district;
4. forecasting indicator of revenue basket of local government budgets.

The size of the revenue basket of the respective budget is determined using an index of relative solvency of the budget of a city or a district based on the data concerning the actual budget performance (implementation) over the three previous budget years. The index of relative solvency is a coefficient that determines the level of solvency of an administrative territorial unit compared to the analogous average indicator in Ukraine on a per capita basis. In this way, in fact, any increase in city revenues shall be accompanied by a reduction in the volume of central government transfers, effectively disincentivising the local authorities to increase their own revenues. The outcomes of the application of this formula to the cities of Donetsk and Makiivka are presented in Table 18.

Table 18. The role of equalisation subsidies in city budgets: Donetsk's expenditure and Makiivka's revenue, % of total

	2005	**2006**	**2007**	**2008**	**2009**	**2010**
Donetsk: equalisation subsidies as % of total city **expenditure**	13.0	20.2	25.7	34.0	37.4	39.4
Makiivka: equalisation subsidies as % of total city **revenue**	20.9	28	23.2	19.5	22.5	27.1

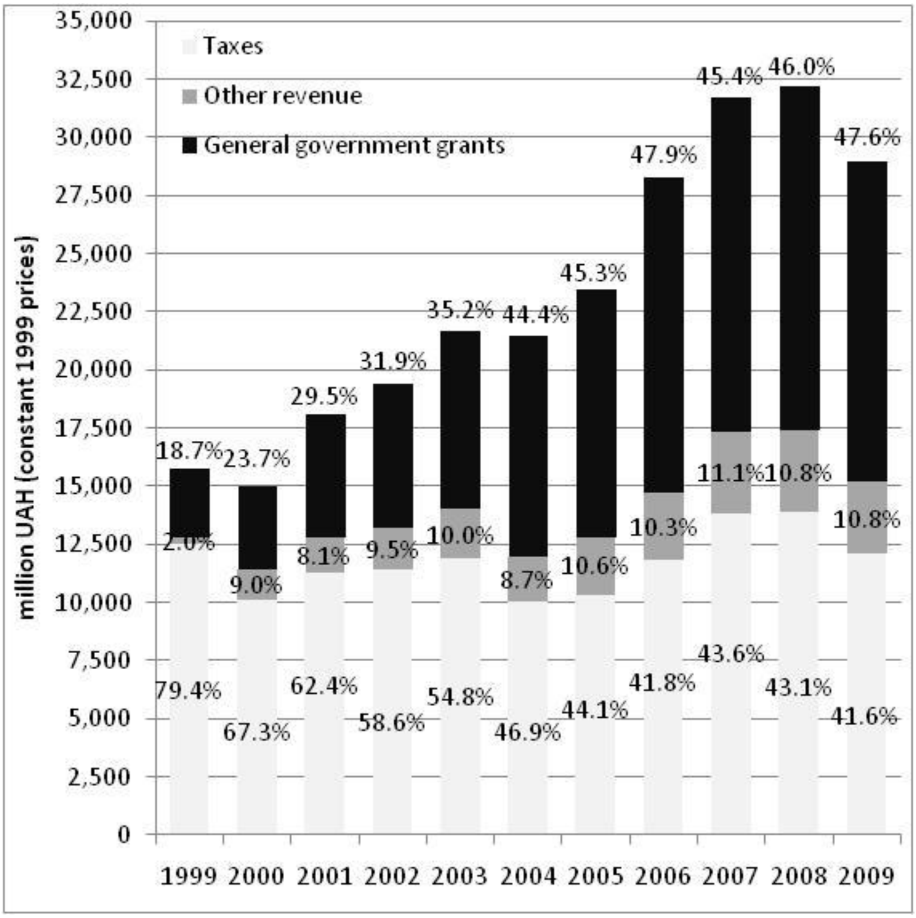
Table 18 demonstrates that for the economy of Donetsk the equalisation subsidy formulation acts as a disincentive. In the last 5 years, the share of the city's transfers into the central state budget increased more than 3 times. It also needs to be stressed that the usage of forecast indicators for the calculation of equalisation subsidies based on the figures for the previous three years makes it impossible from time to time to take into account exogenous shocks which could happen more recently and significantly change the underlying budgetary figures. In particular, the abrupt fall in Makiivka's budgetary revenues in 2009-2009, following the closure of Makiivka Steel Works, was not anticipated. According to the deputy city mayor, the solution to such a problem is not formally finalised, in the Ukrainian legislation; as a result, the city authorities have had to appeal directly for help to the Cabinet of Ministers of Ukraine.

The formation of local finances based on the norms of the Budget Code of Ukraine using the formula described above is aimed at providing approximately equal levels of revenue and expenditure per capita in different localities across the country. The main principle of the state budgetary policy is, therefore, the 'levelling principle'. Ukraine's average GDP per capita is used as a reference point in this regard. The amount of local budget expenditure per capita in Ukraine in 2009 was 2,750.70 UAH on average. Further analysis of this indicator across all Ukrainian regions has revealed a range between 2,400 and 3,000 UAH per capita. The reported gap in budgetary revenues was no more than 20 per cent, which corresponds to (the range of) differentiation of regions by the level of economic potential. On the whole, such an approach to regulating local government finance has continued to be criticised by local government leaders, public figures, and scholars alike. The lack of real stimuli for increasing the budgetary revenue of a locality and the subsequent loss of interest in improving the effectiveness of local authorities is often cited as the main failure of Ukraine's existing public finance system.

9 – Did the Area Experience a Dependence on External Resources?

The relative centralisation of Ukraine's public finance and the reduction of local government expenditure as a share of GDP observed from the mid-1990s onwards have led to the loss of a considerable part of the financial independence by the local government in Ukraine. The dependence of local government finance on central government transfers has increased dramatically during this period. Significant increases can be observed in both the absolute volume of central government grants and in their share of the total revenue of local budgets (see Figure 25). Whereas in 1999, the share of transfers from the central state budget amounted on average to 18.7per cent of the total revenue of local budgets, it rapidly grew through the 2000s to peak at 47.6 per cent.

Figure 25. Ukraine local government revenues by source in 1999-2009 (constant prices), hryvnia, percentage of total



However, the disaggregate reality appears to be more complex. Some cities are dependent on external resources more than others. A more detailed analysis of the city budgets can show whether the dependence of Donetsk and/or Makiivka on the external resources for tackling the problems associated with shrinkage has increased. The relationship of the city of Donetsk council budget with the external sources of finance is shown in Table 19.

