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MULTI-YEAR INVESTMENT PLANNING IN THE CITY OF LUTSK, UKRAINE

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PURPOSE OF THIS REPORT

1. This document constitutes a report of work conducted for development of a Multi-Year Financial Plan (MIP) for the City of Lutsk, Ukraine. It presents the entire range of elements implemented as well as a background to the project. This report is divided into the following sections:

- Background on Ukrainian Local Governments
- Characteristics of the City of Lutsk
- MIP for the City of Lutsk
- Recommendations

BACKGROUND ON UKRAINIAN LOCAL GOVERNMENTS

2. In order to understand fully the challenges facing the City of Lutsk in its efforts to improve capital investment planning, it is important to review essential issues affecting the ability of Ukrainian local governments to plan and implement infrastructure investments. A local government seeking to develop a Multi-Year Financial Plan is best equipped to achieve success when it is able to:

- Plan its budget and anticipate execution of the budget at or close to its plan
- This requires that the local government have stable revenues sources, especially own revenues. The local government must be able to plan these revenues over a longer time horizon; it cannot do this if its revenue sources are unstable, constantly changing and subject to discretionary decision-making or rent-seeking behaviour at higher levels.
- Understand its mandate and how to meet it
- Once the central government has delegated responsibility to local governments, this set of responsibilities should be stable and access to funding should be provided. Unfunded mandates will hamper the local governments’ ability to engage in capital investment.
- Maintain a bank account and borrow long-term at commercial or preferential rates
- Having established its revenue sources and current expenditures, a local government will need to spend on provision and improvement of services entrusted to it, which may entail capital investment. A local government may need to finance this investment by borrowing in the form of a loan or other financial instrument; this borrowing is financed from local government revenues or, even better, from service charges to customers. The access to debt financing, however, must be tempered with mechanisms for the maintenance of fiscal discipline.
- Understand the needs of its constituents
- Finally, in order to forge a successful Multi-Year Financial Plan, a local government must understand the needs of its constituents in order to design optimally services it provides.

3. In this section, the authors review the potential for Ukrainian local governments to finance investment projects from their own sources, through interbudgetary transfers and through borrowing. This potential is important since it impacts local governments' ability to meet mandates delegated to them, as this often requires capital investment. Clearly, the subsidiarity principle should prevail, decisions and investments should be made at the lowest practical level while maintaining a clear focus on accurately targeting expenditures to meet local needs and on providing municipal services as effectively and efficiently as possible. Investment decisions pertaining to local government mandates should be made at the local level and financed to the greatest extent possible at the local level through local budget revenues.

4. This section concludes that Ukraine will face serious challenges with any attempt to introduce investment decision-making at the local level. This is due to several factors that existed in the past or still exist today:

- The budgetary process was completely void of transparent mechanisms; rules for the distribution of budget resources were arbitrary and decisions were made on an *ad hoc* basis. This resulted in wide variations throughout Ukraine in per capita expenditures on social services such as education and medical care.
- The policy framework for fiscal transfers has not provided local governments with a clear structure for planning budget revenues and expenditures; further, it has not provided strong incentives to increase revenues and cut costs. In the past, transfers were made *ad hoc* and based on negotiations.
- It is unclear whether and to what extent reforms, such as the new Budget Code will introduce true fiscal decentralisation and revenue equalisation based on objective considerations.
- The policy framework for borrowing has not encouraged local governments to increase revenues or to try to pay debt.
- The credit market remains underdeveloped, especially with respect to lending to local governments.
- Many types of local governments are not permitted to borrow, neither to finance deficits nor to conduct investments.
- Local governments are inexperienced with borrowing from lending institutions or engaging other financing instruments.

5. The purpose of this section, therefore, is to provide a background on the challenges facing the City of Lutsk on these issues. To demonstrate these issues in the Ukrainian context, this section will first briefly review the structure of Ukrainian local governments. Next, subsequent subsections will treat local government reform and intergovernmental fiscal relations, focusing on revenue equalisation. Third, this section of the report will review the ability of local governments to borrow to meet current and long-term needs. Finally, this section discusses investment needs of local governments based on a study of investments needed in the water and wastewater sector.

6. Clearly, Ukraine requires not only a strong top-down legal and policy framework in support of improved fiscal and political relations between government levels, but also bottom-up instruments capable of putting these principles into practice. One such instrument is multi-year investment planning; the authors advance arguments in favour of this planning tool in later sections of this report based on implementation of a Multi-Year Financial Plan in the City of Lutsk.

7. Given that local governments need to meet current operating expenses and to undertake key investments, it is important to understand the potential and capacity for local governments in Ukraine to address these issues. To this end, this section of the report reviews two key factors impacting the ability of local governments not only to meet responsibilities delegated or entrusted to them, but also to undertake key capital investments required to meet responsibilities. The first issue is fiscal and political decentralisation, which includes predictability of local government budgets through

transparent revenue equalisation rules and clear division of responsibilities among tiers of governments. When local governments are faced with expenditures in excess of planned or actual revenues, it may be necessary, insofar as the law allows, to finance deficits through loans or other financial instruments. The second issue therefore deals with local government borrowing and fiscal discipline in Ukraine

Ukrainian local governments: structure

8. Local government autonomy, organisation and activities of their bodies and officials are based on the Constitution of Ukraine and regulated by the Law on Local Self-Government in Ukraine. Article 133 of the Constitution sets out the administrative and territorial structure to include cities, city districts, settlements and villages. Below the national level, the main levels of Ukraine's local government structure are as follows:

- At the oblast level, representative bodies are organised as oblast councils. The councils elect their chairmen. State executive power is vested in oblast state administrations, which work in close co-operation with executive bodies of oblast and city councils.
- At the rayon level, rayon councils and councils from important oblast cities serve as representative bodies. Councils elect chairmen of rayon councils and city mayors, who supervise executive council staff. State executive power is vested in the rayon or city administration, which works in close co-operation with rayon council executive bodies.
- At the lowest municipal level, local councils and their executive bodies represent municipalities. Council leaders also serve as leaders of their respective executive body.

9. The law on local governments recognises the territorial community of a village, town and city as the primary entity of local self-government with the related functions and powers (Article 6(1)). Although locally elected self-government can be executed directly by the respective territorial communities, as a rule it is conducted through village, settlement, and city councils, including their executive bodies, as well as through rayon and oblast councils, representing the common interests of territorial communities of villages, settlements, and cities (Article 2(2)). Local budgets are recognised as independent, *i.e.*, not included in the State Budget of Ukraine (Article 16(6)). Village, town and city councils, through their executive bodies, are given the right to manage the funds of the relevant local budgets by themselves and to determine their expenditures.[1]

10. For local self-government purposes, Ukraine is divided into the following 27 administrative units:

- Twenty-four regionally based oblasts;
- The Autonomous Republic of Crimea (ARC);
- The City of Kiev; and
- The City of Sevastopol.

11. At the local level, the oblasts and Autonomous Republic of Crimea are divided into 490 rural Rayons to extend local self-governance to smaller areas. Oblasts and rayons, however, are not true local governments in the sense that they are popularly elected and accountable to citizens in the whole Ukraine. There are 451 urban rayons within cities and 175 large cities and towns. At the community level, there are 893 urban settlements and 28,651 rural councils, or villages (Association of Ukrainian Cities, 2001 data). Especially significant is the dramatic increase in rural councils, the number of which has essentially tripled since 1990 and doubled from 2000 to 2001. These new local

[1] DeAngelis, Michael A., Eugene Korniychuk With Yaroslav Gregirchak, "Legal and Regulatory Framework for Sub-national Borrowing," Ukrainian Municipal Development Loan Fund Project implemented by the Urban Institute.

governments are ill equipped to provide public services given their limited experience in public finance management.

12. The Constitution of Ukraine differentiates oblast and rayon level of power from other kinds of the local self-governments. Rayon and oblast councils are bodies of local self-government that represent the common interests of territorial communities of villages, settlements and cities (Article 140). The chairman of a rayon council and the chairman of an oblast council are elected by their respective council and manage the executive staff of the council (Article 141). Oblast and rayon councils approve programmes for socio-economic and cultural development of the respective oblasts and rayons, and control their implementation; approve rayon and oblast budgets formed from state budget funds for 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 (Article 143).

13. Villages, settlements and cities have the right to manage property in their communal jurisdiction, approve and implement socio-economic and cultural development programmes, approve budgets of their respective administrative and territorial units and oversee their continued implementation, establish and level local taxes in accordance with the law and to resolve other issues of local importance within their capacity as provided under law.

14. The division of functions between local government tiers has been neither clear nor stable. Decentralisation has been hampered by the fact that only towns, villages and cities of oblast significance have self-government status and their own executive (administrative) bodies. Through 2001 their autonomy was also limited by the fact that their financial departments were vertically subordinated to the Ministry of Finance and were in practice responsible to a higher-level state administration rather than to the local mayor or elected council. Elected councils at oblast and rayon level have limited powers while their executives (administration) are effectively a representative of the state with vertical rather than local accountability. Apart from the largest cities (of oblast significance), the real scope of functions provided by self-government in Ukraine is extremely limited, while the majority of basic services are delivered by rayon state administrations. Even where functions have been formally delegated to local self-government, local authorities have remained highly dependent on the discretion of regional and central government.[2]

15. Recently, the Verkhovna Rada (Ukrainian Parliament) registered a new draft law “on Conducting Experiments to Develop Local Self-Government” submitted by the Cabinet of Ministers. The draft law is designed to facilitate creation of new organisational forms of local self-government and stimulate unification of territorial communities and their councils. The document suggests that any experiments aimed at unification of territorial units or at delegating significant powers down to the local level would require approval in a local referendum.[3]

[2] Swianiewicz, Pawel, from Final Report on Territorial Adminstrative Reform Component, LARGIS Project.
[3] Financial Analysis Office website, www.fao.kiev.ua news of January 3, 2003.

Table 1 Key laws impacting intergovernmental relations

Title	Date of enactment	Function
Constitution	1996	Defines the basic functions of local self-government, the central government, its executive bodies and their responsibilities.
Law of Local Self-government	1997	Provides the basis for functioning of local government finance.
Law on Local State Administrations	1999	Outlines duties of central government bodies at oblast and rayon levels.
Budget Code of Ukraine	2001	Regulates relationships in the process of preparation, consideration, approval, and execution of budgets and reviewing reports on budget execution, as well as controlling the execution of the State Budget of Ukraine and local budgets.
State Budget Law	annual	Defines intergovernmental transfers; the State Budget Law of 2001 refined the division of responsibilities between the central and local governments.

Ukrainian local self-governance

16. Local self-governance in Ukraine has suffered from several shortcomings, reflected in official laws. Foremost perhaps among these was the Budget Law of 1996 (no longer in force). It fostered a system with a high degree of nontransparent and discretionary decision-making, marked instability of both expenditure and revenue assignments for local governments and disincentives for local governments to raise additional revenue and spend more effectively. Further, the old budget law did not provide for government borrowing on domestic and international capital markets, nor did it delineate the division of fiscal authority between the central and local governments. The budget law, Constitution and Law on Self-Governments contained contradictions that made local governance difficult.

17. In essence, local self-governance has suffered from at least four basis shortcomings:[4]

- High fiscal uncertainty and frequent change.
- Unclear division of responsibility among tiers of local government.

[4] Adapted from "Fiscal Equalization", Local Government and Public Service Reform Initiative Fellowship Series, 2003, [Forthcoming].

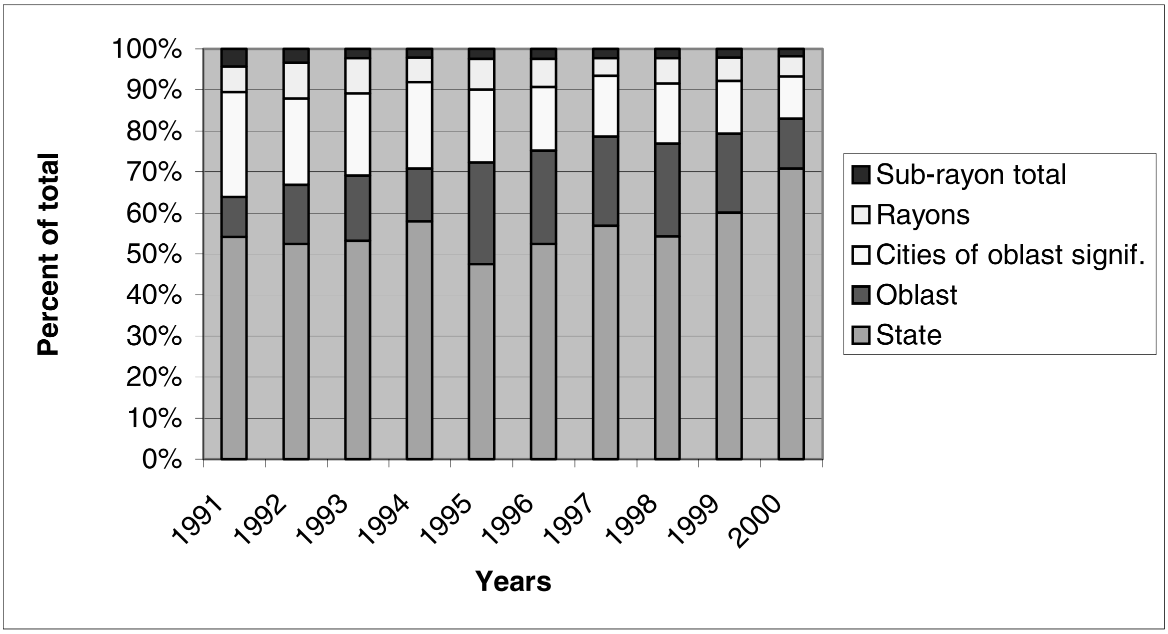
- Informal negotiations involving budgets and intergovernmental transfers.
- Disincentives to save and increase revenues and incentives to distort expenditure needs.

18. A Soviet-style budgetary process has hampered local government development; relationships among governments at different levels were developed on the principle of lower level budgets being dependent on the budget of an upper level (the traditional "*matrioshka*" budgetary model). First, the Ministry of Finance prepared a consolidated budget for the country that divided budgetary resources between the state budget and budgets for all oblasts. Oblast budgets, in turn, were primarily financed by an arbitrary combination of shared taxes (the sharing rates for some taxes such as the personal income tax gradually reached 100%) and subventions from the state budget. Levels for both subventions and contributions were decided as a by-product of political bargaining between the oblasts and the Ministry of Finance. Oblasts submitted their expenditure requests, or needs, using a calculation of what it would cost to finance the existing public sector infrastructure within an oblast and substantiating their needs for benefits that must be granted to legislatively identified categories of population. With the contraction of the Ukrainian economy after independence and the accompanying decline in the economy's revenue base, a gap widened between what the oblasts needed or wanted and what the economy could afford. Bargaining between the oblast and the Ministry became the means of reconciling the difference between the resources demanded and the amount available. Negotiated subventions and contributions became the instrument for filling in any gap between oblast expenditure and revenue. In a highly non-transparent fashion, the most important fiscal decisions affecting local governments, those concerning total expenditure, revenue and subvention levels were made at the pinnacle of the intergovernmental hierarchy.[5]

19. Once the level of oblast revenues was determined, the oblasts in turn would have to allocate their available funds for their own needs and to subordinate cities and rayons. The incentive for oblasts was to divide tax shares in order to finance their own budget needs at the cost of revenue rich cities. Rayons, next in the hierarchy, balanced their budgets and those of their constituent towns, villages, and settlements using a similar combination of shared taxes and transfers. This "trickle-down" budgeting system was open to political and economic games. Further, the fact that one of the main sources of money coming into local economies was local government transfers, the system invited interventions and politics from essential private sector interests seeking a piece of the public pie (Figure 1). Since 2001 oblast governments have been formally displaced from the direct redistribution of public resources. Instead, rayon governments have started to play a decisive role in redistribution of central budget resources on the local level. This role increases political pressure given that a significant amount of public money is at stake.

[5] From Financial Analysis Office, "A Guide to the New Budget Code"2001, p. 2.

