Determining the Territories’ Financial Independence Taking into Account «Financial Potential» and «The Level of Shadow Economy» Indicators

Abstract. Introduction. Economic success of Ukraine and its regions depends a lot upon the politics of financial decentralization. Nevertheless, the principle of financial independence remains only as a thesis and does not provide the territories with real independence. Practically, all the Ukrainian regions are subsidized from the state budget. In such conditions, decentralization of financial resources is vital for the development of the country. Results. Scientifically-methodical approach to the country’s level of financial independence determination is offered. It is designated that the quantitative criterion of the territorial financial independence determination is its financial potential. It is proposed to correct the financial potential of the territory on the level of «shadow» economy. Estimation of financial opportunities in a country must take into account the country’s tactical and strategic characteristics. Calculation of coefficients used in such estimations is proposed. The financial potential of Ukrainian regions, taking into account such coefficients and the level of the shadow economy influence, has been calculated. Usage of the financial potential in case of transfers for the inter-budgetary alignment determination, which is calculated taking into account influence of «shadow» economy on financial flows of the territory, will allow avoiding of manipulations with monetary resources, which are allocated for development of the territory, and determining of donor-regions and regions-recipients. Conclusion. The system of the inter-budget relations may be improved by efficiency increase of territories’ financial potential usage and effective measures taking on fight against shadow economy. Financial independence of the territories leads to self-development, which is impossible without growth of financial potential.

Keywords: Financial Independence; Financial Decentralization; Financial Potential of the Territory; Shadow Economy; Inter-Budget Relations

JEL Classification: G32; H79; R58; R59
1. Introduction. Successful Ukrainian economic development depends on a decentralized financial policy. This policy has separate provisions about local government required by the European charter, Law of Ukraine (the leading foreign experts points), and the Budget Code of Ukraine. However, this policy is just academic and doesn’t provide real independence to the territories. Between 2002 and 2012, the local budgets, as a percentage of Ukraine’s consolidated budget, decreased from 31.4 to 22.6%, while local expenditures grew from 41.1 to 44.9% (by the calculations given in [2, р.152]). Obviously, financial independence of the territories is impossible with such approach to formation of local budgets, and practically all the regions of Ukraine are on subsidizing from the state budget. First of all, financial decentralization consists not only in transmission of separate powers to local authorities. The main task of it is redistribution of financial resources between state and local budgets. Decentralization of financial resources promotes development of the country «if the bankroll is used on places, efficiency will increase by 30% at once» [1]. However, Gerard Roland, professor of economics at Berkeley U., specifies that «this question contains a set of technical aspects (which items of expenditure need to be decentralized, how to decentralize, etc.), it is necessary to avoid ineffective approaches in this solution…» [1]. Existence of financial resources, which provide financial independence, is directly connected with formation and implementation of financial potential of the territory, but thus financial flows which are generated in a shadow sector are not considered in its calculation, that doesn’t allow to carry out a real assessment of volumes of the territorial income (local budget) and volumes of the interbudgetary transfers, on that it can claim.

2. Brief Literature Review. Despite quite significant amount of publications on the researched problem in works of such authors, as Musgrave R. (1973 ) [3], Oates W. E. (1972) [4], Shah A. (2007), Tiebout C. (1961) [5], Bahl R. (1992) [6], Ebel R. D. and Serdar Y. (2001) [7], Charbit C. (2011) [8], Juttling J., Corsi E., and Stockmayer, A. (2005) [9], Zanetta, C. (2007) [10], Abalkin L. I., Balatskyi Ye. O., Hryaznova A. T., Karpinskyi B. A., which examine theoretical and methodical basics of the state financial policy and inter-budget relations, the need for the territories’ potential activation in order to support sustainable development and self-development is not considered, what is topical in relation to the need for decentralization of financial relations. According to Zinchenko S. V., Akhmetova A. V., Ibragimova P. A., Ionenko K. V., etc. a region’s financial stability and potential are represented as separate instruments reflecting a territory’s income increase. The authors’ research also did not show how strategic the influence is, why it does not provide long-term financial independence, and how the financial flows of the shadow economy impact the financial development of the territories.