Table 19. Donetsk's fiscal independence from external sources of funding (in constant 2007 prices)

	2003	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Total revenues of Donetsk city budget, million hryvnia	490.3	554.1	649.4	838.7	1631.2	1777.4	1529.7	1572.0
Of which, inflows from central state budget, million hryvnia	73.1	20.7	126.7	105.0	426.7	348.2	309.3	365.1
Share of inflows from central state budget as % of total city revenue	14.9	3.7	19.5	12.5	26.1	19.6	20.2	23.2
Outflows from Donetsk city budget into the central state budget, million hryvnia	234.5	181.6	226.9	286.9	723.4	865.1	769.7	713.6
Net-balance of inter-budgetary payments between the central state and the city, million hryvnia	161.4	160.9	100.2	181.9	296.7	516.9	460.4	348.5
Share of net-balance of inter-budgetary payments between the central state and the city as % of total Donetsk revenues	32.9	29.0	15.4	21.7	18.2	29.1	30.1	22.1

Table 21 evidently shows that any reported dependence of the municipal budget of Donetsk on external (central government) sources of finance has been largely, if not entirely, fictitious. A positive net-balance of inter-budgetary payments between the state budget and the city budget provides the supportive evidence for such an assertion. Thus, the budget of Donetsk is, in fact, a 'donor' budget. The sum of transfers from the central state budget appears to be fairly unstable, which reflects the problems with the formation of the state budget. The net-balance of inter-budgetary payments between the state budget and the city of Donetsk budget has increased sharply in the aftermath of the current economic crisis. This trend is a consequence of the state policy of subsidising the lagging regions by re-distributing the fiscal resources from the more developed regions. By contrast, the near total dependence of Makiivka on external sources of funding is demonstrated in Table 20. Between 2005 and 2010, the absolute dependence of the city of Makiivka budget on central government transfers increased by 2.4 times. In 2007, the overall share of transfers in the total revenue of Makiivka's municipal budget exceeded the average level in Ukraine.

Table 20. Makiivka's fiscal dependence from external sources of funding (in constant 2007 prices)

	2005	2006	2007	2008	2009	2010
Total revenues of Makiivka city budget, million hryvnia	279.1	347.3	409.5	440.7	447.7	480.1
Of which, inflows from central state budget, million hryvnia	108.1	140.4	214.6	222.4	208.4	260.3
Share of inflows from central state budget as % of total city revenue	38.7	40.4	52.4	50.4	46.5	54.2
Net-balance of inter-budgetary payments between the central state and the city, million hryvnia	-108.1	-140.4	-214.6	-222.4	-208.4	-260.3

The data on the shares of the city's own and assigned funds in Makiivka's budget and of the central government transfers in the form of equalisation subsidies and social protection subventions are shown in Table 21. As Table 21 demonstrates, the share of Makiivka's budgetary revenue coming from the equalisation subsidies has largely matched the average Ukrainian level. At the same time, the share of social welfare subventions has exceeded Ukraine's average. This situation was the consequence of a series of social problems caused by and associated with shrinkage in Makiivka (as analysed in the previous sections). Thus, the growing dependence of Makiivka's local government finance on external resources can be primarily attributed to shrinkage.

Table 21. Makiivka city budget: revenue structure, 2005-2010, % of total

	2005	2006	2007	2008	2009	2010
City's own and assigned revenues	61.3	59.6	47.6	49.6	53.5	45.8
Equalisation subsidies	20.9	28.0	23.2	19.5	22.5	27.1
Social welfare subventions	17.8	12.4	29.2	30.9	24.0	27.1

Did financial and other opportunities of Donetsk and Makiivka reduce due to shrinkage?

As it has been discussed earlier, shrinkage in Donetsk has been marked predominantly by the processes of depopulation, without having a detrimental impact upon the city's budgetary revenue. The dynamics of Makiivka's own and assigned budget revenues, excluding the central government subsidies and subventions, provide a contrasting picture (see Table 22). Table 22 sows that the growth of the city's own and assigned budget revenue in the 2005-2008 period was fairly unstable, which did not correspond with the general growth trajectory of the national and regional economies. In 2009, as the direct result of the economic crisis, the city's own and assigned revenues started going down. In 2010, the downward trajectory continued, despite the resumption of economic growth in the Donbas and Ukraine as a whole.

Table 22. Makiivka's own and assigned budget revenues (in constant 2007 prices)

	2005	**2006**	**2007**	**2008**	**2009**	**2010**
Own and assigned budget revenues, million hryvnia	165.961	187.674	174.561	215.336	208.352	189.839
% change from previous year	-	113.1	93.0	123.4	96.7	91.1

Furthermore, the negative financial results of the city's major businesses have had a detrimental effect on the city budget. De-industrialisation and the decline of Makiivka's traditional industries – coal-mining and steel – have drastically reduced the fiscal base of the city, putting additional pressure on the welfare of its residents. As social assistance and social protection, in considerable part, belong to the assigned expenditure, these funds are secured through the subventions from the state budget to local budgets. Therefore, shrinkage in both Donetsk and Makiivka has had an effect upon the ability of municipal budgets to satisfy the social needs of the inhabitants of these cities. Social welfare subventions to the cities' budgets from the central state budget are shown in Table 23.

The analysis of Table 23 leads to the following conclusions: until 2007, the absolute volume of subventions from the state budget to the budget of Donetsk had been declining; in 2007, as the result of the devolution of the majority of social welfare functions to the local authorities, the fiscal ability of Donetsk and Makiivka to satisfy the enlarged social needs of their inhabitants was dwarfed by the new responsibilities, requiring an increase in the amount of subsidies provided to the city budgets.

Table 23: Inflow of subventions from the central state budget to Donetsk and Makiivka city budgets, per capita (in constant 2007 prices)

	2004	2005	2006	2007	2008	2009	2010
Donetsk: central government subventions per capita, hryvnia	20.6	125.4	104.4	428.8	351.5	313.4	370.8
Makiivka: central government subventions per capita, hryvnia		124.5	128.3	310.8	312.5	310.3	361.1

10 – Financing Ukraine's Shrinking Cities: Contradictions and Instability

The devolution of substantial powers to the local government in the last 10 years has been driven by Ukraine's 'Europeanisation' efforts, i.e. its application of the European Union's and the Council of Europe's normative frameworks and statutory requirements. Despite that, one could also observe the continuation of the overall contradictory and inconsistent approach to the nature of the local self-government in the country.

In general, both cities had to adjust, adapt, and work under a continuously evolving, unstable, and inherently contradictory policy framework as far as the local government finance and powers are concerned. The normative direction of the governance of shrinkage in the Ukrainian context has fluctuated – in the demographics arena – between, on the one hand, attempts to halt and avert the rapid depopulation through various policies aimed at encouraging births, reducing premature deaths via healthcare reforms and the promotion of healthier life styles, balancing emigration and immigration pressures; and, on the other hand, a necessity to manage the inevitable 'long-term demographic change' through labour market reforms. In the sphere of local government finance, the declared normative direction has been towards a greater local fiscal autonomy, subsidiarity, and the reliance on own resources.

Nevertheless, it appears the central government has been involved in micro-managing local government finance, effectively controlling a major share of local public expenditure. In terms of (re-)distributive policies, since the mid-2000s, the national authorities have been undergoing a major re-think towards (potentially) withdrawing direct income subsidies and focusing only on 'viable' growth poles in the regions. The executive decision is yet to be taken and its direction is unclear at the moment.

Influence of instability of governance decisions on the development of Donetsk and Makiivka.

Overall instability in such crucial spheres as general taxation and transfers from state budget has negatively influenced the development of Donetsk and Makiivka and the two cities' capacity for coping with shrinkage. Among the most significant changes in public policy, which has influenced the processes of socio-economic development of Donetsk and Makiivka, one ought to mention the reported change in the revenue base of local budgets. This process has increased the dependence of city budgets on the central budget and has made Donetsk and Makiivka more 'sensitive' to the processes of shrinkage. At the same time, one has to add that the timing of changes in taxation and the budgetary legislation has differed.