Figure 1 Distribution of revenues between local governments (excluding pension fund and direct transfers), in percent.



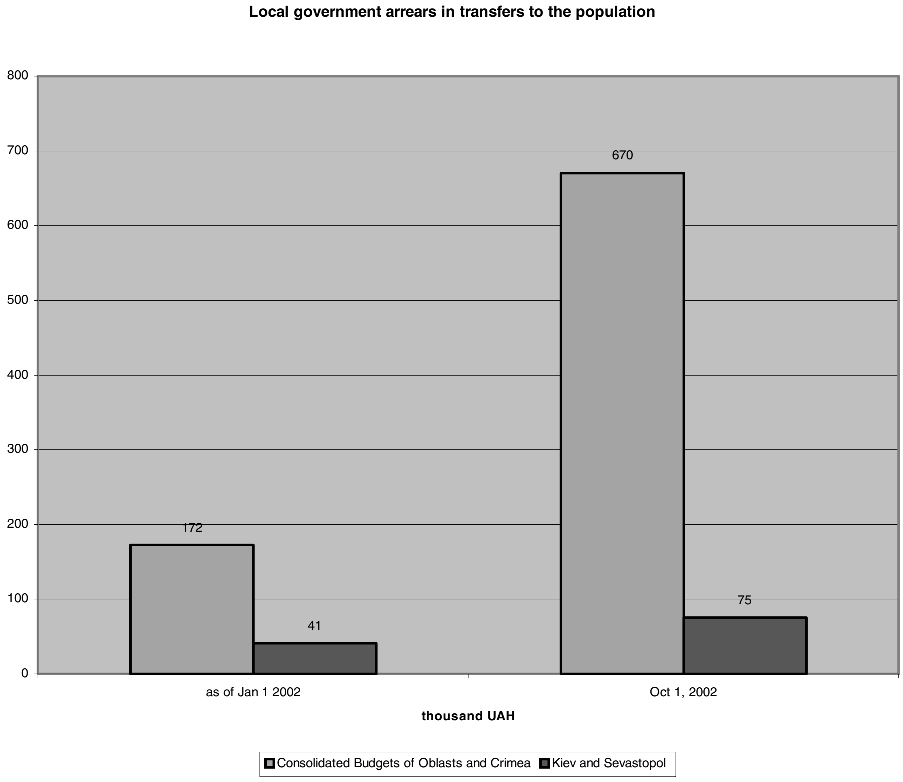
20. Uncertainty in the budget process was further compounded due to the fact that almost every year since independence entailed a different pattern of tax sharing and transfer payment arrangements. For example, until 1997 the value-added tax (VAT) was shared in varying proportions between the state and local budgets. Variable tax sharing also characterised the income taxes paid by individuals and businesses. In 1997 and 1998 proceeds from the personal income and enterprise profits taxes were assigned exclusively to local budgets. In 1999, however, these income tax sources were once again shared between the state and oblast budgets. For the year 2000, the personal income tax was assigned entirely to local budgets and the enterprise profits tax became an exclusively state revenue source.[6]

21. Responsibility for public tasks has also suffered from abstruse division of mandates. For instance, since independence the state has steadily shifted most elements of social protection spending to local governments in the form of an unfunded expenditure mandate. The argument for making social protection a local government responsibility is spurious, especially when the scale of benefits and eligibility for them is decided at the state level. Expenditures on social protection also fluctuate over time and local governments lack the revenue flexibility adequately to respond to these variations. The fiscal instability associated with unstable revenue patterns and unclear expenditure responsibility has adversely affected the ability of local governments to plan and execute their budgets routinely and effectively. One indicator of this unfavourable effect is the fact that the bulk of public sector expenditure arrears are found at the local level. Not surprisingly, local government expenditure arrears are particularly prominent in the area of social protection.[7]

[6] *Ibid.*, p. 3.

[7] *Ibid.*.

Figure 2 Local government arrears in transfers to the population



A measure of potential unfunded mandates is evident in the table below.

Table 2 Ratio of local budget in revenues and expenditures of the national budget of Ukraine (excluding pension fund)

Year	Ratio in Revenues	Ratio in Expenditures
1992	47.4	37.8
1993	47.8	39.4
1994	42.0	35.3
1995	52.4	47.3
1996	47.6	43.6
1997	43.2	39.1
1998	45.9	47.7
1999	39.5	45.0

Source: Ministry of Finance of Ukraine, Fiscal Analysis Office of the Budget Committee of the Parliament of Ukraine, cited in Chemerys, Anatoliy, et. al., ,"The Ukrainian Social Protection System and the Methods of Governance," Chapter 4 in Tausz, Katalin (ed.), Impact of Decentralisation on Social Policy 2002, LGI Books, 2002, p. 244.

22. Clearly, the trickle-down budget system creates incentives for local governments to overstate their budgetary needs, to avoid budget savings and to ignore efforts at increasing revenue bases. Indeed, the object of the intergovernmental transfer game was to extract as large a transfer as possible without giving anything away. Budget savings and an increase in revenues would be rewarded through a raid on the local budget from a higher tier of government.

23. The system lends itself to intense rent-seeking behaviour from elements competing for access to public sources. Entrepreneurs hid their firm's activities in order to escape regulation and reduce bribes they had to pay. As activities entered the informal economy, tax revenues decreased. As tax revenues declined, the government could not afford to provide basic services such as law and order. Consequently, incentives increased to stay underground. Tax pressure on payers increased, placing more pressure on legal activities. As fewer paid taxes, the tax burden on those who did became unbearable, inducing entrepreneurs to stay underground even at the cost of economic efficiency and more rapid growth. At the same time, senior officials and powerful private individuals lived well through corrupt deals and sharing rents. One report maintains that a rent-seeking equilibrium has been reached and that Ukraine has become trapped in an "under-reform" trap.[8] The intergovernmental budget system, therefore, plays into the hands of those who benefit from a rent-seeking environment. Indeed, the system lent itself to abuse from essentially private interests looking to obtain access to public sources and to buy power. Interest groups, involved in this process, use control over public service and decision-making process on the central as well as local level in order to secure their privileged positions. These groups have an interest in maintaining the status quo of non-transparency

[8] Aslund, Anders, Peter Boone and Simon Johnson, "Escaping the Under-Reform Trap", IMF Staff Papers, vo. 48, 2001.

in budget process or in constantly changing rules, as improvements and objective decision-making would preclude their intervention and access to the public purse.

24. Rent-seeking behaviour has had serious consequences for Ukraine. In Ukraine, the Gini coefficient (a measure of income inequality, ranging from 0 – if income is completely equal – to 1 – if almost all income is in the hands of a few individuals) increased by about 0.23 over the first eight years of transition (a doubling of income inequality – the highest increase in income inequality of any transition country). Significantly, research[9] points to a strong negative relationship between GDP growth and income inequality in early transition countries. Indeed, over the first eight years of transition, Poland had the lowest increase in income inequality and the highest growth rate; Ukraine had the lowest growth rate and highest increase in income inequality among transition countries. In effect, the intergovernmental transfer system and its incentives for rent-seeking behaviour have contributed to Ukraine's poor economic performance.

Local government revenues and expenditures

25. One of the most important functions of local governments is to provide municipal services to its citizens. Central government responsibilities, in accordance with the subsidiarity principle, are entrusted to local governments in order that services are designed in a manner that better meets the needs of their citizens. Further, local governments are accountable to their citizens for spending budget funds entrusted as effectively as possible and to meet legitimate public needs.

26. In order to provide municipal services, local governments require revenues to fund the mandates entrusted to them. Therefore, local governments require stable sources of revenues that they can devote towards meeting their mandates. Generally, local governments have an operating budget to meet current expenses. If a local government is responsible for primary education, health care or municipal services such as water and sewer, an investment budget may also be required. In developing a Multi-Year Financial Plan, budget funds available for investment are defined as those funds remaining after accounting for operating expenditures and debt service.

27. Past policies in Ukraine, the distribution of revenues and expenditures responsibilities of the different tiers of government have changed many times during the period since Ukraine gained independence. There were no clear assignments of taxes between different tiers of government over this long period, which resulted in a decrease in the tax base and managerial capacity of the local governments.

28. Clear division of responsibilities is vital, as are resources to fund these mandates. Local governments, while more in tune with public needs, must receive or be able to generate adequate funding in order to maintain services and avoid deteriorating infrastructure.

Expenditures

29. Local government spending occurs on self-defined as well as delegated responsibilities. The central government defines delegated responsibilities and turns them over to local governments for execution. The central government should provide the required financial resources for performance of these expenditures.

[9] Keane, Michael, "Poland: Inequality, Transfers and Growth in Transition", Finance and Development, International Monetary Fund, March 2001.

30. Under the new Budget Code of Ukraine, different tiers of sub-national government have been assigned the following expenditure responsibilities:[10]

- Sub-national government spending is divided into three separate expenditure "baskets", one for oblasts, one for cities and rayons, and another smaller one for towns, villages and settlements.
- The expenditure content of each expenditure basket is different. Each basket is designed to have a comparative advantage over other baskets in carrying out the expenditure functions that have been assigned to it. The choice for the content of each basket is guided by the subsidiarity principle, or assigning a particular task to the type of government best capable of effectively carrying it out.
- Expenditures that potentially affect all residents of an oblast have been assigned to oblast budgets. Examples include specialised secondary educational institutions for disadvantaged students, secondary boarding schools, vocational and higher educational establishments, large general hospitals of oblast significance, specialised medical services, specialised social protection facilities for orphans, invalids, the elderly, hospices, and specialised sports programmes.
- Expenditures, the benefits of which do not ordinarily extend beyond the borders of the local area, have been assigned to city and rayon budgets. Examples include general secondary education, general health care services including health education programmes, and social protection programmes that provide physical services to the socially disadvantaged residing in a local area such as residential home care for the elderly.
- Expenditure tasks of purely local significance have been assigned to the budgets of towns, villages, and settlements, all of whom will be responsible for pre-school education, primary medical care offered through local clinics, first-aid and obstetric centres, and cultural and entertainment programmes. Larger towns with secondary schools and district hospitals will be responsible for the services provided by these facilities. Of course, cities will also undertake other responsibilities as described in the previous item.
- Kiev and Sevastopol will undertake all of the expenditure responsibilities that are assigned to oblasts, cities and rayons, and towns, villages and settlements taking into account other laws of Ukraine that define the special status of these territorial administrative units.
- For social protection programmes of a cash nature and a national scale of benefits, cities and rayons will provide the mandatory benefits but will be compensated for their budgetary expenses by targeted subventions from the state budget. Aid to families with young children, subsidies for communal services and benefits to war and labour veterans are examples of the targeted transfer that will be provided to local budgets from the state budget.
- All aforementioned expenditure tasks are transfer-related expenditure tasks whose funding is calculated on the basis of financial norms of budget sufficiency. In other words, the state plays an important role in defining those resources that are designated to fund these functions since the state is interested in providing these services at comparable levels in terms of volume and quality across administrative-territorial units. The state has the authority to regulate budgetary performance in these areas as well as the responsibility to ensure that they are adequately funded through a combination of assigned tax revenues and either conditional (targeted) or unconditional (non-targeted) transfers.
- Those expenditure tasks left to the discretion of local governments, and hence not taken into account in defining the amounts of transfers, involve public services that are of a housekeeping nature, such as water and sewerage supply, roads and refuse removal and the general maintenance of local public sector infrastructure [our emphasis].
- From the perspective of the budgetary process, at the stage of preparing their budgets local governments must strive to finance their total expenditures from their own source revenues,

[10] From Financial Analysis Office, "A Guide to the New Budget Code," 2001, p. 13-14.

transfers and the basket of revenues designated to fund transfer related expenditure assignments. At the stage of budget execution, however, all hryvnia flow into a common revenue pool and can be used to finance any type of expenditure.

- Within the limits of available budget resources, adjusted per capita expenditure norms will be established for each type of delegated expenditure responsibility and guaranteed by the state.
- Expenditure norms will be adjusted for geographic differences in the cost of providing social services as well as regional and local variations in socio-economic conditions, climatic, environmental and other natural factors.

31. The authors have emphasised the above provision in order to highlight the ability of local governments to finance investments in the provision of public services (and hence of direct concern to the development of a Multi-Year Financial Plan). Article 30 of the Law of Ukraine on Local Self-Government of 1997 (Powers in the Area of Housing Utility Services, Consumer and Trade Services, Public Catering Services, Transportation and Communications) sets out the competence of executive bodies of village, settlement, and city councils, dividing them into exclusive (self-governing) and delegated powers. Among the self-governing powers is to:

> "…resolve issues of water supply, drainage and purification of the sewage system; and to exercise control over the quality of drinking water; to resolve issues of collection, transportation, utilization of domestic waste and rendering it harmless."

32. Delegated powers include to:

> "fulfil measures of expansion and improvement of … public utility services …"

33. At their plenary sessions, rayon and oblast councils establish, *inter alia*, regulations on the use of water supply structures (Article 43, par. 23).

34. Expenditures of local budgets include budget appropriations defined by a local budget decision for concrete purposes related to the implementation of programmes, listed in Articles 88-91 of the Budget Code.

35. Capital expenditures of local budgets include (Article 71 of the Budget Code):

1) Repayment of the principal of debts of the Autonomous Republic of Crimea and local self-government (except for the debt arising as provided under Article 73 of this Code); and
2) capital investment; and
3) contributions of bodies of power of the Autonomous Republic of Crimea and local self-government authorities related to their stakes in statutory funds of business entities.

36. Further, the capital budget of a local budget is a constituent of the special fund of the local budget.

37. According to the Law on Local Self-government, local government budgets are to be divided into own and delegated expenditure functions and be financed from separate revenue sources. For both own and delegated expenditure categories, expenditures are to be further subdivided into capital and operating expenses. The Law also endorses the elaboration of expenditure norms to determine minimum amounts of local government expenditure in different functional areas and requires that funding at these levels of expenditure be guaranteed by the state.

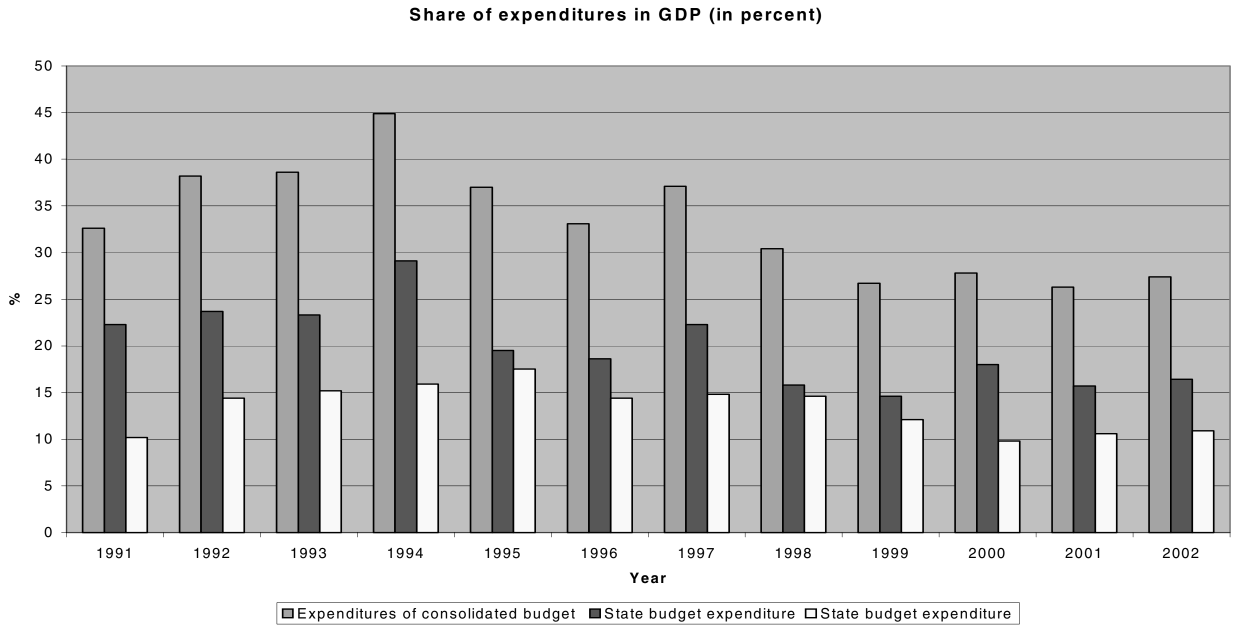
38. The contribution of local government expenditures in total GDP has fallen in recent years (table and accompanying figure).