3. Purpose of the article is to ground the scientific methodological approach to the assessment of financial independence of the territory in view of its financial potential, which is adjusted on the coefficient of «shadow» economy.

4. Results. One of the main causes of today’s problems in Ukraine is centralization of power that does not provide financial independence of local authorities, and therefore, does not contribute effective regulation and stimulation of socio-economic development of the territories. That’s why Ukraine needs to change the control system and bring it closer to self-organization model that will allow, on the one side, to reduce ineffective state regulation and to align profitable and account opportunities of the local authorities, on the other side – will provide financial independence of the local authorities. It is necessary to stress that financial independence of territories must be based on principles of demarcation of profitable powers and on the responsibility between the state and regional levels. It, also, must consider restrictions of the state financial policy and established principles of taxation. In this way, financial independence, that includes budgetary and tax independence, relations between the state and regions and reflects the level of financial isolation of regions. Tiebout C. (1961) researched questions of local authorities’ financial independence and the decrease of ineffective distribution of the interbudgetary transfers. He noted that: «Fiscal decentralization increases the competition among local authorities that limits the volume of a public sector as a result; the decentralization increases efficiency, because local authorities have the best information of residents’ needs, in the contrast to the central government» (Tiebout, 1961) [5, p. 80]. According to Oakes (1972) opinion decentralization of expenditures is defined by asymmetric information effect – inability of the central authorities to have exhaustive information on preferences of residents of municipalities and about local costs of production of the public benefits (the budgetary services) [4, p. 5]. Musgrave R. (1973) considered that the budgetary decentralization promotes effective placement of resources [3, p. 60]. In 2011, Charbit C. conducted a study which showed that «politically, decentralization is rooted in democracy and representation concerns at the local level...» [8].

In the substantiation of the scientifically-methodical approach to an assessment of financial independence of the territories, proceeded from such conditions:

1. Criterion which estimates quantitatively financial independence of the territory, from our point of view, is its financial potential. This definition means hypothetical territorial possiblity to attract, create and use financial resources for ensuring its effective operation and development [11, p. 212]. This definition is a combination of the following key provisions: 1) basic characteristic of potential «possibility»; possibility is just hypothetical, what means that its use isn’t necessarily; 2) the purpose of implementation of territorial financial potential is simple and expanded production (operation and development) of the territory; 3) creation, attraction and use of resources is embodied in the available, untapped and new financial resources, that means totally of own and borrowed resources, directed on execution of tactical and strategic tasks of the region, effective socio-economic development and financial stability [12]. Subjects – state, enterprises, credit and financial organizations, households and other economic agents from the structure of financial potential (methodological approaches for assessing potential of region, including financial potential were considered by us in the works [11, p. 180; 12, p. 86]).

2. Financial independence of the regions (level of financial self-sufficiency of the regions) can be defined by the ratio of financial potential of the region to its expenses (budgetary and extrabudgetary) and it’s achieved when this ratio will be more than 1.

3. Gross regional product (GRP) is an index which characterizes the financial potential of regions (it’s the main generalizing index that characterizes socio-economic situation of the region, despite the methodological problems of its assessment).

4. The level of the shadow economy in Ukraine fluctuates from 30 to 50% by different estimates of experts [13, p. 114]. Therefore, there are some considerable errors in the results of assessment of territorial financial potential, excluding influence of the shadow economy. It is really important for assessment of valid disproportions in the territorial development of the country.