Changes in the legislation concerning the so-called special economic zones (SEZs) and territories of priority development (TPDs) have happened almost overnight. The SEZ Donetsk functions on the territory of the city, occupying the area of 466 ha. It was created in 1999 for the duration of 60 years in accordance with Law of Ukraine 'About special economic zones and the special regime of investment activity in Donetska oblast' (No. 356-XIV of 24 December 1998). The SEZ was characterised by especially preferential customs and tax regime aimed at attracting foreign direct investment. Yet following the Orange Revolution, in 200, Ukraine's Parliament passed a new a law, significantly undermining the operation of special economic zones by effectively removing most of the tax and customs concessions. At the same time, in formal legislative terms, the special economic zones were not abolished. The Law of Ukraine 'On general principles for the creation and functioning of special (free) economic zones' does provide for the possibility to abolish these zones; yet is sets a precise mechanisms for such a decision to be taken, involving the creation of an independent experts committee by the Verkhovna Rada of Ukraine to study the proposition for abolition a SEZ, the adoption of corresponding laws, and the establishment of a special liquidating committee by the Ukrainian government to deal with the matters related to the procedure of closure, such as property and income questions. Undoubtedly, the implementation of this mechanism requires time. This is why, perhaps, the decision by Yulia Tymoshenko's government to maintain the SEZs formally, but to deprive them of their legal substance was later characterised as being based not upon the discreet logic of the law, but on the naked logic of political will.

The official motivation behind the government's decision was to eliminate the 'abuse' of SEZs. The decision was couched into the harsh political rhetoric of fighting the alleged organised crime and the 'Donetsk mafia' (see Kuzin, 2006). Nonetheless, the Ukrainian Cabinet of Ministers did not publish its policy evaluation analysis, as was required by the resolution of the Cabinet of Ministers No. 184 of 28 February 2001, establishing the order for conducting the evaluation analysis of the SEZ operations, their development potential, and projected outcomes of the further operation. The media attention was also drawn to the government's legal error in abolishing all SEZ operations, whereas according to the existing law each SEZ has had to be evaluated separately. In 2006, some attempts were made at the legislative level to bring back the preferential conditions of economic activity in SEZs in one way or another). In 2010, the draft Tax Code of Ukraine contained a provision for the renewal of certain benefits. However, despite this, a sharp change in the legislative framework has destroyed trust of the investors and has generally worsened the business climate in Donetsk SEZ, resulting in the closure of a range of investment projects. This process can be demonstrated indirectly by comparing the amount of investment inflows attracted by SEZs in Donetska oblast since their establishment (see Table 24). Thus, from the end of 2004 onwards one could see an obvious decrease in the amount of corresponding investments, instigated by the instability of investment climate that has negatively reflected on the city's economic development.

Table 24: Foreign investment inflows into special economic zones, Donetska oblast, 1999-2008, million USD, end year

	1999	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Amount of investment	153.3	153.4	108.9	250.7	394.1	544.1	518.4	392.1	198.4	92.3

Another significant factor determining the unstable development of Donetsk and Makiivka was the underfunding by the central government of its obligations in accordance with Donetska oblast's Regional Development Agreement. This Agreement was adopted as a part of the National strategy of regional development until 2015 and the Strategy of economic and social development of Donetska oblast. The Regional agreement has called for the further re-structuring of coal industry in the region; a safe and effective operation of all systems of life support in the localities; the development of an effective system of ecological security across the region; the development and modernisation of the regional infrastructure. The overall cost of financing these measures amounts to 4,238,405,200 UAH, of which 3,628,165,30 UAH were earmarked from the central state budget (with 2,519,493,900 UAH directed to fund targeted state programmes), 235,928,500 UAH from local budgets of Donetska oblast, and 374,257,400 UAH from the private sector and other sources. An additional Agreement on regional development has guaranteed public funding for the construction of an additional runway at Donetsk international airport and of a new ring road around the city. Nevertheless, according to representatives of the Donetsk city council and the regional government, the regional and local authorities has experienced chronic payment arrears with regard to financial this agreement’s projects.

11 – Urban Shrinkage in the Donetsk-Makiivka Conurbation: the Mode of Governance

> The Donbas has always enjoyed the reputation of being free but unmanageable.
>
> Hiroaki Kuromiya, 'The Donbas – The Last Frontier of Europe?'

> In many ways, post-Communist Ukraine at the end of the twentieth century came to resemble the United States a century before, when laissez-faire capitalism allowed "robber barons" to dominate the American economy.
>
> Paul Robert Magocsi, A History of Ukraine

> The historically most prominent oligarchs are the so-called robber barons ... the men who build great industrial and transportation empires in the late 19^{th} century in the United States [...]. The most prominent postcommunist oligarchs, those in Russia and Ukraine ... have displayed greater similarities with the American robber barons than is usually understood because time has beautified U.S. history, and we can better understand the Russian and Ukrainian oligarchs by comparing them with their American colleagues. In all three countries, big businessmen responded rationally to the existing economic, legal, and political conditions. The oligarchs stood out as the true *homos oeconomicus* in a world of bewilderment.
>
> Anders Åslund, *How Capitalism Was Built*

The definition of the central category of this project – urban governance – is broad and encompassing all possible relations between the institutions and individuals aimed at managing the city affairs. The depiction of how city budgets are managed represents just a part of the whole mechanism of governance; yet it reflects the general pattern of governance in the cities. Some specific institutional context of Ukraine and its evolution over the past 20-30 years have been already mentioned in earlier sections of this report. Here we attempt to apply an integrated approach to categorise the urban governance of Greater Donetsk conurbation. This section will argue that a number of different governance arrangements have been used to govern the municipal finance of Donetsk and Makiivka as well as the broader shrinkage-related processes affecting the two local governments, generating very different outcomes as a result.

Before we proceed with our own research findings regarding the issue of urban governance in Donetsk and Makiivka, and the Great Donetsk conurbation in general, we would like very briefly to review the recent academic literature on the topic. So far, the numerous depictions of urban and regional governance, the actors, and structural conditions that influence the governance of Greater Donetsk, the Donbas, and the country as a whole, have focused almost exclusively on the political side of the issue, especially on the (reportedly) oligarchic and clientelistic character of power relations in their portrayal of Ukraine's 'crony' capitalism in general (King 2007; Myant and Drahokoupil, 2011; Magosci, 2010; Tatur, 2004; Wilson, 2009; Yekelchyk, 2007) and the Donbas region in particular. For example, Anders Åslund (2009: 106-115), telling a story of 'how capitalism was built' in Eastern Europe and the former USSR, does not fail to mention the "criminal anarchy in Donetsk in the 1990s", which gave rise to Ukraine's most powerful business groups based in the city: "Five out of 18 'oligarchs' or plutocrats are from Donetsk; amongst Ukraine's six biggest oligarchic groups, two were based in Donetsk (System Capital Management and the Industrial Union of the Donbas)".