Table 3 Share of expenditures of sub-national government (SNG) budgets in GDP (in percent, excluding transfer and pension fund expenditure)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Expenditures of consolidated budget	32.6	38.2	38.6	44.9	37.0	33.1	37.1	30.4	26.7	27.8	26.3	27.4
State budget expenditure	22.3	23.7	23.3	29.1	19.5	18.6	22.3	15.8	14.6	18.0	15.7	16.4
SNG total	10.2	14.4	15.2	15.9	17.5	14.4	14.8	14.6	12.1	9.8	10.6	10.9
Oblast expenditure	2.6	4.3	3.6	3.6	6.4	5.1	4.4	5.2	4.5	3.3		
SNG sub-oblast total	7.6	10.0	11.6	12.3	11.1	9.3	10.4	9.48	7.66	6.53		
Expenditure of cities of oblast significance	4.11	5.90	7.28	7.99	6.30	5.23	5.87	5.21	3.93	3.3		
Rayons expenditure	2.42	2.92	2.90	2.82	3.40	2.89	3.34	3.32	2.87	2.43		
Sub-rayon expenditure total	1.06	1.21	1.42	1.45	1.44	1.21	1.18	0.95	0.86	0.77		
Expenditure of cities of rayon significance	0.22	0.28	0.34	0.34	0.34	0.33	0.30	0.25	0.21	0.19		
Settlements expenditure	0.24	0.28	0.34	0.34	0.31	0.26	0.26	0.22	0.19	0.17		
Rural councils expenditures	0.60	0.66	0.74	0.77	0.78	0.62	0.62	0.48	0.45	0.41		

Source: Slukhai S. "Formation of intergovernmental relations in Ukraine: Does Decentralisation Occur?" Proceedings of the Conference for Ukrainian alumni of U.S. academic exchange programmes "Ukraine in the Modern World" (Yalta, Sept.12-15, 2002), Kyiv: Stylos, 2002: 31-42.

Figure 3 Share of expenditures in percent of GDP



Revenues

39. The Constitution (Article 142) defines the materials and financial basis for local self-government as movable and immovable property, local budget revenues, land, ownership of natural resources within jurisdictions and other funds. The Constitution also establishes that the state provides funds for and participates in the formation of local self-government budgets. Again, the state should compensate local governments for tasks the state requires of them.

40. Ukrainian local government budget revenues can be divided into four groups:

1) Own revenues. These revenues are collected in each local jurisdiction and assigned to the respective local government; they are composed of local taxes and duties, user charges, revenue from municipal property, etc. The government has frequently changed the list of such taxes.

2) Fixed revenues. The state levies and administers taxes and duties, which are transferred to local budgets.

3) Regulated revenues. These are revenues transferred to local budgets for financial equalisation. These revenues come from shares in state taxes such as VAT, PIT, PIT and excise tax. The amounts from own and national taxes, assigned to the local governments long-term are small.

4) Intergovernmental transfers. The main sources of local government revenues are subventions and transfers from the central budget.

41. A significant challenge in Ukraine has been to strengthen local financial bases through the introduction of local tax levies. Observers[11] have pointed out many deficiencies that existed prior to 2001 in the revenue side of intergovernmental fiscal relations, including:

- No incentives to collect taxes at the local level. Local authorities that collected greater taxes were penalised by having a large share withdrawn to the central budget.
- No objective criteria for revenue distribution and for establishing tax sharing ratios.
- Irrational system of revenue mobilisation. Lower level budgets (villages, towns and cities), although ostensibly the backbone of the budgetary system (as per the Constitution), received low levels of revenues. For instance in 1999, these local governments' revenues amount to less than 4% of GDP.
- No institutional or legal framework for forecasting revenue and medium-term planning. Revenue distribution changed dramatically each year.

42. Budget revenues must stabilise as essential prerequisite to the establishment of multi-year investment planning. Still, local revenue has decreased from year to year (Table 2), mainly because of annual debt write-offs. Large sums of money remain unpaid to the central as well as local government budgets due to tax privileges extended to various communal, state-owned and private enterprises. Some mechanisms used include: tax privileges, special economic zones, tax arrears - payments to the state not settled on the due date (enterprises trying to decrease their actual tax obligations and

[11] For example, Kononets, Alexey, "Reform of Intergovernmental Fiscal Relations in Ukraine: New Approaches and Emerging Problems," Local Government and Public Service Reform Initiative, p. 122.

alleviate the tax burden); writing off or restructuring tax arrears; tax evasion; hidden unemployment – low salaries and extended vacations. This manoeuvring has resulted in a loss of revenue for the central as well as local governments' budgets.[12]

Table 4 Share of the local governments in aggregate budgets of Ukraine 1996-2001 (percent)

	1996	1997	1998	1999	2000	2001
Revenues	36.2	43.2	45.7	40.0	29.1	25.1
Expenditures	34.4	39.9	48.1	45.4	35.3	33.9

Source: Agency for Humanitarian Studies, 2001. "Preservation Instead of Development", in: Budgetary politics, Kiev, June, cited in "Fiscal Equalization."

43. The share of local budgets in aggregated state budget revenues (tax and non-tax revenue, excluding transfers and revenues of state-owned enterprises) has decreased over the years to 25.1% in 2001. Over the same period – since independence – the share of transfers in local government income has doubled[13].

Table 5 Distribution of revenues between tiers of local governments of Ukraine (excluding revenues of pension fund and direct transfers), percent

Budgets	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
State	54.08	52.44	53.28	57.96	47.62	52.43	56.82	54.31	60.03	70.86	67.38
Oblast	9.81	14.33	15.85	12.84	24.78	22.74	21.73	22.62	19.35	12.16	
Cities of oblast significance	25.58	21.12	20.02	21.03	17.60	15.51	14.81	14.65	12.77	10.26	
Rayons	6.30	8.68	8.57	5.99	7.54	6.86	4.41	6.17	5.75	4.84	
Sub-rayon SNG total	4.24	3.44	2.28	2.19	2.46	2.47	2.22	2.24	2.11	1.88	

Source: Slukhai, *op.cit.*.

44. In Ukraine today, revenues of local budgets do not depend on taxes, collected by local governments in their jurisdictions, but rather on resources provided by the central budget. In 2001, as many as 11 oblasts of Ukraine received from the state budget 1.3-1.9 times more revenue than from their own taxes or other revenues.[14] Rayons, however, have received a significantly increasing share of local taxes.

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[12] "Fiscal Equalization".

[13] Agency for Humanitarian Studies, 2001. "Preservation Instead of Development", in: *Budgetary Politics*, Kyiv, June.

[14] Fomenko E. 2001. "Proposals of All-Ukrainian Association "Budget" Concerning Intergovernmental Fiscal Relations to be Included to the BC", in System of Public Finance in Ukraine: Ways toward Transparency and Optimal Fiscal Decentralization. Materials of Experts' Forum, Kyiv: East-West Institute, pp. 91-92.

Table 6 Share of local taxes and duties in local government revenues (excluding transfers from other level government budgets), percent

Year	Consolidated budget	Oblast budgets	Cities of oblast significance	Rayon budgets	Cities of rayon significance	Urban settlements	Rural settlements
1992	0.03	0.00	0.05	0.01	1.54	0.83	0.61
1993	0.13	0.00	0.27	0.03	0.34	0.10	0.63
1994	0.51	0.02	0.83	0.12	2.54	1.56	0.49
1995	1.46	0.35	2.96	0.35	8.86	6.94	1.90
1996	2.63	0.67	5.28	0.63	13.14	12.90	4.33
1997	2.94	0.78	5.42	1.24	15.38	14.38	5.21
1998	2.97	0.41	2.40	5.80	15.66	16.43	5.93
1999	3.36	0.29	3.16	6.66	14.59	16.41	6.88
2000	3.65	0.28	5.92	3.35	12.23	14.27	5.29

Source: Slukhai, op.cit.

Budget code

45. After introducing the State Budget Law of 2001, a new Budget Code was passed in 2001 in order to improve interbudgetary relations. The Budget Code proposed four important structural changes. These structural changes include a set of expenditure and revenue assignments among different types of government, a formula based transfer system connecting the state budget to all local governments, oblasts, cities, and rayons, and a targeted transfer programme for certain kinds of social protection. Specifically, these structural changes include:[15]

- **Different tiers of subnational government have distinct expenditure responsibilities.**

46. This division of responsibilities was intended to be consistent with the subsidiarity principle. For instance, expenditures on tasks potentially affecting all residents of an oblast have beenassigned to oblast budgets (specialised secondary education for disadvantaged students, secondary boarding schools, vocational and higher education establishments, large regional hospitals, specialised medical services, specialised social protection facilities for orphans, disabled, elderly, hospice patients and specialised sports programmes).

47. Those tasks not extending local boundaries are in the purview of city and rayon budgets (general secondary education, general health care services including health education programmes, and social protection programs that provide physical services to the socially disadvantaged residing in a local area, such as residential home care for the elderly). Purely local tasks are assigned to the budgets of towns, villages, and settlements (pre-school education, primary medical care offered through local clinics, first-aid and obstetric centres, and cultural and entertainment programmes. Not all types of

[15] Financial Analysis Office, "A Guide to the New Budget Code" 2001, pp. 12-20.

expenditures are used to determine intergovernmental transfers (for instance, provision of municipal services such as wastewater treatment and solid waste management).

- **State and local budgets will have distinct revenue sources.**

48. In order to finance expenditures, a basket of revenues is defined for the purpose of funding local budgets. This revenue includes receipts from personal income tax, stamp duties, licensing and business registration fees, as well as fines and penalties.

- **A formula-based transfer system will apply to all local governments.**

49. Since expenditure and revenue calculations will seldom be equal, transfers, both positive and negative, are needed to balance expenditure needs with revenues.

- **Conceptual foundations developed for equalisation transfer.**

50. The Budget Code stipulates that the formula conform to a set of principles on how to calculate equalisation transfers, such as that a transfer is equal to the difference between a local government's estimated per capita expenditure needs and its estimated per capita revenue capacity multiplied by the number of residents. Indices of relative fiscal capacity are developed and can be revised once every three years.

51. The Code sets out new principles for guiding the system of interbudget relations in Ukraine (Article 7):

- **Integrity.** Ukraine’s budget system is based on a unified legislative framework, monetary system, budgetary relationships, budgetary classification and procedures for budget execution.
- **Independence.** State and local budgets are independent from one another. In other words, local governments are not liable for budget commitments of other local governments or the state (and *vice versa*).
- **Subsidiarity.** Expenditure responsibilities are divided between the State budget and local budgets, as well as across local government budgets such that social services are provided at a level of government closest to the place of direct consumption of the service.
- **Equity and impartiality.** The budget system is based on the principle of equitable and impartial allocation of public wealth among citizens and communities.
- **Publicity and transparency.** The National Parliament and local councils, respectively, approve decisions on the execution of the State Budget and local budgets.

Major fiscal objectives that the Budget Code seeks to achieve.

- To obtain a clear separation of expenditure responsibilities, on the one hand, between State and local budgets and, on the other, among the three types of local budget with the aim of enhancing accountability for expenditure performance and thereby improving the effectiveness of expenditure policies. Exclusive expenditure assignments also facilitate the comparison of local budget expenditure needs for purposes of making formula based transfers.
- To provide greater stability and predictability to the annual revenue flow received by local budgets with the goal of improving budgetary planning and avoiding budgetary arrears.
- To impose a hard budget constraint on the total spending of local governments that safeguards the ability of the State government to maintain overall expenditure control while permitting local governments considerable discretion in choosing how to use the budgetary resources that are made available to them.
- To stimulate local governments to develop the economic potential of their territories and expand their tax bases without fear of losing a substantial portion of any additional revenues to the State budget.
- To offer local governments greater incentives to spend efficiently by allowing them to capture the full benefits of any cost-saving measures.
- To remove from local budgets the burden of financing social protection programmes that are mandated and controlled by the State government. The record of recent years reveals that budgetary arrears are highest in this area of expenditure and the regional pattern of payment is highly uneven across the regions, leaving citizens in some parts of the country with a highly inadequate social safety net.
- To introduce equalisation measures ensuring an equitable distribution of public services across all regions of the country such that all local governments will have approximately the same per capita revenue resources to deliver the public services for which they are responsible.
- To obtain simplicity and objectivity in the design of transfer payments with the goal of making them more transparent in their determination, relatively immune from manipulation by local governments and easier to administer.
- To develop improved institutional mechanisms that will produce complete and timely delivery of all transfer obligations.
- To impose strict limits on the amount of debt and borrowing State and local governments may incur.
- To introduce Treasury execution of local budgets in an effort to improve the effectiveness of local budget expenditures and control unauthorised spending.

From Financial Analysis Office, “A Guide to the New Budget Code” 2001.

52. The Budget Code divides sub-national governments into three “separate and independent local budgetary units”: oblasts, cities of oblast significance and rayons. It reflects the Ministry of Finance’s view that “having 279 budgets of cities, 793 budgets of villages and 10,256 budgets of settlements in Ukraine, it is not technically feasible to fiscally disaggregate rayon into their constituent towns, villages and settlements.”[16] As cited earlier, the number of rural councils increased to more than 28.5 thousand. For transfer purposes, villages and settlements are not viewed as local governments but as parts of a rayon. It may be wishful thinking to suppose that this viewpoint will ensure that local needs are met. On the other hand, the view does address an important issue, which is consolidation of smaller units into viable local self-governments.

[16] Cited in "Fiscal Equalization" [forthcoming].

53. Further, the Budget Code is intended to introduce a clear division of responsibilities and revenues among difference levels of government. These responsibilities are divided into the following categories:

- State responsibilities – executed and financed by the central government. They cannot be transferred to local governments.
- Delegated responsibilities – transferred to local governments in order to increase the efficiency of local functions.
- Own responsibilities – to fulfil the rights and obligations of local authorities.

54. This division is intended to allow local governments to be accountable to their constituents rather than to their superiors in the central government.[17]

55. On the revenue side, the Code provides that local governments may raise revenues for their own spending from assigned sources. These revenue sources constitute one “basket” of revenues; these are factored into interbudgetary transfer calculations (see box).

56. The other revenue basket – not taken into account in defining transfers – includes those revenues that local governments need to meet their mandates. This includes taxes and fees to local budgets, such as portions of land fees, tax on vehicle ownership, profit tax on local enterprises, craft tax, dividends from municipally-owned enterprises, fixed agricultural tax, rent payment for municipal property, fee for special utilisation of natural resources and others.[18] The idea behind this split was to assign the most predictable taxes to the local government and to prevent bargaining for items such as the corporate profit tax. By excluding these revenue sources from transfer calculations, local governments should be able to engage in strategic planning aimed at the strengthening of their tax bases. This is to be accomplished through the introduction of this steady revenue component.

57. Different levels of government receive different levels of taxes such as PIT and land tax. For example, the cities of Kiev and Sevastopol (as cities of state significance) receive 100% of PIT and land tax while cities of oblast significance receive 75% of PIT and land tax. These shares decrease as the size of the local government decreases.

58. Despite the solid theory behind the Budget Code, a key challenge will be to ensure that the gap between local government expenditure obligations and their revenue bases will be as small as possible. Otherwise, local governments will have to continue dependency on central budget transfers or cut their expenditures. This is the opposite of what the Budget Code was trying to accomplish.

[17] Kononets, p. 130.