5. Self-development of the territory is impossible without growth of its financial potential. To calculate the territory’s financial potential, solve for the tactical and strategic tasks of territorial development as a function of its growth coefficient.

\[ k_p = \frac{\text{GRP}_n - k_n}{\text{GRP}_n - k_0}, \]

where \(\text{GRP}_n\) is the average value of GDP per capita of the midlevel income countries; \(\text{GDP}_0\) is value of GDP per capita in Ukraine (Ukraine is on the 122nd place with value of $3007 per 1 capita and refers to the group of countries with the average level of this index,
According to the rating of the countries of the world on GDP index. This rating is made by the World Bank Countries from this group but higher than Ukraine on a rating have the maximum value of GDP per capita nearly 12000 US dollars with an average value of 6320 US dollars [14]:

- coefficient of shadow economy of the middle level income countries;
- coefficient of shadow economy in Ukraine (we take the value of shadow economy level in Ukraine as 55% and for middle-income countries it is 40%, what is based on summarized information [15].

- growth coefficient of financial potential for the solution of strategic tasks ($k_s$) is calculated by the formula:

$$k_s = \frac{GDP_s}{GDP_s - k_s},$$

where $GDP_s$ is the average value of GDP per capita of the high level income countries (average value of GDP per capita is 38108 US dollars in the countries with high level of development [16]);

- coefficient of shadow economy of the high level income countries (the average value of shadow economy coefficient for countries with high level of the income was defined as 20% [15, 16]).

Usage of the calculated values of coefficients is provided in the Table, they give the following results of reference points of future development (2010 year is considered as a base of calculations).

Table show that nearly half of the region's general amount on the absolute index of financial potential does not exceed even 50% of its mean value throughout Ukraine. Such prerequisites complicate the achievement of acceptable results, obviously, in the short term.

6. Financial potential (calculated by means of growth coefficients and coefficients of shadow economy) can be the objective base for an assessment of budgetary receipts and receipts. From here, in the calculation of the interbudgetary transfers' volume, instead of the estimated volume of the incomes (revenue basket), which are fixed in compliance with local budgets, we suggest to use the volume of territory's financial potential (TFP), that's corrected on the level of efficiency of its use. The basic formula for calculating aligning grant volumes is:

$$T_i = a_i(V_i - FP_i * K_{obj}/100\%),$$

where $T_i$ is grant-in-aid volume from the state budget, that is provided by specific $i$-th territory or resources, transferred from such territories' budgets in the state budget; $V_i$ – calculated index of consumable volume of $i$-th territory; $K_{obj}$ is level of using financial potential, which defines financial independence of the territory; $FP_i$ is the financial potential of the $i$-th territory; $a_i$ is coefficient of aligning of appropriate $i$-th territory.

5. Conclusions. Important financial characteristics of the territories is their financial independence, which includes the right to have sufficient resources and also the responsibility of local governments in formation and use territorial resources. The base of territorial financial independence is its financial potential, which represents the maximum volume of financial resources in the quantitatively expressive. The territory can generate this volume for a certain period of time. Proceeding from it, we suggest to use financial potential for determination of interbudgetary transfers' amount. It will allow carrying out a real assessment of profitable volumes and compensation volumes of the local budget, for which the territories can claim, and also avoid a manipulation problem with budgetary funds. It's offered to take into consideration financial flows, which are generated in economic shadow sector, for determination of financial potential of the territory. Financial independence of the territories leads to self-development and self-development is impossible without growth of financial potential. The offered approach, of calculation of financial potential's growth coefficients for the solution of tactical and strategic tasks, can be used for determination of territories' finan-

Table: Ukrainian regions’ financial potential indices in absolute values for tactical and strategic development, million UAH