Kerstin Zimmer and Claudia Šabić (2004a; 2004b) provide further colourful evidence generally in support of Åslund's description of the Donbas as a rent-seeking captured economy. Focusing specifically on the political economy of Donetsk and Donetska oblast, Zimmer (2004) also tells a post-communist transition story filled with populist politicians, paternalistic mayors, and various dodgy characters in cahoots with a clandestine (quasi)-mafia organisation ruling the region. Serhii Kuzin (2006) has gathered a series of journalist investigations and reports about 55 high-profile contract killings of local businessmen/gangsters across the Donbas carried out in the course of the mass privatisation and spontaneous redistribution of the state-owned property during the turbulent 1990s (cf. Mykhnenko, 2002; 2004).

To sum up, according to these accounts, the defining feature of the region and its capital city under post-communism has been 'political capitalism' set within a rigid patrimonial, clientelistic system. Furthermore, on the national level, as it has been long alleged, the Donbas-based political actors, business elites, and 'violent entrepreneurs' (see Volkov, 2000) located in Greater Donetsk have actively fostered a 'competitive authoritarian' system of governance (see D'Anieri, 2007; Levitsky and Way, 2010), coming dangerously close to the establishment of a 'clan-based' power machine back home (see Balmaceda, 2008; cf. Varese 2001).

Nevertheless, a number of similarly well-informed scholars have provided a series of much more ‘mundane’ – though, perhaps, not less powerful – and complex accounts of the political economy of the Donbas and its evolving governance mechanism, focusing on the endogenous capacity of the region to restructure and the ability of local governance actors successfully to oppose unsolicited policy advice and new predatory practices imposed from above and/or overseas (Mykhnenko, 2011; Swain and Mykhnenko, 2007; see also Sarzhan, 1999). The analysis carried out in this report of the formal (though not less real) governance arrangements and public finance policy mechanisms functioning in Donetsk and Makiivka pictures the local authorities’ ingenuity in distress rather than scenes from a Mafia-based fiction drama. One may, perhaps, argue that, by focusing exclusively on municipal fiscal accounts and a national public finance system, one might fail to grasp the ‘reality’ of power relations between various agents and overlook the way governance decisions are ‘really’ made in Donetsk, Makiivka, and elsewhere. Yet we argue that behind the fairly sensationalist (even if gruesome) headlines, coming out of Greater Donetsk (and popularised by Western academics), lies a much more prosaic and complex picture of urban governance, not dissimilar to the one found in almost any other large, de-industrialised shrinking city.

Table 25 lists a range of standard functions and statutory powers of provincial state administrations, city, and district councils. It shows that the exclusive authorities and competencies of the lower-tier branches of the state can be better described as a long list of obligations to report the relevant data and information to the higher-tier authorities as well as to fulfil their duties to implement local development programmes designed by other public bodies and institutions. The role of the local government as spelt out below provides it with very little autonomy, given its main functions appear to be about ensuring and reporting; hardly any of these statutory functions fosters the leadership or stimulates the initiative of a city manager. Nevertheless, this report has uncovered a number of substantial differences in the outcomes of urban governance in Donetsk and Makiivka, despite the two local authorities operating within the same strait jacket of limited autonomy, as outlined in Table 25.

Table 25. Statutory powers of the representative and executive branches of Ukraine's local and regional government, 2000s

The authority of executive bodies of village, township, and city councils	The authority of district and provincial state administrations
• To draft, submit, and execute the local authority budget • To write quarterly reports on the local budget implementation • To prepare and submit to the respective district councils and provincial assemblies relevant fiscal indicators and financial proposals for drafting district and provincial budgets • To determine (upon the receipt of approval from the respective local council) the way of utilisation of monetary resources and property jointly-owned by territorial communities • To implement, in accordance with the established procedure, the local budget expenditure • To gather, on a contractual basis, funds from local firms and organisations (of any type of ownership), local residents, and public funds for the construction, expansion, repair, and maintenance on an equal footing of various social and industrial infrastructure and for environmental protection activities • To pool, on a contractual basis, budgetary resources of the respective local authority with other local authority budgets for joint projects, co-financing municipal enterprises, organisations, and establishments, or for other activities in the common interest of territorial communities • To ensure, according to law, the local budget revenue incomings from local firms and organisations (of any type of ownership)	• To prepare and submit for consideration by the respective council/assembly social-economic and cultural development programmes for the respective territory and special-purpose programmes in other areas; also to prepare and submit national and cultural development projects for the localities with high concentration of ethnic minorities • To ensure the execution of the council/assembly decisions • To collate and submit to the respective central government bodies financial data and proposals with regard to the State Budget of Ukraine • To gather, on a contractual basis, funds from local firms and organisations, local residents, and public funds for the construction, expansion, repair, and maintenance on an equal footing of various social and industrial infrastructure, local roads, and for environmental protection activities
The exclusive competence of village, township, and city councils	**The exclusive competence of district councils and provincial assemblies**
• To approve the local budget and its amendments • To approve the local budget execution report • To impose local taxes and charges and determine their rate of taxation within legal boundaries • To issue local authority bonds	• To approve social-economic and cultural development programmes for the respective district/province, special-purpose programmes in other areas, and to hear their implementation accounts • To approve the respective district/provincial budget, their amendments, and execution reports

• To make loans from other local authority budgets and local sources and on transferring local budgetary resources • To grant, according to law, local tax concessions • To permit self-organisations of residents to execute some authority of local self-government and to transfer to them public funds, facilities, equipments, and other resources in order to enable such functioning • To approve social-economic and cultural development programmes for the respective administrative territorial unites and special-purpose programmes in other areas of local self-government • To establish the level of profit, which municipally-owned enterprises, organisations, and establishments have to contribute to the local authority revenue	• To assign and distribute transfers from the State Budget in the form of general subsidies and special grants amongst the respective local budgets of villages, townships, cities of 'district significance', cities of 'regional significance', as well as amongst district budgets within the province concerned • To manage, according to the established legal procedure, the common, jointly-owned property of the territorial communities of villages, townships, cities, and inner-city boroughs, which is administered by the respective district council/provincial assembly • To delegate to the local state administrations some statutory authority of the respective district council/provincial assembly • To take legal action with regard to illegitimate acts by local authorities, businesses, organisations, and establishments, which constrain the rights of territorial communities in the sphere of their common interests or abridge the powers of the district council/provincial assembly and its bodies • To impose and regulate, according to law, a trans-border transit charge on outgoing road vehicles

Source: authors' own construction on the basis of Appendix 1; Blysniuk *et al.* (2007); Chala *et al*. (2010); Chvaliuk (2011);Kaminska (2010); Karin (2008a; 2008b); Priieshkina (2004); Suntsova (2010); Verkhovna Rada of Ukraine (1997a).

Urban governance is typically understood as a "process blending and coordinating public and private interests" (Pierre, 1999: 374). One of the most important advances made by the few recent theoretical approaches to urban governance (see DiGaetano and Strom, 2003; Pierre, 2011) has been in the attention paid to the institutional and cultural setting of a country, the characteristics of the existing public-private partnerships, as well as the relations between the local government and the higher-tiers of public administration, including the central government. This refers to the degree of autonomy that cities have in planning their development, as well as the perception and evaluation of the existing opportunities by local urban authorities. The institutional approaches have focused on the values and objectives of political process of governance, helping to uncover and understand its meaning in day-to-day urban affairs.