[18] Article 69 of the Budget Code of Ukraine. These sources are: local taxes and fees payable to local self-governmental budgets;100% of the land tax – for budgets of Kiev and Sevastopol; 75% of the land tax – for budgets of cities of Republican (in the Autonomous Republic of Crimea) or oblast significance; 60% of the land tax – for budgets of towns, villages, settlements, and associations; portion of the transport vehicle owner tax payable to the relevant budget; proceeds from interest payable for use of temporary surplus budget resources; handicrafts tax payable to local self-governmental budgets; dividends on the stake (stock, share) of the relevant territorial community in statutory funds of business entities; portion of the levy for pollution of natural external environment payable to the relevant budget; proceeds from the sale of assets owned by territorial communities, including from sale of communally owned land plots used for non-agricultural purposes; portion of the fixed agricultural tax payable to local self-governmental budgets; rental payments payable for rent of communally owned property complexes; proceeds from local lotteries; fees for guarantees subject to conditions defined under Article 17; grants and gifts (in value); own revenues of budget entities maintained from the relevant budget; enterprise profit tax payable by communally owned enterprises; levies for special use of natural resources of local significance; and other receipts provided for under legislation.

Fiscal equalisation

59. A system of fiscal equalisation is introduced to support less developed areas in a given country. In such a system, financially weak areas receive transfers from wealthier areas and from the national government. In theory, this should yield a substantial redistribution of income in favour of the poorer oblasts. Transfers should cover the gap between the amount of local government expenditures needs to finance subordinated units and the amount of planned revenues. In the past in Ukraine, transfers were determined through negotiations. Now, the Budget Code governs the mechanisms of such transfers.

60. In order to address fiscal disparities, the Budget Code introduces fiscal equalisation methods designed to enable the decentralisation process (Articles 96-108). Equalisation transfers serve the dual purpose of providing sufficient revenues for local budgets to fulfil their transfer related expenditure obligations and equalising the revenue capacity of local budgets having different sized tax bases or revenue baskets. A key element of the new approach is that transfers are formula-based and take into account the difference between a local government's estimated transfer related expenditure needs and its estimated revenues. The Budget Code outlines a number of different transfer programmes that address a variety of local government fiscal needs apart from equalisation. In addition to equalisation transfers, the Budget Code envisions three other kinds of budgetary transfers.[19]

- Targeted subventions from the state budget to the cities' budgets of Kiev, Sevastopol, the Autonomous Republic of Crimea, to the budgets of oblasts, cities of oblast significance and rayons to pay for the state mandated social protection programmes.
- Targeted subventions from the state budget to the local governments' budgets of cities of Kiev, Sevastopol, the AR Crimea and oblasts for investment purposes. These subventions are to be redistributed to other local self-government bodies. The leading role of the oblast level in the investment-related development of the territories is supported by the assumption that investment projects as a rule have impacts on territories beyond the jurisdiction of a local government. To bolster the integrity of investment decisions, contribution is required from the recipient budget in order to give local governments a stake in the investment outcome.
- Transfers may also occur between local governments in exchange for contractually provided, and mutually agreed upon, public services provided by the transfer recipient. For example, towns, villages and settlements may contract among themselves or with another local government to provide services related to the fulfilment of their expenditure assignments. This may be necessitated by economic factors (economies of scale, more efficient provision of a service by some other local government etc). Funds from the State budget may also be transferred to local governments for the "subvention of investment projects" (Article 97, (1) 3).

61. The Budget Code stipulates that the equalisation formula conform to the following set of principles[20]:

- Equalisation transfers are to be based on a percentage of the difference between a local government's estimated per capita expenditure needs and its estimated per capita revenue capacity multiplied by the size of the population served by the local government.
- In the event a city or rayon enjoys estimated revenues surplus to its estimated expenditure needs, a negative transfer or contribution, calculated according to the same formula, is to be made to the state budget.

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[19] Financial Analysis Office, "A Guide to the New Budget Code" 2001, p. 16.

[20] *Ibid.*, p. 17.

- Estimates of revenue capacity reflect a local government's index of relative fiscal capacity, measured on a historical basis as the ratio of a local government's per capita revenue basket relative to the national average per capita revenue basket (whose revenues are taken into account in transfer calculations).
- Once calculated, indices of relative fiscal capacity cannot be revised more frequently than once every three years. From the point of view of authors of this approach, it would encourage local governments' revenue efforts. But in fact, till now budgets of the local governments are changed during financial year and the central government can do very little in controlling budget discipline.
- A transfer is equal to the difference between a local government's estimated per capita expenditure needs and its estimated per capita revenue capacity multiplied by the number of residents. To encourage local governments' revenue efforts, the central government in the Budget Code promises that it will not withdraw the so-called "surplus" which stems from the formula (where the need in expenditures is lower then the anticipated revenue).

62. These principles have been developed into a set of formulas contained in the Resolution of Cabinet of Ministers of Ukraine of 14 September 2002 on the formula for distribution of inter-governmental transfers (equalisation grants and transfers to the state budget) between the state budget and local budgets.

63. In order to support local governments' revenue efforts, the Budget Code provides that surpluses anticipated in revenues over expenditure needs would not be entirely absorbed by equalisation. Therefore, Article 98 of the Budget Code provides for the establishment of the "degree of equalisation". This coefficient cannot have a value of less than 0.6, meaning that a local government having a surplus would retain 40% of it. A coefficient of 1 would mean that the local government would have to pay the entire surplus to the state for the purposes of equalisation. A coefficient below unity, however, also means that transfers to recipient governments will be lower as well.

64. The formula-based transfer system is designed to meet several objectives of inter-governmental fiscal reform, including improved local budget preparation, greater transparency of budgetary decisions, the maintenance of local expenditure autonomy, an equitable geographic distribution of budgetary resources and proper incentives for local expenditure economy and revenue mobilisation.[21]

65. The new system of transfers should help in the better preparation of local budgets because it will dismantle the old system of inter-budgetary relationships. Local governments will know their level of transfer at an early stage (second reading of the state budget) and then can proceed with budget preparation. Since, the law provides that the formula holds for a period of three years, local governments will be able to plan based on stable levels of transfers. This is designed to give stability to local governments in that they will know their revenue levels and will have a firmer basis on which to prepare the expenditure side of local budgets. Greater stability and information on revenue flow will be essential in any capital investment planning, especially using borrowing.

66. The new system is designed to increase the level of objectivity and transparency in budget decisions because the size of a local government transfer is based on objective measurements of expenditure need and revenue capacity; local governments will clearly see how their amount of transfer is determined. Local governments will be able to crosscheck calculations. This is designed to eliminate the bargaining and negotiations that typically take place in the old system of establishing the amount of local government transfer. It remains to be seen, however, if transfer lobbying by local governments will be eliminated entirely and whether budgetary officials will be able to devote more

[21] *Ibid.*, p. 18 and for the following discussion, p.18-21.

of their time and energy to other, more important, budgetary issues such as more effective delivery of local public services.

67. Local governments should also be able to increase their expenditure autonomy, given that the Budget Code and formula-based equalisation system is based on the subsidiarity principle, which recognises that local governments are better equipped to perform certain functions on the grounds that they are better attuned to the expenditure needs of their citizens.

68. The Budget Code equalisation transfers are designed to remove the revenue consequences of these disparities and give each local government the ability to deliver a comparable level of public services at comparable rates of taxation. Because equalisation transfers are not tied to financing particular expenditures, these transfers operate to equalise the expenditure potential of different local governments at the oblast, city and rayon level.

69. Since estimated revenue needs and revenue capacity are based on previous performance, the formula creates important incentives to save money and raise additional revenue wherever possible. The transfer that is calculated on a formula basis should be thought of as a fixed, lump sum payment whose size is unaffected by the efforts of local governments to obtain either expenditure economies or a larger revenue base. Therefore, if a local government finds more cost-effective ways of delivering local public services, it gets to keep all of the expenditure savings it realises. Similarly, if a local government makes quick, successful efforts to expand its tax base, it gets to keep the increase in revenues, because the index of relative fiscal capacity upon which transfers are based remains fixed for a period of at least three years. In general, the equalisation formula was not designed to reward a local government for having a high initial tax base, but instead seeks to reinforce efforts to achieve growth in that tax base.

70. Despite these positive aspects, in the system of intergovernmental transfers established in the Budget Code and accompanying legislation, the lowest tiers of local governments are not guaranteed equalisation grants. "The councils of Kiev and Sevastopol, cities of Republican (in the Autonomous Republic of Crimea) and oblast significance, and rayons in their respective budgets may envisage equalisation grants to the budgets of municipal districts, villages, settlements, towns and associations, as well as contributions from these budgets" (Article 101(1)). Clearly, there is still room for old-style manoeuvring and negotiations to obtain transfers. Ukraine will certainly require additional legislation that more clearly defines government responsibility, especially at the lowest level.

71. Pursuant to the Budget Code and for the purposes of calculating transfers, local government budget revenues in Ukraine can be divided into two groups: revenues included and not included in defining the amount of intergovernmental transfers. There are 17 revenue sources of local governments, which are included in defining the level of intergovernmental transfer from the central government to oblast, cities of oblast significance and rayons (see section on Budget Code). Significantly, rayons are disaggregated, when it comes to revenue base and collection of revenue, to the rural, urban settlements and towns of rayon significance. On the other hand, these sub-rayon entities are integrated for purposes of transfer definition. This means that these self-governments depend on the upper levels for strategic decisions and may have no incentive to increase their revenue base.

72. Fiscal equalisation, in order to work effectively must be based on more than a transparent formula. Legislation is needed unequivocally to define local government responsibilities by government tier. Until this happens, the system is still open to manipulation and abuse.

Developing local government borrowing

73. In this section, we review arguments for developing local government credit markets as a financing tool for local government investments. Borrowing can serve at least two important and legitimate functions in assisting local governments in meeting their mandate: to finance short-term liquidity and to finance long-term debt used to undertake capital investments. Long-term debt should be used to increase productivity and means of repayment. Indeed, the benefit from long-term debt in financing capital investments is that they will generate a future stream of income that can be used both to repay the debt and defray operating costs through user fees. Further, long-term debt helps local governments concentrate funds for financing capital investments in order that they may be completed quickly and that benefits may accrue to the budget and constituents. Benefits may also come from improved service delivery, such as modern school facilities that, while not generating revenues, may lead to reductions in operating costs and will have other social benefits not readily measured in monetary terms.

74. Prior to any local government borrowing, however, it is important that local governments establish their creditworthiness and identify investment priorities. These are precisely the two major objectives of multi-year investment planning: creation of a Multi-Year Financial Plan and a list of priority investments based on an analysis of constituent needs. In absence of these two elements, local government borrowing is fraught with risk associated with long-term budget deficits and public debt.

75. The following discussion draws significantly from findings and recommendations from the report "Legal and Regulatory Framework for Sub-National Borrowing" as part of the Municipal Development Loan Fund Project (MDLFP) in Ukraine (Urban Institute, June 2002). The MDLFP aims to create a sustainable credit mechanism for financing priority infrastructure investments by sub-national governments. The MDLFP is intended to make a limited amount of capital investment financing available to SNGs (sub-national governments) in Ukraine, in a manner that:

- Is consistent with the evolution of a healthy sub-national credit market.
- Creates the conditions for a commercial credit market to develop.

76. The Urban Institute Report lays out several preconditions for sustained development of the local government debt market and growth in the volume of private sector lending to local governments. These include:

- Central government commitment to decentralise important parts of local public service delivery, along with the financing of such services and the capital facilities essential for their provision.
- Sound system of intergovernmental finance.
- Shift away from physical collateral and toward general obligation and revenue-based financing.
- Capital market confidence in the binding nature of a financial obligation on succeeding legislative bodies (especially affecting the volume of long-term debt). This principle should be explicitly affirmed in any local government debt legislation. The law itself should recite the binding nature of the obligation to repay debt that has been duly authorised.
- Pilot loans to identify the obstacles to smooth market operation that arise in practice so that these can be addressed in terms of new legislation or regulation. Pilot loans, however, must meet the standards of prudent lending and will require clarity and certainty on key elements of the legal and regulatory framework for local government borrowing.

77. The first two points are perhaps the most important, without which the remaining preconditions are of secondary concern. Indeed, in order to engage in long-term borrowing for financing capital investments, local government must be able to plan future budgets and they must be confident in the

clarity of their mandate including how it is to be funded. To effect the recommended changes will require legislation and other policy initiatives that may require some time to be implemented and will evolve from experience. Nevertheless, other factors, especially inflation and interest rates, external to intergovernmental and political reforms also determine the success of the growth in local government borrowing. Moreover, local government borrowing would benefit from increased maturity of private financial and capital markets.

78. The Urban Institute report emphasises that local government borrowing in Ukraine has been an important source of short-term liquidity for local governments especially villages and settlements, but has not been a source of funds for long-term capital investment. Therefore, in effect the real purpose of credit market development for local governments is to increase the volume of capital investment in support of essential services. As discussed earlier in the report, governments at all levels in Ukraine are under severe budget constraints. Well-designed borrowing based on an analysis of creditworthiness and investment needs often can finance needed infrastructure today, then repay the debt that is incurred from the future earnings of the facilities themselves through user charges or cost savings.

79. Apart from short-term liquidity borrowing, Ukrainian local governments do not engage in much borrowing. Past reasons for this state of affairs include high inflation, no creditworthiness in local governments and lack of available capital for such lending. Indeed creditworthiness is difficult to establish when the local government mandates and revenue sources are in a constant state of flux. Between 1995 and 1998 there were several local government bond issues that yielded mixed results. In 1998, the credit market suffered a blow to its credibility with the watershed Odessa bond default.

80. The Odessa bond default and Presidential Decree 655/98 stopped increases in borrowing. This failure illustrated the need to construct a legal framework that fosters better borrowing practices and limits abuse. Decree 655/98 effectively prohibited the issuance of local government debt without approval of the Ministry of Finance; the Ministry has not approved any local government borrowing. While the default dealt a severe blow to development of the credit market, the central government's refusal to provide a bail out sent a clear message that no sovereign guarantees will be extended. Further, while the Budget Code provides that only the Autonomous Republic of Crimea and city councils are permitted to borrow from domestic sources (except for budget deficit financing and only councils of cities with a population exceeding eight hundred thousand may borrow externally, the Code does not mention government approval of borrowing.

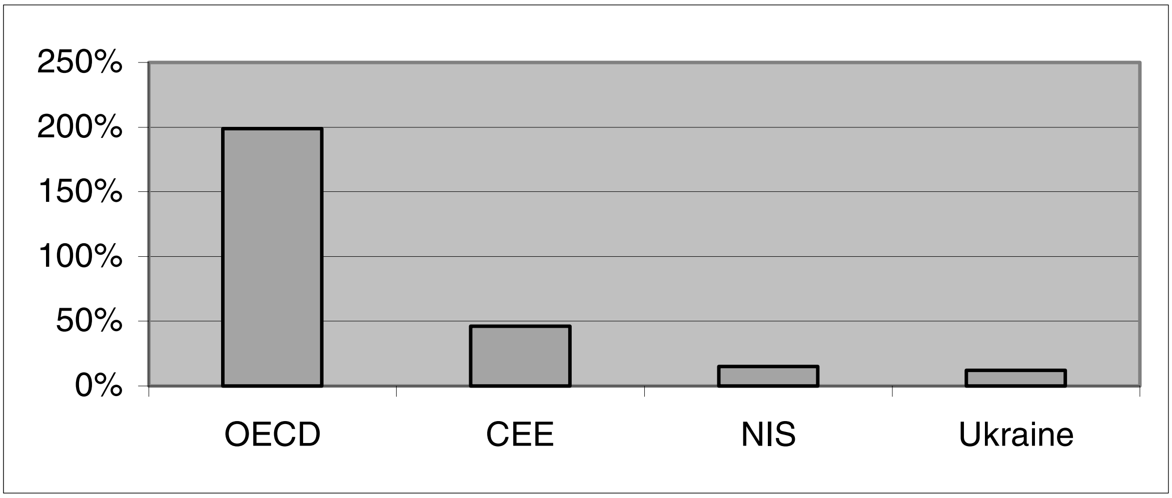
81. The Urban Institute report concludes that a successful local government credit market needs to be forged simultaneously both from the top down, in terms of a legal and policy framework that will support efficient credit market operations, as well as from the bottom up, in terms of practical experience for banks and other lenders in making loans, and for local governments in borrowing to finance high priority investments and making timely debt service payments.