<table>
<thead>
<tr>
<th>Area, region</th>
<th>Excluding shadow economy</th>
<th>Taking into account shadow economy</th>
<th>Financial potential of development</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ar of Crimea</td>
<td>196658.2</td>
<td>437018.2</td>
<td>690488.8</td>
</tr>
<tr>
<td>Vinnytsia</td>
<td>116443.2</td>
<td>258762.7</td>
<td>408845.0</td>
</tr>
<tr>
<td>Volyn</td>
<td>73401.7</td>
<td>163114.8</td>
<td>257721.5</td>
</tr>
<tr>
<td>Dnepropetrovsk</td>
<td>583016.7</td>
<td>1295952.6</td>
<td>4040736.7</td>
</tr>
<tr>
<td>Donetsk</td>
<td>626999.6</td>
<td>1473323.3</td>
<td>4327865.4</td>
</tr>
<tr>
<td>Zhytomyr</td>
<td>87274.1</td>
<td>199942.4</td>
<td>306429.0</td>
</tr>
<tr>
<td>Zahkarpatia</td>
<td>73591.4</td>
<td>167363.5</td>
<td>264707.6</td>
</tr>
<tr>
<td>Zaporizhzhia</td>
<td>216002.3</td>
<td>480005.0</td>
<td>758407.9</td>
</tr>
<tr>
<td>Ivanovo-Frankivsk</td>
<td>100550.0</td>
<td>223444.5</td>
<td>353042.3</td>
</tr>
<tr>
<td>Kyiv</td>
<td>1172118.5</td>
<td>2604707.8</td>
<td>4101543.4</td>
</tr>
<tr>
<td>Kirovograd</td>
<td>45785.4</td>
<td>165279.8</td>
<td>261853.0</td>
</tr>
<tr>
<td>Lugansk</td>
<td>241443.6</td>
<td>536541.4</td>
<td>847735.4</td>
</tr>
<tr>
<td>Lviv</td>
<td>209017.4</td>
<td>466813.4</td>
<td>733883.3</td>
</tr>
<tr>
<td>Mykolayiv</td>
<td>114172.8</td>
<td>253717.4</td>
<td>400873.5</td>
</tr>
<tr>
<td>Odessa</td>
<td>246413.8</td>
<td>547586.2</td>
<td>865186.2</td>
</tr>
<tr>
<td>Poltava</td>
<td>179723.1</td>
<td>399384.6</td>
<td>631027.7</td>
</tr>
<tr>
<td>Rivne</td>
<td>82369.3</td>
<td>183040.0</td>
<td>2892096.0</td>
</tr>
<tr>
<td>Sunny</td>
<td>95116.3</td>
<td>211369.4</td>
<td>633963.7</td>
</tr>
<tr>
<td>Ternopil</td>
<td>65396.2</td>
<td>145324.9</td>
<td>22613.3</td>
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<tr>
<td>Kharkiv</td>
<td>270668.0</td>
<td>601448.4</td>
<td>950345.3</td>
</tr>
<tr>
<td>Kherson</td>
<td>82473.5</td>
<td>183274.5</td>
<td>289573.7</td>
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<tr>
<td>Khmelnytsky</td>
<td>91223.6</td>
<td>202719.1</td>
<td>302926.9</td>
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<tr>
<td>Chernivs</td>
<td>54547.6</td>
<td>121217.0</td>
<td>191522.8</td>
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<tr>
<td>Chernihiv</td>
<td>80335.9</td>
<td>178524.3</td>
<td>280608.4</td>
</tr>
<tr>
<td>In all</td>
<td>528175.3</td>
<td>1175372.3</td>
<td>18570882.3</td>
</tr>
<tr>
<td>Average value</td>
<td>211567.0</td>
<td>470148.9</td>
<td>742635.3</td>
</tr>
</tbody>
</table>

1 The main task for Ukraine is achievement, at least, the average value of GDP per capita in the countries' group where it consists. This tactical task and estimated value growth coefficient of the financial potential ($K_{obj}$) makes 58. The following tactical task is achievement of high rates of the development that is typical for groups of the countries in which Ukraine enters. Estimated value of growth coefficient ($k_t$) is defined at the level of 2.99.

The purpose of the strategic development will be achieved if the index of the financial potential will be increased by a factor of strategic development ($k_s$), the estimated value of which is equal to 7.13 [17].

Source: Calculated by authors proceeding from [15, 16, 17]
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