One of the popular typologies of urban government was developed by Jon Pierre (1999; 2011). Based on government objectives and values, he distinguishes four types or models of urban governance – managerial, corporatist, pro-growth, and welfare – each with its own objectives, participants, instruments, and outcomes. It is fair to say that the institutional setting of the post-Soviet Ukraine is somewhat different from the one observed in Western Europe, North America, and other advanced OECD member-states on which Pierre's and DiGaetano and Strom's typologies are based. Hence, matching and comparing the governance of the Greater Donetsk conurbation with any ideal type is possible only to a certain extent. It is necessary to reiterate that any theoretical classification presents ideal type phenomena, which can rarely – if ever – be found in real life situations in such a refined state. Any adherence to or categorisation of one or the other model of governance is relative, given that most really-existing cities may exhibit multiple signs of different governance models. Furthermore, the way the Ukrainian cities were governed under post-communism had evolved during the two decades since the country's independence in 1991.

During the last twenty years, the local government system has undergone considerable changes. The Soviet administrative planning arrangements which existed until 1991 were characterised as a highly hierarchical, top-down Communist Party-rule based upon redistributive command principles. It was a system that in the language of urban governance theorists may be categorised as 'managerial', but in a heavy 'administrative and command' fashion. During the chaotic (and violent) post-communist transformation of the

1990s, the mode of governance in both Donetsk and Makiivka had indeed resembled the 'clientelist' and 'pluralist' ideal types. As this report shows, in the 2000s, one could observe a significant shift back generally to the managerial mode of governance, with further elements of corporatism in Donetsk and clientelism in Makiivka.

Recent developments in Ukraine's urban and regional policy, together with the aftermath of the economic crisis of 2008-09, have significantly narrowed the room for manoeuvre for the two city administrations and made it difficult to speak about distinct city strategies, as the latter have also been impaired by the lack of finance. City's own, locally-generated revenues (via land rents, user charges, fees) have been fairly limited; yet there were rising in Donetsk (from 9 to 15 per cent of the total budgetary revenue) during the 2000s, whilst remaining at steadily low level (about 6%) in Makiivka. However, by the way the two cities were seeking and finding new sources of budgetary revenue, and through the goals they were targeting the new funds for, one can uncover the traits of one or another particular mode of governance. For instance, as Donetsk's economy was (made) stronger and more capable of withstanding external shocks in the 2000s, the city's technical, social, and cultural infrastructure was maintained in a much better shape than in neighbouring Makiivka, with the city of Donetsk council revenues returning to growth in 2010. Some basic features the mode of urban governance in Donetsk are shown in Table 26, with those features marked in blue being more characteristic; those marked in yellow being less characteristic; and those unmarked being least representative.

Table 26. Donetsk: a model of urban governance, 2000s

Characteristics	**Models of urban governance**			
	Managerial	Corporatist	Pro-growth	Welfare
Political objectives	Efficiency	Distribution	Growth	Redistribution
Policy style	Pragmatic	Ideological	Pragmatic	Ideological
Political exchange	Consensus	Conflict	Consensus	Conflict
Public-private exchange	Competitive	Concerted	Instrumental	Inclusive
City-citizen relationship	Exclusive	Inclusive	Exclusive	Inclusive
Primary contingency	Professionals	Civic leaders	Businesses	The state
Key instruments	Contracts	Deliberations	Partnerships	Networks
Patterns of subordination	Positive	Negative	Positive	Negative
Key evaluative criterion	Efficiency	Participation	Growth	Equity

Source: based on Table 9.2. in Pierre (2011: 143).

Donetsk is clearly a ‘pro-growth city’. The main declared objective of the local government and of the directly-elected city mayor has been to boost the local economy, which in turn would also lead to the increase in the city’s revenues and capacity to deal with the dilemmas of shrinkage. Aggressive anti-shadow economy measures and competitive land lease-hold bidding processes pursued by the city authorities have dramatically increased the city’s tax intake. The effective managerial stance of the mayor and his city executive has turned Donetsk into a major ‘donor’: whereas central government transfers account for just 19.4 per cent of Donetsk’s budgetary income; the city’s equalisation subvention *outflow* amounts to 39.4% of its total expenditure. The effective formation of both formal and informal public-private partnerships with local business elites has brought well over US$1 billion of fresh private investment into the city (e.g. see Figure 26) .

Figure 26. The Donbas Arena, home of FC Shakhtar Donetsk, opened on 29 August 2009

Source: Vlad Mykhnenko

These pro-growth/managerial measures have intensified, when the city administration was contracting out development projects, allowing the construction of private housing in the city centre (as well as in the suburbs), and with the creation of a special economic zone and a territory for priority development. The city's ambitious investment drive has largely paid off, most importantly with respect to the sport-led urban regeneration linked to the EURO-2012. Donetsk has benefited from the construction of a large number of brand new hotels, a US$400 million football stadium, an airport extension, an a ring road. Some similarities with the managerial mode of governance can also be seen in the attempts by the city authorities to enhance efficiency as well as in the consecutive city mayors' 'conservative' and 'pragmatic' policy styles; all in striking contrast to the ever-expanding territorial income redistribution policies of Ukraine's central government, which is supposed to have a detrimental impact on the local incentive to generate extra revenues.

The local authorities' relations with the citizens in Donetsk are predominantly exclusive. Civic participation in the city council sessions and meetings of the city executive, where the most important urban affairs decisions are made, exists *de jure*, but does not work in practice. The fact that the city executive pays more attention to working with the major taxpayers is another characteristic, confirming the city's pro-growth mode of governance. Nevertheless, in performing different local government functions, the local authorities may resort to different modes of governance. More concisely, amongst many roles performed by the local government, the most characteristic features of urban governance in Donetsk are presented in Table 27.

Table 27: Donetsk: the role of local government, 2000s

Roles of the local government	**Models of urban governance**			
	Managerial	Corporatist	Pro-growth	Welfare
Financing	Yes	Yes	(Yes)	**(Yes)**
Regulating	**Yes**	No	Yes	No
Mediating	No	**Yes**	No	No
Coordinating / monitoring	Yes	No	**Yes**	No

Source: based on Table 9.1. in Pierre (2011: 140); bold emphasis added to highlight the role, which appears to be the 'first amongst equals' in each model.

To sum up, by the way the Donetsk city authorities handle municipal finance, they may be best classified as pro-growth. The style of the regulation of urban affairs and projects, and their coordination by the city executive leans towards the pro-growth model as well. However, the mode of urban governance shows some corporatist features in mediating conflicts of interests between the private business and local residents; for instance, by ensuring the regular payment of full wages to the public and private sector workers, and by aiming at the timely delivery of social housing, especially to large families with many children (sees Figure 27).

Figure 27. A regular phone-in programme with Oleksandr Lukyanchenko, the Party of Regions mayor of Donetsk (2002-present), Donbas TV & Radio Company, 7 December 2010.