82. This section of the report will review issues in local government borrowing in order to determine the impact of the regulatory framework on the City of Lutsk's ability to borrow to finance capital investment. While issues in local government borrowing are vast, this section focuses on the main issues: local governments' authority to borrow, restrictions on local government borrowing and issues in developing a market for local government borrowing. As will be demonstrated later in this report, local government borrowing can make an important difference in the timing and speed of infrastructure investment completion by helping local governments concentrate financing over a short period.

Banking sector's capacity to lend

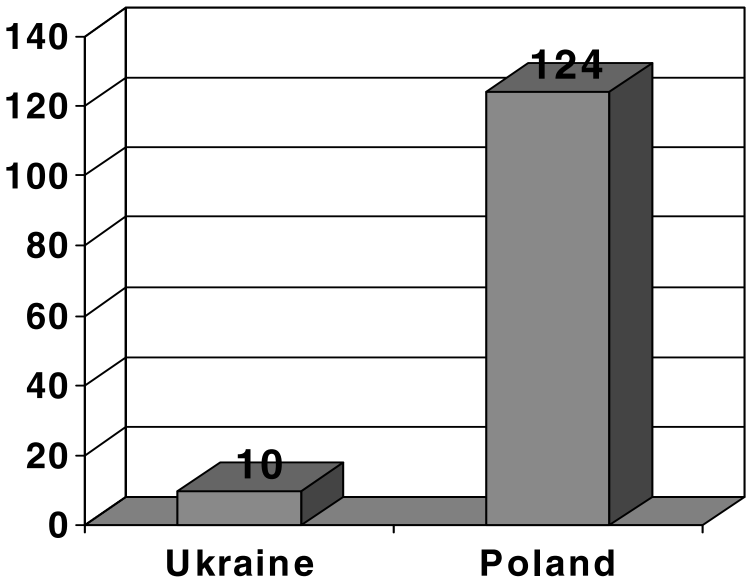
83. The financial sector in Ukraine is still emerging. Low liquidity and a mismatch between long-term lending requirements and short-term nature of available funding hamper banking sector effectiveness. Banking system assets in absolute terms and as a percent of GDP are low (see figures below). Yet, both metrics are improving.

Figure 4 Financial sector as a % of GDP.



Source: OECD

Figure 5 Assets of the banking institutions (Billion USD).

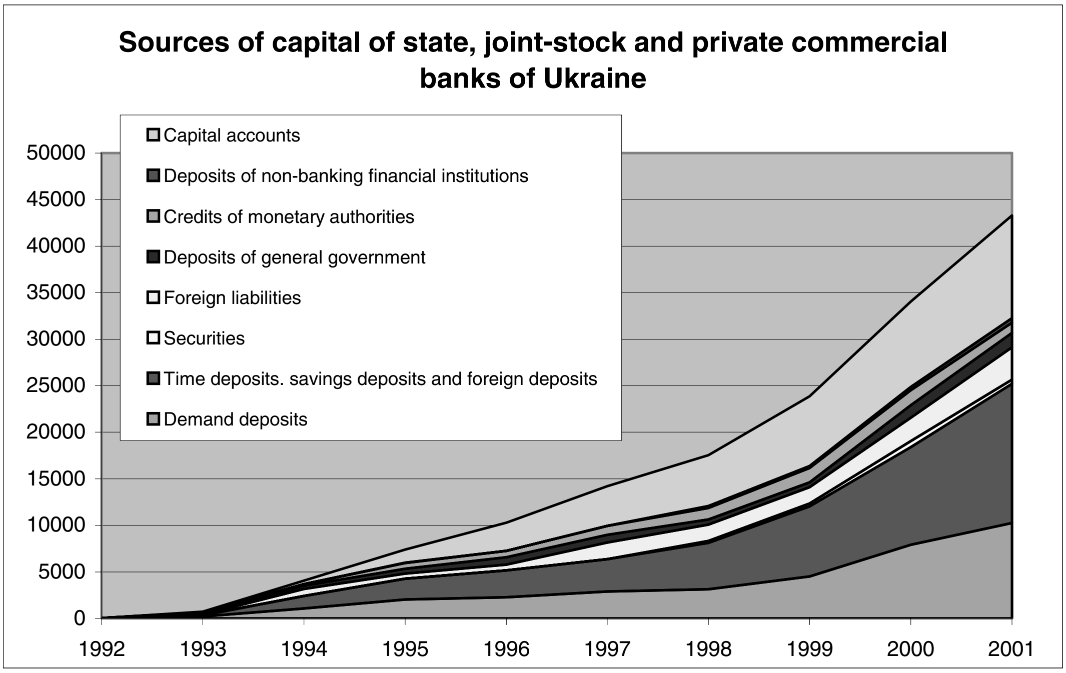


Source: OECD

84. Demand and time deposits constitute an increasing share of banking sector assets (Figure 6). General government deposits constitute a small share of total assets.

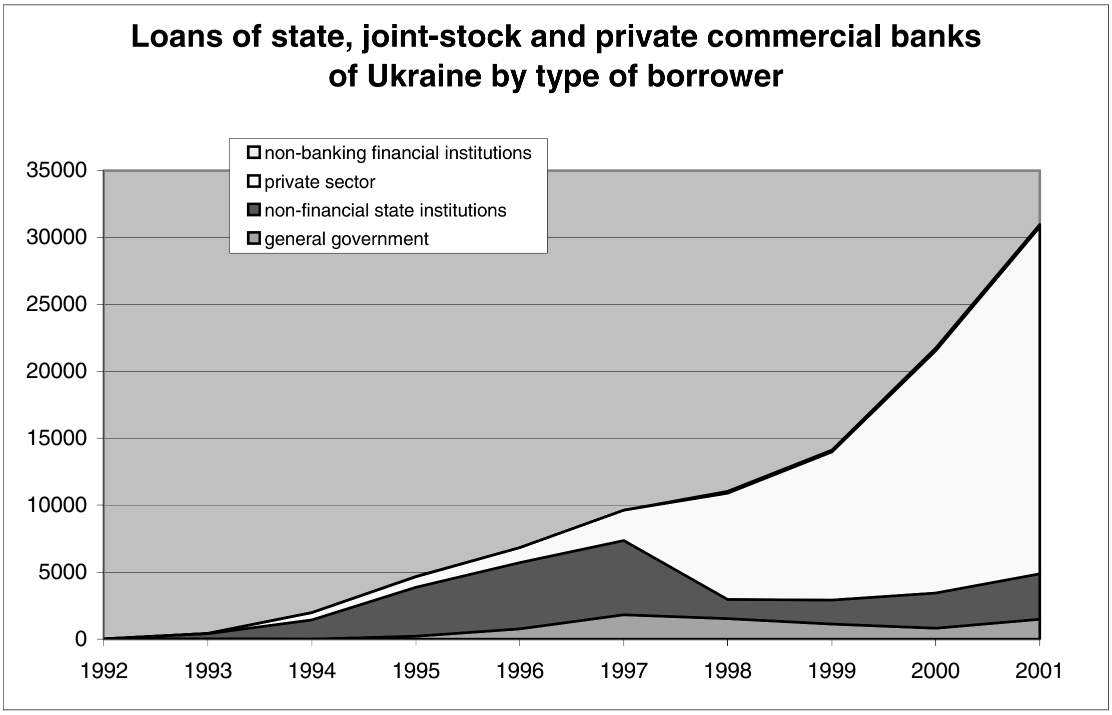
85. The share of long-term credit in the total loan portfolio of Ukrainian banks was 17% of the total loan portfolio of 2001. The average loan-term was about six months, while longer term lending was provided in foreign currency terms. General government loans make up a small proportion of total loans of state, joint-stock and private commercial banks (Figure 7).

Figure 6 Sources of capital state, join-stock and private commercial banks of Ukraine



Source: National Bank of Ukraine

. **Figure 7 Loans of state, join-stock and private commercial banks of Ukraine by type of borrower**



Source: National Bank of Ukraine

86. Clearly, much growth in the banking sector in Ukraine is needed in order for it to play a large role in infrastructure financing, regardless of local government's ability to incur debt.

Legal framework for local government credit

Local government authority to borrow

87. The authority for local governments to borrow derives from the Constitution and the Law on Local Self-Governments of Ukraine. Also important in local government borrowing are the Budget Code of Ukraine, Presidential Decree no. 655/98 and other government directives. Local governments have historically had access to three types of borrowing:

(i) Borrowing from higher levels of government.
(ii) Borrowing from commercial banks.
(iii) Issuing bonds.

88. In Ukraine, typically borrowing from higher levels of government has been done without clear guidelines for determining how to allocate such loans, the loans are interest-free and are frequently written-off at the end (becomes a grant-in-aid). This practice is effectively the subsidisation of local government budgets through the non-payment of the loans. It promotes soft credit while ignoring principles of prudent lending and borrowing and distorting the distinction between loans and subsidies. The recent Budget Code contains provisions that effectively prohibit this type of borrowing (Article 73).

89. In Ukraine, commercial bank borrowing has been limited to oblasts and medium-sized cities for liquidity purposes, with short payback times. Indeed, a common practice is that the lender bank acts as the depository of the borrowers' cash accounts and effectively "intercepts" local budget funds. By holding local government cash deposits, the lending bank becomes familiar with the local government's cash flow and has a high degree of certainty as to timely repayment. Local government borrowing is supported by little, if any, analysis of the local government creditworthiness. The Odessa bond default has effectively arrested development of the bond market.

90. Local government borrowing authority is provided under the Law on Local Self-Government (Article 70 and 26), the Law on Securities and Stock Exchange (Articles 3 and 11) and the Budget Code of Ukraine (Articles 16, 72-74). The Law on Local Self-Government and the Budget Code relate to all forms of debt, while the Law on Securities and the Stock Exchange only relates to debt issued in the form of securities, such as bonds.

91. The Law on Local Self-Government, the Law on Securities and Stock Exchange, and the Budget Code each provide that debt shall be authorised by the "council".

92. The Budget Code makes a distinction between the current and capital budgets (capital budgets are defined in Article 71). The Code provides that the budget of the AR of Crimea and city and town budgets cannot be passed with a deficit other than the capital budget deficit; borrowing should cover such deficits (Article 72 (1) and (2)). Significantly, oblast, rayon, municipal district, village and settlement budgets cannot be passed with a deficit.

93. The Budget Code stipulates that "the Council of Ministers of the Autonomous Republic of Crimea, local state administration, executive bodies of local councils may secure short-term loans authorised by local rada's decisions in financial and credit establishments for a term of up to three months but within the limits of a current budget year for purposes of liquidation of current budget short-term cash gaps. The procedure for securing such loans shall be defined by the Ministry of Finance of Ukraine." Further, "no loans can be provided from one budget to another" (Article 73 (1) and (2)). In other words, loans for budget deficit financing must be repaid at the end of the year.

94. Article 74 sets out the main provisions for borrowing by local governments, stating that:

(1) Borrowing by local budgets shall be targeted and subject to obligatory repayment. Borrowing by respective budgets may be undertaken only for financing the capital budget, except for the cases under Article 73.
(2) The state is not liable for local budgets' borrowing.
(3) Servicing payments shall be made at the expense of the general fund of the budget.
(4) Annual spending for servicing of the debt of a local budget cannot exceed 10% of the general fund of the relevant local budget in any budget period in which the debt is to be serviced.
(5) If, in the process of repayment of the principal and interest, the borrower violates the contract schedule, the relevant local Rada is prohibited from new borrowing for the next 5 years.
(6) Procedures for raising capital to fund local budgets shall be established by the Cabinet of Ministers of Ukraine in compliance with procedures defined under this Code.

95. The authority to borrow is provided under Article 16, which stipulates that:

(1) Authority to make public borrowing from domestic and foreign sources within the limits and on the terms provided for under the State Budget Law of Ukraine shall be vested in the state in the person of the Minister of Finance of Ukraine on an errand of the Cabinet of Ministers of Ukraine.
(2) Only the Verkhovna Rada of the Autonomous Republic of Crimea and municipal local radas are allowed to borrow from domestic sources (except for cases under Article 73). From foreign sources, only municipal radas of the cities with a population exceeding eight hundred thousand (as per official statistical data available at the time of decision-making) may borrow.

96. Article 18 governs limitations on domestic and foreign debts

(1) The maximum amount of domestic and foreign state debts, debt of the Autonomous Republic of Crimea, and debts of local self-government, and the maximum amounts of guarantees shall be established for each budget period, respectively, by the State Budget Law or budget decisions of local radas.
(2) The principal amount of the state debt cannot exceed 60% of the annual Gross Domestic Product of Ukraine.
(3) If the state debt exceeds the maximum debt amount stipulated under Section 2 of this Article, the Cabinet of Ministers of Ukraine shall undertake measures to reconcile the maximum amount with provisions of this Code.

Who may borrow?

97. The Budget Code provides that only the "Verkhovna Rada of the Autonomous Republic of Crimea and city radas (councils) are permitted to borrow from domestic sources (except for budget deficit financing) and only radas of cities with a population exceeding eight hundred thousand may borrow externally". The limitation of the authority to issue long-term debt to the councils of the Republic of Crimea and cities effectively prohibits the issuance of debt by oblasts, rayons, city rayons, villages and settlements, except in the case of budget deficits, if they are permitted. The Budget Code provides that procedures for local borrowing shall be established by a Resolution of the Cabinet of Ministers in compliance with the Budget Code.

98. Presently, pursuant to the Presidential Decree adopted as a result of the Odessa default, and Regulation 48 of the Security and Exchange Commission, all local government debt must be approved by the Ministry of Finance. The Ministry of Finance established a procedure (Directive 19 of January 19, 1999) requiring the submission of internal borrowing to the Ministry of Finance. The

Ministry of Finance approves the amount of internal local borrowing, and the procedures provide that such approval does not constitute a guarantee or an approval of the creditworthiness of the local government (Article 6.2). Significantly, the Budget Code does not require any approval of local government borrowing by the Ministry of Finance, perhaps opening the door for future borrowing.

99. Further, bond issues require specific authorisation procedures for the local council. These requirements are consistent with the Law on Local Self-Government and the Presidential Decree relating to all forms of debt. Still, as the authors of the Urban Institute study point out, the practice of including separate or additional authorisation requirements in different elements of the legal framework could result in conflicting and inconsistent provisions. They point out that the legal framework should not create separate and conflicting requirements for authorisation of debt between bonds and loans that would create a market distortion in the use of one form of debt over another. Apart from the necessary additional disclosure requirements for a public offering of bonds, the two forms of debt should be competing with each other on the basis of market factors rather than legal factors.

Purposes of borrowing

Short-term borrowing:

100. The Law on Local Self-Government permitted intergovernmental financing of cash flow deficit financing (Article 70). The Budget Code prohibits this type of intergovernmental financing (Article 73(2)). Additionally, the Budget Code provides that "…local state administrations and executive bodies of local councils authorised by local council's decision…. May secure short-term loans for a term up to three months but within the limits of a current budget year for the purpose of [cash flow deficit financing]" (Article 73). The Budget Code provides that the Ministry of Finance is responsible for determining procedures for securing such loans. Local government short-term borrowing is occurring despite the fact that the procedures have not been established.

101. The Urban Institute report emphasises the benefits from short-term financing as a means for banks and local governments to develop working relationships. This, coupled with the fact that local governments can hold bank accounts (Article 70(2) on local self governments), provides a basis for a natural relationship for financing, provided that such financing is re-paid within the budget year and that refinancing of such debt beyond the budget year is prohibited.

102. Still, the authors emphasise, in accordance with the Budget Code, the State Treasury is now doing the execution of the revenue side of local budgets with the expenditure side expected to be transferred in the near future. This would effectively eliminate the ability of local governments to maintain commercial bank accounts and substantially inhibit the willingness of banks to lend to local governments in absence of deposits. If the State Treasury holds local government funds without interest, the development potential of service provider-client relationship between banks and local governments is severely decreased.

Long-term debt:

103. Capital investment financing typically requires long-term debt, or that the payment period of which exceeds one year. The Ukrainian Budget Code permits the financing of a budget deficit related to capital budget expenses (Articles 14 (1), and Article 72) that would include:

1. Repayment of debt principal (other than short-term debt).
2. Capital investments.
3. Contributions related to ownership in commercial enterprises.