Source: Vlad Mykhnenko

By contrast, Makiivka has become a ‘welfare city’. Welfare functions have started to dominate the local government’s affairs after the industrial component of city’s economy had rapidly declined. The city is currently entirely dependent on external sources of public finance: central government transfers amount to 54.2% of the city budget; the income equalisation subsidy inflows grew to 27.1% of the city’s total revenue. Makiivka’s urban governance profile, however, is more patchwork. On the one hand, such fragmentation could be due to the fact that the city authorities are much more geared towards delivering the guaranteed welfare functions and managing the state assigned funds, as Makiivka does not have its own revenues to develop any programmes from the bottom-up. At the time of writing, Makiivka was still suffering the aftershock of the global economic crisis of 2007-2010, trying to accommodate 6,000 redundancies at the Makiivka Kirov Steel Works and cope with a substantial loss of income tax revenue. Severe de-industrialisation and the ageing population have forced the local government to focus on redistributive functions, whereas in its style, urban governance actors still try to maintain efficiency and pragmatism amongst their major objectives and criteria (see Table 28).

Table 28: Makiivka: a model of urban governance, 2000s

Characteristics	**Models of urban governance**			
	Managerial	Corporatist	Pro-growth	Welfare
Political objectives	Efficiency	Distribution	Growth	Redistribution
Policy style	Pragmatic	Ideological	Pragmatic	Ideological
Political exchange	Consensus	Conflict	Consensus	Conflict
Public-private exchange	Competitive	Concerted	Instrumental	Inclusive
City-citizen relationship	Exclusive	Inclusive	Exclusive	Inclusive
Primary contingency	Professionals	Civic leaders	Businesses	The state
Key instruments	Contracts	Deliberations	Partnerships	Networks
Patterns of subordination	Positive	Negative	Positive	Negative
Key evaluative criterion	Efficiency	Participation	Growth	Equity

Source: based on Table 9.2. in Pierre (2011: 143).

Throughout the 2000s, Makiivka struggled with the immense tasks of welfare redistribution, whilst trying, at the same time, to maintain at least some degree of social cohesion. The cost-cutting and expenditure 'optimisation' strategy (e.g. the dissolution of inner-city borough councils, poor maintenance of municipal infrastructure, school closures) followed by the city administration has hardly been adequate to offset the ever-growing problems of a sinking urban economy. Table 29 provides a concise depiction of Makiivka's model of urban governance by the primary roles performed by the local authority. A closer look at various paradigmatic roles of the local government, in the context of the four ideal-types as outlined by Jon Pierre, demonstrates that Makiivka's overall welfare mode of governance is determined by its redistributive role in handling the city finance. Although the city administration has been looking for the most efficient way of delivering public services and running urban programmes, these attempts and actions do not significantly alter the overall model of urban governance in Makiivka.

Table 29: Makiivka: the role of local government, 2000s

Roles of the local government	Models of urban governance			
	Managerial	Corporatist	Pro-growth	Welfare
Financing	Yes	Yes	(Yes)	**(Yes)**
Regulating	**Yes**	No	Yes	No
Mediating	No	**Yes**	No	No
Coordinating / monitoring	Yes	No	**Yes**	No

Source: based on Table 9.1. in Pierre (2011: 140); bold emphasis added to highlight the role, which appears to be the 'first amongst equals' in each model.

Another typology of urban governance is offered by DiGaetano and Strom (2003), who single out five 'modes' of governance. This typology was the result of an integrated approach, which has combined the institutional, cultural and rational actor perspectives and taken into account certain contemporary developments in urban governance and state-society relations. DiGaetano and Strom take governing relations and its logic, political objectives, and key decision makers as main differentiating criteria to create a taxonomy of urban governance. However, the criteria on which both DiGaetano and Strom's and Pierre's typologies are based appear to be similar and there is a certain correlation between the types of governance as well. For example, the managerial model repeats itself in both typologies; the pro-growth model in Pierre's typology closely resembles the corporatist mode of governance suggested by DiGaetano and Strom. However, trying to match the urban governance of Donetsk and Makiivka with these ideal types has not been easy. The result is a more scattered pattern, perhaps, because the assumed level of autonomy of cities and the political involvement of their actors is set high for all modes (see Table 30). One theme of the city's financial management alone hardly allows us to make a definitive categorisation of Donetsk's and Makiivka's mode of urban government according to this classification.

Table 30: Greater Donetsk: modes of urban governance across the conurbation under post-communism

	Clientelistic	Corporatist	Managerial	Pluralist	Populist
Governing relations	Particularistic, personalised, exchange	Exclusionary negotiation	Formal, bureaucratic, or contractual	Brokering or mediating among competing interests	Inclusionary negotiation
Governing logic	Reciprocity	Consensus building	Authoritative decision making	Conflict management	Mobilisation of popular support
Key decision makers	Politicians and clients	Politicians and powerful civic leaders	Politicians and civil servants	Politicians and organised interests	Politicians and community movement leaders
Political objectives	Material	Purposive	Material	Purposive	Symbolic

Source: DiGaetano & Strom (2003)

Based on the previous literature and all the data obtained for this project from expert interviews with the city officials and from other sources, one can conclude that in this typology the mode of governance in Donetsk has been a mixture of corporatism and clientelism, with some elements of the managerial as well as pluralist types of governance. The mode of governance in Makiivka is identified mostly with the managerial and clientelistic types, but in a fairly limited sense. Makiivka's model of urban governance, which has fitted extremely well into Pierre's classification as the welfare type, does not possess enough political autonomy from the higher tiers of public administration for the lack of resources. This does not leave much managerial choice to the local authority in choosing an urban strategy other than the one focused almost exclusively on the redistribution of assigned funds and 'fire-fighting' acute shortages of funds related to growing welfare entitlements caused by shrinkage. As a summary, Table 30 illustrates the governance profile of the Greater Donetsk conurbation, where the blue-colour marking indicates the closer resemblance of Donetsk and Makiivka to the respective mode of urban governance.

12 – Conclusions

The socio-economic and political development of Ukraine, after gaining independence, has involved a revolutionary and devastating transformation of the national economic model and has had a profound effect on the nation's public finances at all levels. This report has shown that Ukraine's continuously evolving struggle over local government finance in the past two decades has been similar to many other divided nations, with the central government, frantically trying to maximise its capacity for the territorial re-distribution of national income towards lagging regions, and (relatively) better-off, 'donor' regions and cities like Donetsk, trying to retain a bigger share of their revenue. A general decrease in the role of the state in the economy has led to a fall in the share of local public spending in Ukraine's gross domestic product. The ongoing processes of nation-building and further 'consolidation' of the state power, which were most prominent under President Leonid Kuchma (1994-2004), have resulted in a substantial decrease in the tax base of the local budgetary revenue, thus, reflecting the will of the central government to control the economic processes in the country from 'above' in Kyiv.

During the 2000s, the personal income tax had become the main source of the assigned income of local budgets; simultaneously, the role of transfers from the central state budget to the local government had dramatically increased. The reform of Ukraine's public finances has allowed the central government to roll-out its far-reaching policy of the re-distribution of national income from the more economically developed donor-territories to less developed territories, reducing the ability of the local authorities to regulate the development of their territories. The territorial income re-distribution has often occurred regardless of the actual interests of the territories concerned; it was heavily influenced by party politics and electoral engineering; and undermined the stimuli for endogenous growth.

During the entire post-communist period, Donetska oblast was considered a donor-region. However, as this report has uncovered, the budgetary development of Donetsk and Makiivka – the region's first and third largest cities - were fundamentally different. De-industrialisation and economic decline in Makiivka has led to a sharp decrease of municipal revenues, whilst at the same time increasing the amount of mandatory budgetary spending on unemployment benefits, income support, and pensions. As a result, the city's dependence on transfers from the central budget has increased to more than 50 per cent of its total revenue. The amount of Makiivka's own revenues has remained insignificant during the whole period of this study, preventing the local authorities from designing and implementing any large-scale regeneration projects. The city could not afford putting money into its (public investment) development budget. The city authorities has reacted to the challenges posed by urban shrinkage in Makiivka and the resultant fiscal stress by drastically cutting public spending on the maintenance of social and technical infrastructure, and increasing social welfare payments to local residents, with the funding for the latter being actually provided through subventions from the central state budget to the city of Makiivka. This governance response to shrinkage in Makiivka was, in fact, forced upon the city administration.

By contrast, the dependence of Donetsk on the central government funding in this period was significantly lower than that of Makiivka, with total transfers from the state budget not exceeding 26 per cent of the city budgetary revenue. In general, the net-balance of transfer payments between the city of Donetsk budget and the central state budget has always remained positive, confirming the role of Donetsk as a donor-city. Donetsk's public finances have been far less influenced by shrinkage than Makiivka's city budget. With growing wages and salaries in the city, and given that the personal income taxation has become the main source of the city budget revenue, the negative demographic trajectory of Donetsk did not lead to shrinking revenues. Taking into account the existence of development budget and given that the overall amount of the city's own revenues in Donetsk significantly exceeds those of Makiivka, Donetsk authorities have managed to have a more intensive budgetary policy, investing in urban infrastructure and trying to develop the peripheral and poor inner-city boroughs. The share of public spending on social and technical infrastructure in Donetsk has remained stable during the entire period under study, indicating a significant increase in real terms.

The budgetary policy process in Donetsk and Makiivka has been considerably affected by a range of national legislative norms. Outflows from the 'donor' city budget into the central state budget and inflows from the state budget into the city budget are regulated by the Budget Code of Ukraine and normative acts by the relevant government departments.

Nevertheless, as this report has stressed, Ukraine’s inter-budgetary transfer system appears to be rather inflexible and (literally) formulaic, unable to respond to rapid exogenous shocks affecting localities, and effectively de-stimulating urban development. Faced with an emergency, the city authorities of both Donetsk and Makiivka have lobbied the central government directly through various informal channels of power, resorting to personal and party-political connections, if necessary.

In the second half of the 2000s, economic regeneration and development efforts made by the local authorities in Greater Donetsk were hamstrung by an adverse political climate in the country and frequent attempts by the newly-formed central government to ‘punish’ the entire region of the Donbas, along with all the urban areas of eastern Ukraine, for opposing the Orange revolution. Political expedience and arbitrary decisions by the national government have further curtailed the limited autonomy of the local government. Nevertheless, the role of local budgets in Ukraine has gradually begun to change. A wide range of public and social services has been devolved to the local communities to be provisioned and delivered through local government budgets, leading to a certain recovery of the local government’s financial capability. Moreover, the public debate about financial decentralisation, fiscal autonomy, and the proper role of the local government in Ukrainian society has begun, with active civil involvement by various local government associations. Evidently, the outcome of this debate will have long-term consequences for the future territorial integrity of Ukraine.

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Appendix 1. The Constitution of Ukraine of 26 June 1996.

Chapter XI. Local Self-Government

Article 140

Local self-government is the right of a territorial community — residents of a village or a voluntary association of residents of several villages into one village community, residents of a settlement [township], and of a city — independently to resolve issues of local character within the limits of the Constitution and the laws of Ukraine.

Particular aspects of the exercise of local self-government in the Cities of Kyiv and Sevastopol are determined by special laws of Ukraine.

Local self-government is exercised by a territorial community by the procedure established by law, both directly and through bodies of local self-government: village, settlement [township] and city councils, and their executive bodies.

District [*raion*] and oblast [provincial] councils are bodies of local self-government that represent the common interests of territorial communities of villages, settlements [townships] and cities.

The issue of organisation of the administration of city districts lies within the competence of city councils.

Village, settlement [township] and city councils may permit, upon the initiative of residents, the creation of house, street, block and other bodies of popular self-organisation, and to assign them part of their own competence, finances and property.

Article 141

A village, settlement [township] and city council is composed of deputies elected for a four-year term by residents of a village, settlement [township] and city on the basis of universal, equal and direct suffrage, by secret ballot.

Territorial communities elect for a four-year-term on the basis of universal, equal and direct suffrage, by secret ballot, the head [mayor] of the village, settlement [township] and city, respectively, who leads the executive body of the council and presides at its meetings.

The status of heads [mayors], deputies and executive bodies of a council and their authority, the procedure for their establishment, reorganisation and liquidation, are determined by law.

The chairman of a district council and the chairman of an oblast [provincial] council are elected by the respective council and lead the executive staff of the council.

Article 142

The material and financial basis for local self-government is movable and immovable property, revenues of local budgets, other funds, land, natural resources owned by territorial communities of villages, settlements [townships], cities, city districts, and also objects of their common property that are managed by district and oblast [provincial] councils.

On the basis of agreement, territorial communities of villages, settlements [townships] and cities may join objects of communal property as well as budget funds, to implement joint projects or to jointly finance (maintain) communal enterprises, organisations and establishments, and create appropriate bodies and services for this purpose.

The State participates in the formation of revenues of the budget of local self-government and financially supports local self-government. Expenditures of bodies of local self-government, which arise from the decisions of bodies of state power, are compensated by the state.

Article 143

Territorial communities of a village, settlement [township] and city, directly or through the bodies of local self-government established by them, manage the property that is in communal ownership; approve programmes of socio-economic and cultural development, and control their implementation; approve budgets of the respective administrative and territorial units, and control their implementation; establish local taxes and levies in accordance with the law; ensure the holding of local referendums and the implementation of their results; establish, reorganise and liquidate communal enterprises, organisations and institutions, and also exercise control over their activity; resolve other issues of local importance ascribed to their competence by law.

Oblast [provincial] and district councils approve programmes for socio-economic and cultural development of the respective oblasts and districts, and control their implementation; approve district and oblast budgets that are formed from the funds of the state budget for their appropriate distribution among territorial communities or for the implementation of joint projects, and from the funds drawn on the basis of agreement from local budgets for the realisation of joint socio-economic and cultural programmes, and control their implementation; resolve other issues ascribed to their competence by law.

Certain powers of bodies of executive power may be assigned by law to bodies of local self-government. The State finances the exercise of these powers from the State Budget of Ukraine in full or through the allocation of certain national taxes to the local budget, by the procedure established by law, transfers the relevant objects of state property to bodies of local self-government.

Bodies of local self-government, on issues of their exercise of powers of bodies of executive power, are under the control of the respective bodies of executive power.

Article 144

Bodies of local self-government, within the limits of authority determined by law, adopt decisions that are mandatory for execution throughout the respective territory.