104. Oblast, rayon, municipal district, village and settlement budgets cannot be passed with a deficit, which means they cannot borrow.

105. Under security and exchange commission provisions, the purpose of a bond issue must be stated and the proceeds of a new bond issue may not be the source of payment of a bond issue. No stipulation, however, is made against the refinancing of a bond though a loan or the refinancing of a loan with another. This restriction, while apparently prudent given the experience from the Odessa default, also precludes legitimate bond refinancing that becomes desirable under conditions of lower interest rates. Clearly, the system of local government lending would benefit from a unified set of provisions on local government debt rather than creating additional and potentially different provisions. Local government debt legislation should be the "sole" source of legal authority setting the permitted purposes of local government borrowing. Further, separate purposes for loans and bonds is not appropriate and leads to the selection of the form of debt instrument based on legal factors rather than market factors.

106. The Budget Code does not stipulate any "public purpose" criteria in the purposes for local government debt used to finance capital expenditures. The law should distinguish between debt that is issued for a "public" purpose and that which is issued for a publicly owned, but inherently, private entrepreneurial activity or commercial activity. This is important since a number of local governments remain engaged in the ownership and operation of varied private entrepreneurial businesses, if not directly at least indirectly, through local government-owned corporations. It should be made clear that public purpose precludes incurring public debt for the benefit of private enterprise, including guarantees of that debt. Enterprises that are supported through local government debt should provide public services or be wholly or majority-owned by the local government.

Restrictions on the Issuance of Local Government Debt

107. The Budget Code provides that:

- Only the Supreme Council of the Autonomic Republic of Crimea and city councils are authorised to borrow internally and only city councils with a population in excess of 800,000 are entitled to borrow externally (article 16 (2)).
- The maximum amount debt and guaranties shall be set forth in the local government budget for the budget period (Article 18 (1)).
- All local governments may borrow short-term for not more than three months for cash flow financing that must be paid within the budget year (Article 73).
- "Debt service" cannot exceed 10% of the current general budget fund expenditures in any budget period in which the debt is to be serviced Article 74 (4).
- The failure to pay timely principal and interest of the borrowing contract shall prohibit the borrower from new borrowing for five years Article 74 (5).

108. Directive No. 19 of the Ministry of Finance provides that the:

- Maximum amount of internal borrowings does not exceed 15% of applicable local budget revenues, excluding State budget subsidies and subventions, as well as loans and credits received from banks (Paragraph 1.7.1).
- Debt service interest and principal shall not exceed 15% of applicable local budget expenditures in the projected budget year.

109. Regulation 48 of the Securities and Exchange Commission provides that the "maximum total value" of all SNG bonds shall not exceed 30% of the revenue part of the issuer's budget for the preceding year."

110. As the Urban Institute report contends, these regulations have many shortcomings and inconsistencies, including, but not limited to, the following:

- No aggregate limitations on the amount of short-term debt, only period of payment is stipulated (three months).
- Different debt limitations for bonds and loans.
- Compliance with the various limitations requires projections and estimations of future finances rather than being based on actual historical performance; making such projections and forecasts in an uncertain environment is difficult.
- Actual interest rates based on variable formulas can increase over time and create difficulty with compliance in the future; increasing interest rates and decreasing budget basis could produce a violation in a subsequent year: resulting in non-compliance in a year subsequent to the year in which the debt is issued.
- Basing a "debt test" as a function of expenditures rather than revenues does not relate to the local government's "ability to pay".
- Guarantees are not "tested" as debt at the time as issuance but only calculated as debt at the time actual payments are required to be made on a guaranty.
- The five-year penalty prohibiting borrowing by a defaulted borrower could restrict the ability to do "workout refinancing".
- The provisions of the debt limit of the Budget Code relating to "debt service" have been interpreted to relate only to "interest" and do not include principal payments within the debt service that is being limited; this can result in the issuance of "balloon" or "bullet" maturities that do not bear any relationship to the "ability to pay". Alternatively, Regulation 48's debt limitation provision relates to both principal and interest.

111. The authors point out that these issues contribute to substantial confusion on local government borrowing; this confusion constitutes an effective barrier to long-term borrowing and the development of a local government credit market.

112. While the Budget Code repealed the conflicting provisions of the Law on Local Self-Government with regard to intergovernmental financing, still no borrowing limits have been set. The only restriction is the 10% of the general fund limit on debt servicing in any budget period in which the debt is to be serviced (Article 74(4)). The only requirement is that of the three-month maximum payment period. The typical practice is to set limitations based on some relative measure of the local government budget. More types of local governments are permitted to borrow short-term compared to long-term, which is reserved for the Republic of Crimea and large cities.

113. The Budget Code limits the purpose of short-term borrowing to budget deficit financing and requires repayment prior to the end of the budget year.

114. Long-term debt should be permitted to finance investments serving a clear public purpose. Further, limits on borrowing should be set according to budget revenues. As an example in other countries, Polish legislation stipulates that annual debt service shall not exceed 15% of budgeted revenues, and debt carried beyond the current year may not be greater than 60% of budgeted

revenues. (Law on Public Finances 1998, Articles 113 and 114). The limit is further decreased as the total public debt approaches the EU criteria that "total public sector debt" shall not exceed 60% of GDP, i.e., by declining to 12% of revenues when the public sector debt is at 55% and the prohibition of municipal borrowing at 60%.

Restrictions on debt versus fiscal discipline

115. This section has focused almost exclusive attention to the need to remove barriers to borrowing. The reason for this focus is two-fold. First, local government borrowing remains at low levels. As local government revenue sources stabilise, efforts will be made to enhance these sources. Increasing predictability on the revenue side will enable local governments to pursue more ambitious public works and services investments. Steady revenues, however, will also provide security for debt financing. For this reason, debt mechanisms for local government will need to be created. Second, debt financing has worked successfully in other transition countries, notably Poland.

116. Even in Poland, however, emphasis is placed on maintaining fiscal discipline. Regional clearing authorities check budgets for correctness and strict limits on local government debt are monitored. The Regional Accounting Clearing Chamber (RIO) reviews all local government resolutions, especially those related to the budget. The role of RIO is to check that local resolutions (including execution of the budget) are passed in conformance with the law. In Poland, limits on local government debt are as follows:

- The total amount in a given year spent on credits, loans or due to guarantees extended by the local government, including interest, discounts and bonds and securities scheduled to be re-purchased in a given year, may not at any time exceed 15% of the local government's planned budget revenues for the given yearThe total debt carried by a local government unit at the end of the budget year may not exceed 60% of revenues of that local government in the current budget year

117. Polish experience has shown that provisions for fiscal discipline must be introduced as debt financing becomes more available. The current debt limits in Ukrainian law will be inadequate when restrictions on incurring debt are lifted.

Investment needs: water and wastewater sectors22

118. Having reviewed the background in which local governments in Ukraine operate, this section focuses on public investment needs based on an example from the water and wastewater sectors. The Ukrainian water sector has for a number of years faced several obstacles to development. Physical water and wastewater facilities have deteriorated to a degree where substantial investments are required simply to stop further deterioration.

119. Pursuant to current legislation, the self-government level of Ukraine, *i.e.* the ***territorial community*** (town, township and village councils) is considered to be the main "care-taker" of water supply and wastewater treatment. The role of successive higher layers of governance (national, oblast and rayon levels) is mostly limited to advisory and facilitation functions, such bodies not being empowered to intervene directly at the lower level to perform the "care-taker" function. At the same time, nothing prevents the town and village councils, from delegating authority for the management of water supply and wastewater facilities to other levels, *e.g.* the oblast Administration. In other words, a Village or Town Council which has its own water supply and/or wastewater treatment facilities (i.e. capital equipment, pipe network, etc), may decide to either manage the facilities directly or delegate this responsibility to an "upper" level, *i.e.* an oblast or rayon Council.

120. From the outset (1997), some village and town councils decided to continue to allow the Oblast or Rayon Administrations to provide their water services. However, when empowered by law, many Village and Town Councils decided to operate their own facilities, separating themselves from the Oblast Vodokanals. There are two main organisational approaches to the provision of water supply and wastewater service management in Ukraine at local levels (*i.e.*, oblast, rayon, village, etc. as follows:

- The first organisational model is based on the "Bottom to Top" (Territorial Community Council – Oblast Council) approach in terms of delegated responsibility and the "Top to Bottom" approach in terms of water supply and wastewater facility management.
- The second organisational model represents the independent direct management of water supply and wastewater facilities by the Village/Town Councils or their administration.

121. The following table outlines the functions that the local self-governance bodies oblasts, rayons, and territorial communities (i.e. city district, town, township or village council) perform in relation to the water sector.

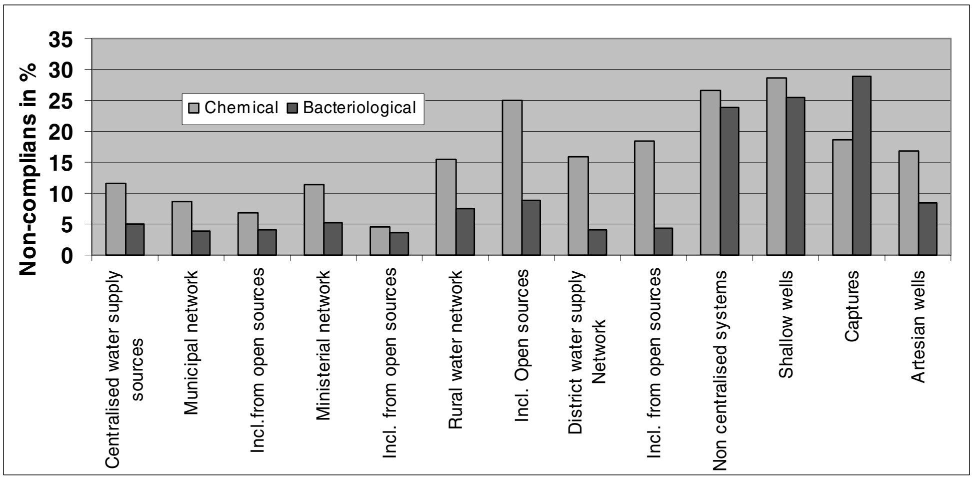
[22] The following text consists of edited excerpts from the "Ukraine National Water Sector Strategy and Action Plan," Interim Report on the National Water Sector Profile, produced by the Danish Cooperation for Environment in Eastern Europe (DANCEE) at the Ministry of Environment, Denmark for the Ukrainian State Committee for Housing and Municipal Economy, June 2002.

Table 7 Functions of Local Self-Governance Bodies in Relation to the Water Sector

Local Body of Executive Power	**Water Sector Functions**			**Reference to legal document**
	Water Resources	**Water Supply**	**Wastewater**	
Local state administrations	Implementation of national and regional programmes of social-economic and cultural development, programmes of environment protection, etc			Constitution of Ukraine (1996), art. 119/3
		Ensuring that the housing-municipal services are provided to households by utilities, regardless of the form of property.		Law “On Local State Administrations” (1999), art. 20
Council of Ministers of Crimea, state administrations of oblast, cities of Kiev and Sevastopol		Preparation and implementations of water supply programmes, participation in national and regional water supply programmes. Temporary suspensions of activity or closing down those water utilities that violate the potable water supply legislation. Licensing economic activity that intakes water from centralised water supply system. Restriction on or banning of potable water supply for industrial use. Imposing sanctions on water utilities for violating legislation/regulation.		Law “On Potable Water and Potable Water Supply” (2002), art. 12
Village, township and town councils	Prescribing special regulation of water abstraction facilities that are used for potable water supply needs.	Local potable water sector programmes adoption. Authorising deployment of economic entities that might threaten potable water supply sources. Potable water quality control. Imposing sanctions on water utilities for violating legislation/regulation. Informing the general public on potable water quality and tariff setting procedure. Restriction on or banning of potable water supply for industrial use.		Law “On Potable Water and Potable Water Supply” (2002), art. 13
Village, township and town councils	Operating and managing the housing-municipal enterprises that they own, ensuring that the quality conforms to standards.			Law “On Local Self-Governance in Ukraine”, (1997), art. 30

122. Water quality is of key concern in the Ukraine. The following figure presents water quality compliance data for different supply structures.

Figure 8 Water quality compliances for different supply structures



123. It is clear from the figure that non-compliance is much higher in non-centralised systems than in centralised systems, and the data for many oblasts show figures between 30-50% non-compliance for chemical parameters and 20-40% for bacteriological parameters. Especially many of the southern and eastern oblasts are areas with high non-compliance figures.

124. According to the World Health Organisation (WHO), poor water quality poses a health hazard for 25% of the Ukrainian population. During recent years the epidemic situation in Ukraine is aggravating in terms of acute intestinal infectious diseases spread caused by the supply of drinking water bacterially and virally contaminated. Especially acute problems are connected with Viral Hepatitis A disease. In each of years 2000 and 2001 there were six outbreaks of infectious diseases. In 2001 there were three outbreaks of Virus Hepatitis A connected with drinking water supply in the Lwow and Donetsk oblasts.

125. The water related health situation in the rural areas is worse than in urban areas. The number of non-compliances with the water quality hygienic norms is some 2.3 and 4.8 times larger for non-centralised water supplies compared to centralised water supply networks with respect to chemical and bacteriological parameters, respectively.

126. The quality of groundwater used without any treatment by the majority of the village population is even more critical. Nitrate contamination is increasing due to uncontrolled use of mineral and especially organic fertilisers at private and collective agricultural farms.

Coverage and quality of service

127. The following table provides an overview of the level of coverage of number of cities/settlements serviced by centralised potable water supply and wastewater systems as of January 2000.

Table 8 Coverage by centralised potable water supply and wastewater, 2000

Type	Total in Ukraine Number	Water Supply Coverage No. (%)	Wastewater Coverage No. (%)
Cities	448	448 (100%)	426 (95%)
City-like settlements	921	796 (86.4%)	518 (58%)
Villages	28 900	6 650 (23%)	841 (2.9%)

128. The overall coverage for centralised water supply is estimated to be 65%, while the figure for the urban population is estimated to be 83%.

Water supply and wastewater - state of repair and operation

Water supply

129. The abstraction of centralised water supply amounts to 5.3 billion m³ in year 2000 of which 0.4 billion m³ is in rural water supply. Out of the total first level pumping capacity (intake pumps) 25-40% needs rehabilitation, equal to 8-13 million m³/day. Low efficiency and oversized submersible pumps require that at least 5 000-8 000 submersible pumps need replacement.

130. Both surface and groundwater treatment plants are designed as standard plants and are often not adapted to the actual water quality. Furthermore, seasonal fluctuations of the surface water quality often result in non-compliances in water quality requirements. A substantial part of the groundwater is not treated and it does not comply with water quality standards.

131. It is assessed that about 40% of the present treatment capacity corresponding to 6 million m³/day, needs rehabilitation or improvements in order to comply with the water quality standards. In total there are about 2 000-3 000 second lift pump stations with more than 10 000 pumps. Reportedly, 30-40% of the second lift pumping stations (corresponding to a capacity of 8-10 million m³/day) need replacement including a major part of the electrical equipment; replacement is required owing to oversized pumping systems with low energy efficiency.

132. Also, a number of water utilities need to construct additional clean water reservoirs to balance the supply and demand.

133. The total length of centralised water supply network is approximately 180 000 km, of which at least 110 000 km is within urban water supply. About 40 000 km of pipes needs replacement, of which 30 000 km in urban and 10 000 km within rural water supply.

134. Typically, the number of reported pipe network breakdowns is 1-4 breakdowns per km of pipes per year, which is 5-40 times more than in Western Europe. Most of the breakdowns are experienced in pipe diameters of less than 200 mm and on un-coated steel pipes.

135. The water loss in the urban network is very high - in the range of 10-70 m^3/km/day, compared to Western European figures of 2-10 m^3/km/day. The water losses in the distribution system are experienced to be in the range of 30-50% or more of the distribution input, although official statistics often show losses (including water for technical use) at about 25%. As water delivered to the distribution network is not fully metered, and only 10% of the water consumption is metered, water loss estimates are based on norm figures and assessments.