Decisions of bodies of local self-government, for reasons of nonconformity with the Constitution or the laws of Ukraine, are suspended by the procedure established by law with a simultaneous appeal to a court.

Article 145

The rights of local self-government are protected by judicial procedure.

Article 146

Other issues of the organisation of local self-government, the formation, operation and responsibility of the bodies of local self-government, are determined by law.

Source: Verkhovna Rada of Ukraine (1996).

Appendix 2. Complementary tables.

Appendix Table 1. Statement of sources: revenue of local governments in Ukraine, 1999-2009, % of total (constant prices)

Source of revenue		**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**1999-2009 change, %**	
													Points	Volume*
Taxes	Taxes on income, profits, and capital gains:													
	Payable by individuals	19.99	35.09	35.80	40.21	41.80	34.40	33.31	32.89	36.24	36.57	34.90	14.9	221.1
	Payable by corporations and other enterprises	30.77	12.14	10.90	5.79	1.97	1.90	1.68	1.38	1.18	0.93	0.87	-29.9	-94.8
	Unallocable between personal and corporate taxation	0.00	0.00	0.00	0.46	0.33	0.30	0.33	0.19	0.14	0.10	0.09	0.1	-69.2
	Taxes on payroll and workforce:													
		0.00	0.00	0.00	0.53	0.43	0.40	0.30	0.22	0.17	0.13	0.12	0.1	-66.3
	Taxes on property:													
	Recurrent taxes on immovable property	0.00	0.00	0.00	5.35	4.64	4.07	3.09	2.28	1.75	1.86	2.15	2.2	n.a
	Taxes on goods and services:													
	General value added, sales, or turnover taxes	0.11	0.08	0.06	0.02	0.02	0.02	0.01	0.01	0.01	0.01	0.01	-0.1	-90.9
	Excises	3.48	2.44	1.91	0.76	0.32	0.12	0.12	0.09	0.08	0.08	0.27	-3.2	-85.8
	Taxes on specific services	0.31	0.22	0.17	0.07	0.05	0.06	0.06	0.06	0.05	0.05	0.04	-0.3	-77.4
	Taxes on use of goods or on permission to use goods or to perform activities:													
	Motor vehicles taxes	9.99	7.02	5.49	2.19	1.87	1.77	1.64	1.54	1.40	1.24	1.21	-8.8	-77.8
	Other taxes on use of goods or on permission	14.48	10.17	7.95	3.18	3.32	3.77	3.45	3.03	2.35	1.97	1.79	-12.7	-77.2
	Other taxes on goods and services:													
		0.18	0.13	0.10	0.04	0.05	0.13	0.14	0.14	0.12	0.19	0.19	0.0	85.8
	Other taxes:													
		0.05	0.00	0.00	0.01	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.0	-100.0
Grants	Grants from general government units:													
	Current	17.78	22.60	28.13	31.30	33.93	39.45	43.43	43.36	40.16	41.71	47.32	29.5	389.6
	Capital	0.88	1.12	1.40	0.61	1.32	4.91	1.85	4.50	5.22	4.33	0.28	-0.6	-41.3
Other revenue	Property income:													

Interest	0.06	0.05	0.04	0.16	0.10	0.07	0.17	0.25	0.27	0.43	0.16	0.1	395.5
Dividends	0.02	0.02	0.01	0.05	0.05	0.05	0.03	0.03	0.03	0.01	0.01	0.0	-2.6
Withdrawals from income of quasi-corporations	0.02	0.02	0.01	0.06	0.02	0.03	0.04	0.07	0.11	0.14	0.41	0.4	3,093.7
Rent	0.46	0.37	0.27	1.19	1.46	1.98	2.18	2.09	2.21	3.34	4.25	3.8	1,615.1
Sales of goods and services:													
Administrative fees	0.85	7.92	7.26	0.95	0.83	0.60	0.35	0.30	0.26	0.24	0.28	-0.6	-39.9
Incidental sales by nonmarket establishments	0.00	0.00	0.00	4.63	4.28	4.55	3.92	5.31	5.09	4.63	4.82	4.8	n.a
Fines, penalties, and forfeits:	0.00	0.00	0.00	0.11	0.07	0.06	0.04	0.03	0.00	0.00	0.00	0.0	n.a
Voluntary transfers other than grants:	0.00	0.00	0.00	1.55	1.84	2.08	1.90	0.00	0.00	0.00	0.00	0.0	n.a
Miscellaneous and unidentified revenue:	0.56	0.61	0.49	0.79	1.32	-0.71	1.95	2.24	3.17	2.06	0.82	0.3	173.2
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	0.0	84.0

Source: authors' own calculations on the basis of IMF (2011a).

Appendix Table 2. Outlays by functions of local governments in Ukraine, 1999-2009, % of total (constant prices)

	1999	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**1999-2009 change, %**	
												Points	Volume*
General public services	4.41	11.88	14.34	16.71	13.43	10.54	9.29	9.89	11.63	12.46	11.92	7.51	414.45
Defence	0.11	0.09	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.11	-100.00
Public order and safety	1.14	1.42	0.98	1.31	0.41	0.37	0.16	0.18	0.13	1.64	0.14	-1.00	-76.87
Economic affairs	18.27	13.47	11.03	7.80	10.49	13.00	10.81	10.55	12.03	10.64	5.91	-12.36	-38.46
Environment protection	0.00	0.00	0.00	0.60	0.69	0.88	0.62	0.57	0.53	0.47	0.57	0.57	n.a.
Housing and community amenities	7.48	6.09	5.82	4.61	4.84	5.87	7.00	10.31	4.66	5.99	5.12	-2.36	30.13
Health	21.90	22.72	20.60	21.15	21.48	21.33	22.07	20.91	20.00	19.24	21.28	-0.63	84.75
Recreation, culture and religion	3.42	3.85	4.11	3.60	4.20	4.23	4.10	4.01	3.70	3.75	3.82	0.40	112.50
Education	20.82	22.39	22.43	24.64	25.70	26.02	30.79	28.71	28.35	28.69	31.11	10.29	184.13
Social protection	22.46	18.09	20.69	19.58	18.77	17.77	15.16	14.87	18.96	17.11	20.14	-2.32	70.50
Total outlays	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	0.00	90.17

Source: authors' own calculations on the basis of IMF (2011a).

Appendix Table 3. Major changes in Ukrainian local government revenues by source, % of total revenue, and change in absolute volume and percentage points, 1999 and 2009

	1999	2009	share in total, change in % points	1999-2009, absolute % change, UAH
Taxes on income, profits, and capital gains by corporations / enterprises	30.8	0.9	-29.9	-94.8
Excises	3.5	0.3	-3.2	-85.8
Motor vehicles taxes	10.0	1.2	-8.8	-77.8
Other taxes on use of goods or on permission to perform activities	14.5	1.8	-12.7	-77.2
Incidental sales by non-market establishments	0.0	4.8	4.8	...
Taxes on income, profits, and capital gains by individuals	20.0	34.9	14.9	221.1
Current grants from general government	17.8	47.3	29.5	389.6
Property income: rent	0.5	4.2	3.8	1615.1
Recurrent taxes on immovable property	0.0	2.2	2.2	...

Source: authors' own calculations on the basis of IMF (2011a).