Wastewater

136. The major part of the existing wastewater collection systems in the urban areas was built 30 to 40 years ago.

137. The entire wastewater collection system in Ukraine consists of approximately 47 000 km of pipes and 1 700 pumping stations with approximately 7 500 pumps. 42 000 km of the pipes (89%) is located in urban areas. Statistics show that more than 50% of the pipes are in the range of 100-250 mm and that 80% of all pipelines are smaller than 500 mm.

138. More than 10 000 km of the wastewater pipes in the urban areas (24%) are in a state of emergency and need immediate replacement to avoid breakdown.

139. In rural areas the total length of wastewater pipes is approximately 5 000 km, of which 13% are reported in an "emergency condition".

140. An indication of the condition of the sewers is the frequent breakdowns or serious blockages of pipes that requires action by the emergency teams. The number of serious emergency incidents recorded is on average 1.4 per km per year. This is far more than seen in Western Europe. Moreover, an infiltration rate of 20% also indicates a deteriorated condition of the sewers.

141. About 40% of the approximately 7 500 pumps within the urban area need replacement now. They were installed 30-40 years ago and have been in operation since then. The general impression is that many of the pumps are installed for a much larger capacity than actually needed. This means that it is necessary to throttle the valves at the discharge valves to reduce the pump capacity to what is required. The result is an energy consumption of 20 to 50% higher than necessary[23].

[23] This was for instance revealed during detailed measurements at the Left Bank Wastewater Pumping Station in Kyiv in connection with the preparation of a Feasibility Study for Kyiv Vodokanal, 2001.

Wastewater Treatment

142. More than 80% of the wastewater produced in the municipal sector is treated in mechanical-biological treatment plants.

143. The treatment plants were established in the period from 1960 to 1980 and have an average age of about 25 years. 25% of the plants are older than 30 years, and only about 10% are younger than 15 years. The equipment in many of the plants is old and outdated and needs replacement. Many of the structures, which have been exposed to the corrosive environment at the plants, are also in need for rehabilitation.

144. A consequence of the general poor state of repair is that not all plants are working to standard. Data from 88 wastewater treatment plants for instance indicate that:

- The load on the wastewater treatment plants is only up to three-fourths of the design load, where the largest cities are exposed to the largest loads.
- The treatment efficiency is high and good (>90%) for the largest plants, and lower and not so good (<90%) for the smaller plants.
- The larger plants do mostly comply with the effluent standards specified for the individual plants, whereas the compliance decreases with decreasing size of plant. Less than 50% of the smaller plants servicing populations below 20 000 do comply with the given effluent standards.
- The fact that there is still spare capacity at the plants indicates that the wastewater collected but not treated could be treated at the plants.

145. This situation will not improve if rehabilitation is not initiated at the most deteriorated plants. Although the largest plants seem to be in a better position than the smaller plants, it is in the largest plants that approximately 50% of the wastewater is treated. Further, the discharges from the largest plants, when not functioning properly, have a much higher impact on the receiving waters than smaller discharges spread along the receiving waters. So efforts should be concentrated on the largest plants before the smaller plants.

Key Technical Obstacles and Challenges to Improvements in Water Sector

146. The water sector in Ukraine is suffering from many years of insufficient investments in infrastructure renewals, combined with oversized and outdated equipment, and inadequate organisational and institutional arrangements. This has caused a decline in service, where the customers have lost confidence in water utility providers. Lack of comprehensive and integrated project design considering, *inter alia*, operational costs have in many cases worsened the situation.

147. The past years of operation have resulted in a decrease in constancy of water supply, increased number of interruptions and poorer quality of the water delivered to the customers. In order to reinstate the operational safety of the centralised water supply, the current situation will require huge technical improvements, which must be based on comprehensive improvements as well in both organisation and institutional arrangements supported by law enforcements.

148. Also, the rural water systems need improvements, including increased coverage by centralised water supply, improved the water resource protection and the establishment of overall planning for long-term improvements.

149. The urban wastewater sector today is in a severe situation throughout Ukraine. The main assets – the pipe networks – are in a poor state of repair and lack of funds makes proper operation and

maintenance difficult. Huge technical improvements will be required to bring the wastewater systems back to a reasonable state. These comprehensive technical improvements must be implemented together with improved institutional arrangements supported by law enforcement.

150. The wastewater situation in the rural areas is characterised by low centralised coverage, less than 10%, and lack of central interest and control of wastewater planning in areas not served by centralised systems. In fact more than 14 million people within the rural areas are responsible on their own for handling and disposal of their wastewater. Furthermore, only 40% of the wastewater collected is properly treated before being discharged into the receiving waters.

151. The wastewater systems in rural areas are generally in a very poor condition.

Customer affordability and willingness to pay further tariff increases

Household affordability

152. The average monthly wages in 2001 is reported at USD 61.6. The Ukrainian government reports that per capita income now equals around 113 UAH, and that 70% is spent on food. According to World Bank reports approximately 27% of the total population is considered poor and 18% of households are considered extremely poor.

153. Official figures, however, generally overstate the unfavourable economic developments of the past few years since the informal economy continues to expand beyond the reach of government regulations and taxes. In fact, estimates for the informal economy range as high as 40-50% of the total measured GDP.

Household willingness to pay

154. In general, recent household survey findings indicate that most households in Ukraine spend somewhere in the range of 2-4% of their average income on water bills. However, this does not take into account the fact that income profiles are skewed. In Kiev for instance, it was found that more than 45% of households paid more than 4% of their total expenditure on water and wastewater services[24].

155. Based on studies conducted in Ukraine (during 1996, 1997, 1999[25] and 2000[26]), it appears households are generally willing to pay somewhere in the range of 20-100% more for improved services, wherein for the upper end of the range improvements mean 24 hour continuous supply.

[24] Kyiv Socioeconomic Survey (2000) undertaken as part of the Kiev Vodokanal Feasibility Study.

[25] Desk study of urban water services reform projects in Eastern Europe, the Caucasus and Central Asia.

[26] Kiev Socioeconomic Survey (2000) undertaken as part of the Kiev Vodokanal Feasibility Study.

METHODOLOGY FOR MIP INTRODUCTION

MIP background

156. The ability to undertake long-term capital improvement planning directed at meeting the infrastructure needs of the community is of crucial importance for the future economic and social development of communities. The project preparation stage itself takes longer than one year for most infrastructure projects and when the implementation period is also considered, infrastructure investment planning has to be long-term. A tool that helps local governments to develop a long-term financial vision is the Multi-Year Financial Plan. This planning tool is based on the Capital Improvement Planning (CIP) approach used in the United States and other countries, not only by local governments, but also by many other institutions. Multi-year Investment Planning has been successfully implemented in a number of local governments in CEE, most notably in Poland.

157. Given the challenges that Ukrainian local governments face, MIP was selected as a tool that could help improve investment planning. Low and unpredictable revenues, rent-seeking in investment planning and interbudgetary transfers and limited access to loans and credits are just a few of the problems that can be alleviated through better financial planning and more transparent project selection.

158. Multi-year investment planning is a process of selecting strategic investment projects in a long-term perspective that achieve the largest possible benefits (financial, social, ecological and other) as a result of their implementation.

159. It includes the following elements:

- Multi-Year Financial Plan:
  - Local government revenue and operating expenditure forecast.
  - Service and repayment of liabilities incurred.
  - Amount of debt to be incurred.
  - Total funds intended for investments projects.
  - Clear selection criteria and investment project priorities.
  - List of investment projects to be implemented, their scope and sources of financing year by year.

160. There are several objectives to introducing multi-year investment planning:

- Introduce multi-year perspective as opposed to one-year planning.
- Ensure that investment project selection is objective.
- Establish transparent selection criteria for investment projects.
- Serve as a tool for development strategy implementation.

161. There are several advantages to implementing a Multi-Year Financial Plan:

- Decreases influence of current political issues on the investment process in the local government, in particular the investment selection process.
- Better concentrates resources, leading to faster implementation of investment projects.

- Reduces practice of overstating needs.
- Serves as a tool for communication with the local community.
- Facilitates access to external sources of finance that require a MIP.

162. A Multi-Year Financial Plan, by organising and rationalising the local government investment process, often decreases losses during the planning and implementation period. By concentrating on only the few most efficient (from the local community's point of view) investment projects, the local government may build more cheaply and quickly.

163. In other countries, local governments have used the Multi-Year Financial Plan as an additional document for a loan application. A very similar methodology is used to prepare municipal bonds, but in this case a professional memorandum is required.

164. Since many environmental projects in CEE countries involve infrastructure investments, a Multi-Year Financial Plan is one tool used to increase investment in this area. There are several reasons for this:

- Past negligence in sewer network and sewage treatment means that high priority will be assigned to such investments.
- External financing is available for environmental projects; this assistance is typically soft, which makes such investments high priority.
- Many municipalities want to be viewed as environmentally friendly, so environmental investments have a high priority.
- Decreasing number of investment tasks leads to concentration of resources.
- Decreasing number of investment tasks leads to improved efficiency and frees financial resources for top priority investments.

165. Local governments cite the following reasons for deciding to implement Multi-Year Financial Plan:

- Easier access for external financing (Multi-Year Financial Plan can be used as a part of bank/fund application).
- Concentration of financial resources.
- Decreased number of investment tasks with well-defined financing (quicker and cheaper implementation).
- Decreased political role in selection of investment tasks.

Methodology of MIP development

166. Multi-Year Financial Plan (MIP) preparation is based on the following successive stages:

<u>Stage I – analysis of past data</u>
The goal of this stage is to analyse historic budget data as well as to evaluate the City in terms of its financial and investment potential. The analysis focuses on budget lines that have been stable in the past, because they provide the basis for future projections. This allows us to forecast revenues and expenditures for the planned years.

<u>Stage II – Forecast of City revenues and expenditures</u>
The goal of this stage is to forecast City revenues and expenditures as well as investment potential over the planned period of analysis.

Stage III – Analysis of City current debt and ability to incur further debt
The goal of this stage is to define the City's capacity to incur debt.

Stage IV – Presentation of City's planned investments

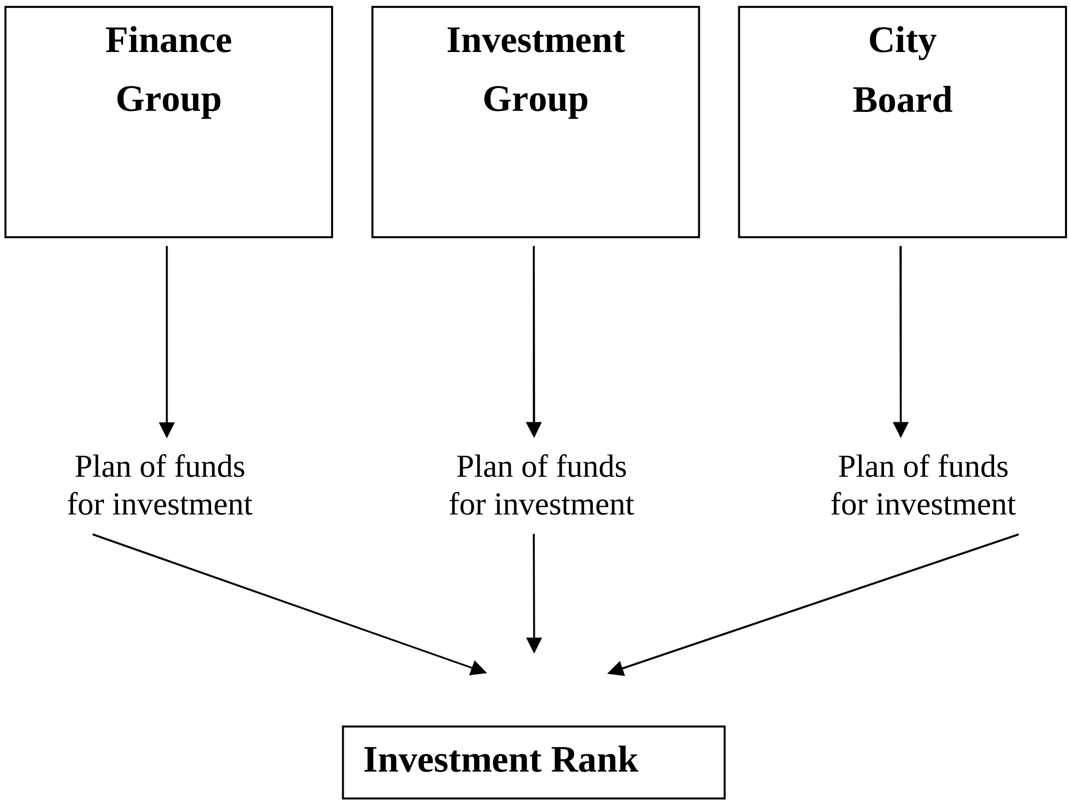
167. The goal of this stage is to describe the characteristics of all investments that the City is planning to implement in the analysed period.

Stage V – Determination of rules for selecting investments for implementation

168. The goal of this stage is to define a list of investments ranked from the best to the worst according to the accepted procedures for classifying and prioritising investments.

169. A few working groups were responsible for completion of each stage; their work is linked together through the end result.

Characteristics of the City of Lutsk



Strategy

170. In June 2002, representatives from the City of Lutsk embarked on a strategic planning exercise under an USAID-sponsored project aimed at developing government associations. The city analysed its competitive strengths and weaknesses and selected strategies for city development. To achieve desired targets, the city must continuously identify and enhance its competitive strengths, realise which city functions should be developed, what barriers inhibit achievement of targets and how such barriers should be addressed. The strategic plan considered strategies and actions with regard to:

- Supporting key city industries and companies, which are viewed as areas for focus of growth.
- Improving competitiveness both on the domestic and world market.
- Creating a friendly investment climate in the city.
- Reforming city services.
- Improving efficiency of budget spending, etc.

171. The strategic plan concentrates on the key and most promising areas, identified on the basis of capacity assessment, analysis of city strengths and weaknesses, and possible scenarios of its development.

172. The strategic plan contains ideas and principles which serve as benchmarks for businesses, potential investors, city government and citizens and which helps to make responsive decisions on the basis of the vision of development perspectives. The strategic plan is not a purely administrative document. Rather, it is a social consensus agreement based on which the local government, enterprises, and non-governmental organisations assume certain obligations.

173. The strategic plan is not a directive. Rather, it is a code of agreed and reasonable demands set forth by enterprises before the city administration and, conversely, it is an agreement with regard to concrete actions that have a strategic significance for the city, and which must be initiated for the benefit of business circles and the population in general. The strategic planning process aims at finding a social consensus, at involving an ever wider number of active citizens in decision-making and implementation processes.

174. The strategic plan combines long-term vision and specific immediate actions. It identifies not only long-term benchmarks and prospective development areas, but also specific actions. It is a long-term benchmark with regard to the depth of forecast and duration of the consequences of the planned actions.

175. The plan sets out the main goal and objectives, a set of specific targets, tasks, and measures. It also specifies the participants in implementation, performance indicators for measurements of success, estimated costs, and efficiency.

City of Lutsk: location and history

176. The City of Lutsk is situated in the western part of Ukraine on the Styr River at the confluence of the Pripyat River. Lutsk has a population of 217 thousand and is the administrative centre in the Volhynia Region.

Figure 9 Ukraine – administrative division

177. Lutsk is one of the older cities in Volhynia, and references to it may be traced as far back as 1085. Initially Lutsk lay in the Great Principality of Kiev and later in the Vladimir-Volhynia Principality and the Galatia-Volhynia Principality. In 1240, Tartars destroyed the city. In the 13th century, Lutsk was the principality capital and seat of the orthodox bishops. In 1320, Lithuania occupied the city. In 1349, the city was temporarily occupied by Casimir III the Great and was a point of contention between the Grand Duchy of Lithuania and Poland. From 1428, the city was the seat of catholic bishops. In 1432, Lutsk received city rights. In 1569, it was incorporated into the Polish-Lithuanian crown, the capital of the Volhynia Voivodship.

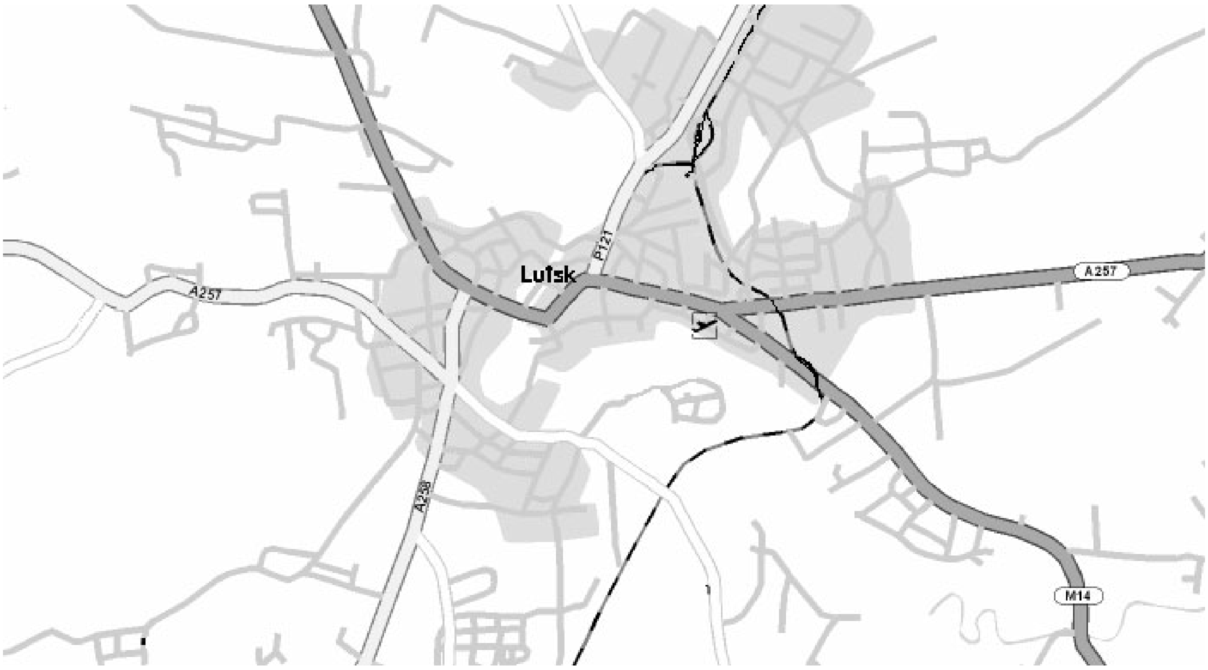
Figure 10 Volyn oblast – administrative division

178. Traditionally, Lutsk had a large concentration of Jewish residents and was a craft and trade centre. In 1795, the city was annexed to the Russian Empire. During the First World War, in 1916 the city was a region of fighting between the Russians and Austrians (Brusilwova offensive). From 1920 to 1939, Lutsk lay in Poland. From 1939-1941, the USSR occupied the city and a portion of the population, chiefly Poles, was relocated deep into the USSR. Then, from 1941 to 1944, the city was under German army occupation. From 1941-1942, a ghetto operated in the city, most of the inmates of which were murdered on Polanek Hill. The vicinity of the city served also as the territory for soviet partisans and divisions of the National Army. From 1945 to 1991, Lutsk lay in the Ukrainian SRR. Since 1991, Lutsk has lain within the border of Ukraine.

179. Lutsk has much industry including electrical machines, automobile, machines, metal, textiles, clothing, shoes, chemicals (production of synthetic fibres and household chemicals), furniture, food, construction materials, and ball bearing plants. The city is a transportation hub and tourism centre. It is home to a pedagogical academy, a branch of the Lwow Polytechnic, a philharmonic and a regional museum with an art gallery. It has larger amounts of green space, including a 100-hectare park in the river basin.

180. The city has many monuments, including fragments of the upper castle – defensive walls with three turrets (XIII-XIV, XVI centuries), manor houses (XVIII century) and bishops' residence (XVIII century), fragments of the lower castle with the Czartoryski Tower (XIV-XV century), and fragments of the Brigittine convent (XVII-XVIII century). Other historical sites include the Church of the Jesuits (1606-1610, after 1781 reconstructed into a Roman Catholic cathedral) and the Bernadine church and monastery (1752-1755, from the second half of the XIX century an orthodox cathedral). The city is home to the following monasteries: Basilians (XVII century), Dominicans (XVII century), Trinitarians (XVIII century), Sisters of Charity (XVIII century) and two Greek Orthodox churches (XVI century). It also has a fortified synagogue ("small castle", XV century) and various historic homes (XVI-XVIII century).

Figure 11 City of Lutsk



Government organization

STRUCTURE OF EXECUTIVE ORGANS OF THE CITY COUNCIL

- **City Council 45 Members**
- **Board**
- **Mayor**

- **Council Secretary, First Deputy Mayor**
  - Permanent Council Commissions - 7
  - Review Commission 1
  - Organisational Department of the City Council - 3
  - Education Department - 9
  - Department of Health Protection - 3
  - Culture Department - 6
  - Social Care Department - 67
  - Department of Trade, Group Nourishment and Provision of Economic Services - 8
  - Committee for Physical Fitness and Sport - 11
  - Section for Youth and Families 2
  - Services for Minors - 4
  - Centre for social services for youth - 2
  - Section for Internal Policy - 2

- **Deputy Mayor**
  - Department of Municipal Housing Management - 25
  - Department of Architecture of Urban Planning - 10
  - Department of Capital Construction - 14 (not financed from the budget)
  - Section for Registry and Division of Housing Space - 7
  - Section for Privatisation of Housing Fund - 7
  - Section for Coordination of the Work of Municipal Personal Transportation - 3
  - Social Benefits Section - 46
  - Section for Use of Nature and Environmental Protection - 4
  - Department for Emergencies and Civil Defence - 3
  - Section for Land Resources - 4

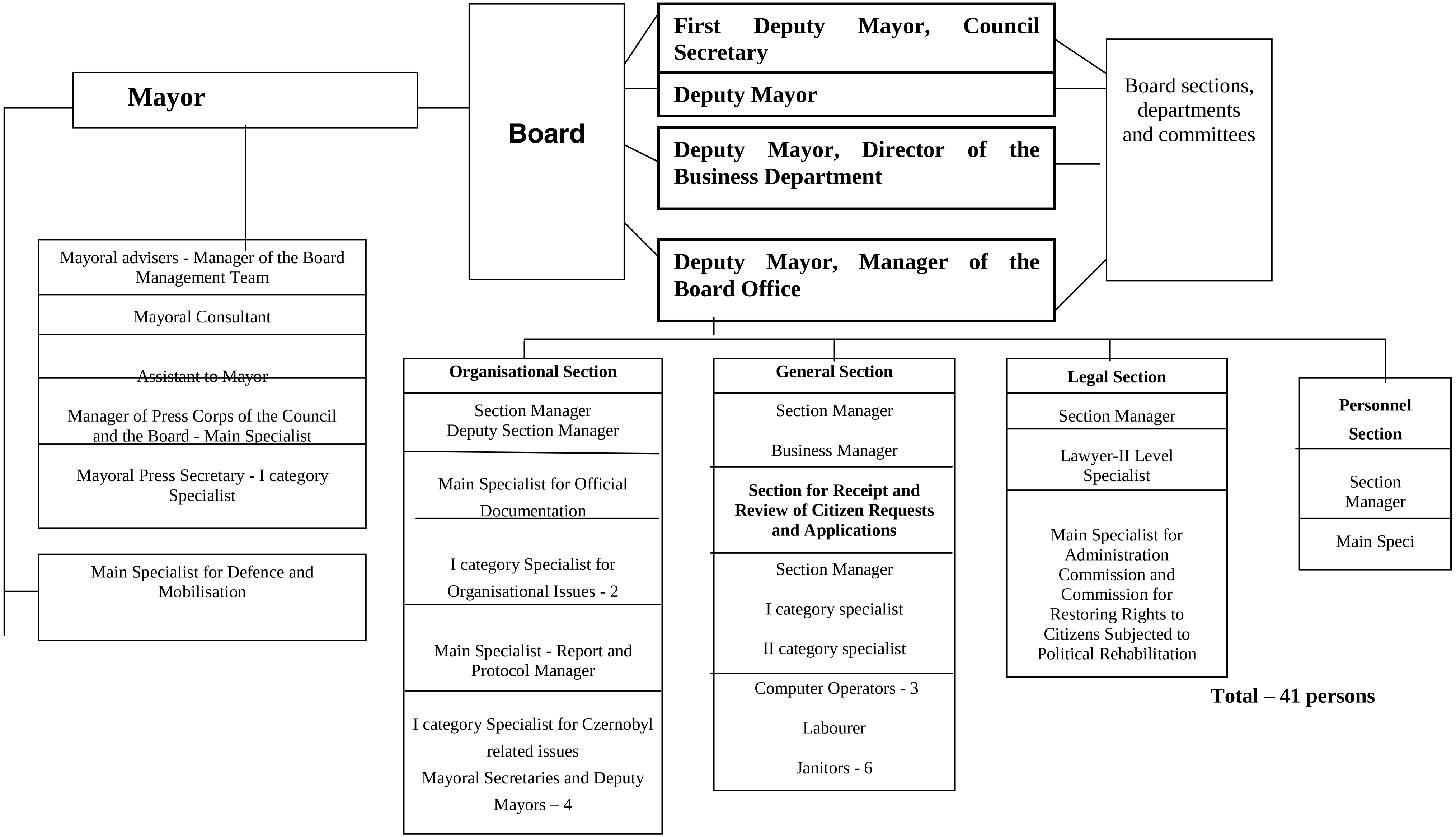
- **Deputy Mayor, Director of Business Department**
  - Business Department - 13
  - Section for Registration of Businesses – 6.5
  - Department of Investment, Foreign Trade and Tourism - 4

- Section for Registry of Communally Owned Assets - 6
- Finance Department - 30
- Section for Registration and Reporting - 4

- **Deputy Mayor, Manager of Board Office**
  - Board Office - 41 **of which:**
    - Organisational Section - 11
    - General Section 15
    - Legal Section - 3
    - Personnel Section - 2
      - Archives - 1

Total employees in the structure of the executive organs of the Council financed from the city budget - **351.5**

STRUCTURE FOR BOARD OFFICE OF THE LUTSK CITY COUNCIL



Municipal finance in past years

Analysis of budget revenues from 1999 to 2002

181. Ukrainian laws on the Central Budget of Ukraine for each budget period establish the taxes and untaxed fees of the city budget, as well as norms for their payment into the city budget.

182. Pursuant to Ukrainian laws on the Central Budget of Ukraine for 1999, 2000, 2001 and 2002, as well as to the Ukrainian Budget Code, which came into force on 1 January 2002, the following revenues are city budget revenues reserved for the city budget and included in calculations of intergovernmental transfers:

Table 9 Budget revenues, years 1999-2002, thousand hryvnia (UAH)

	CITY REVENUES	1999	2000	2001	2002-plan
A	**Own revenues**	**17 905**	**33 856**	**42 456**	**46 418**
1.	Personal income tax	12 198	30 207	35 883	39 931
2.	Fees for issuing licenses and certificates	2 827	-	-	-
3.	Fee for state registration of businesses	79	80	81	105
4.	Fee for trade patent (excluding petroleum products)	2 031	1 861	1 720	1 730
5.	Single tax on small businesses	181	1 042	3 069	3 450
6.	State customs, which pursuant to current law is paid into the city budget	377	482	1 199	1 200
7.	Administrative fines and sanctions	212	184	504	2
B	**Subventions**	**55 769**	**58 189**	**26 863**	**28 984**
C	**Total revenues not included in calculation of intergovernmental transfers**	**22 760**	**11 228**	**9 962**	**12 144**
1	Income tax on communally owned enterprises	13 718	902	-	1 300

2	Land tax	4 554	4 907	5 007	4 340
3	Handicraft tax	122	103	66	65
4	Licensing fees with right to retail sales of alcoholic beverages and tobacco products	734	1 112	-	800
5	Local taxes and fees	3 393	4 075	4 644	5 054
6	Proceeds from interest for temporary handling of free city budget sources	47	34	26	33
7	Other receipts provided for by law	47	-	81	-
8	Fees for support of children in boarding schools	7	9	13	12
9	Fee for lease of self-contained complexes of communal assets	-	-	-	500
10	Proceeds from loans, which have expired	9	5	-	-
11	Other untaxed receipts	139	81	125	40
D	**Special funds**	**2 532**	**9 320**	**10 853**	**9 132**
	Capital budget, of which:	863	3 808	4 650	3 000
1.	Dividends from shares in communally owned companies	206	308	-	-
2.	Receipts from expropriation of communal assets	657	2 485	3 292	1 000
3.	Proceeds from sale of land	-	1 015	1 358	2 000

	Special fund, of which:	1 669	5 512	6 203	6 132
1.	Tax on owners of means of transport	1 597	922	562	1 880
2.	Issuing trade patents to sellers of petroleum products – petrol and filling stations	-	-	-	75
3.	Own proceeds from budget enterprises	-	3 541	5 230	3 604
4.	Fees for environmental pollution	72	120	127	58
5.	Earmarked funds created by local government bodies	-	929	284	515
	TOTAL REVENUES	**98 966**	**112 593**	**90 134**	**96 679**

Figure 12 Own revenues structure

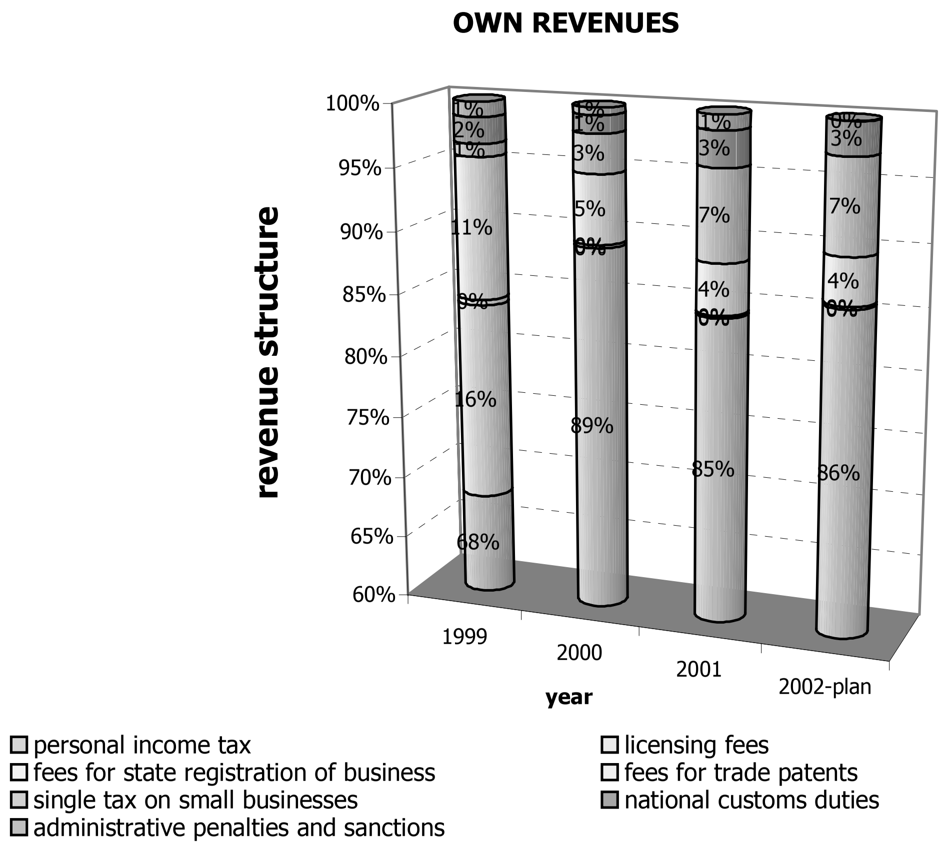


Figure 13 Revenues not indicated in intergovernmental transfers

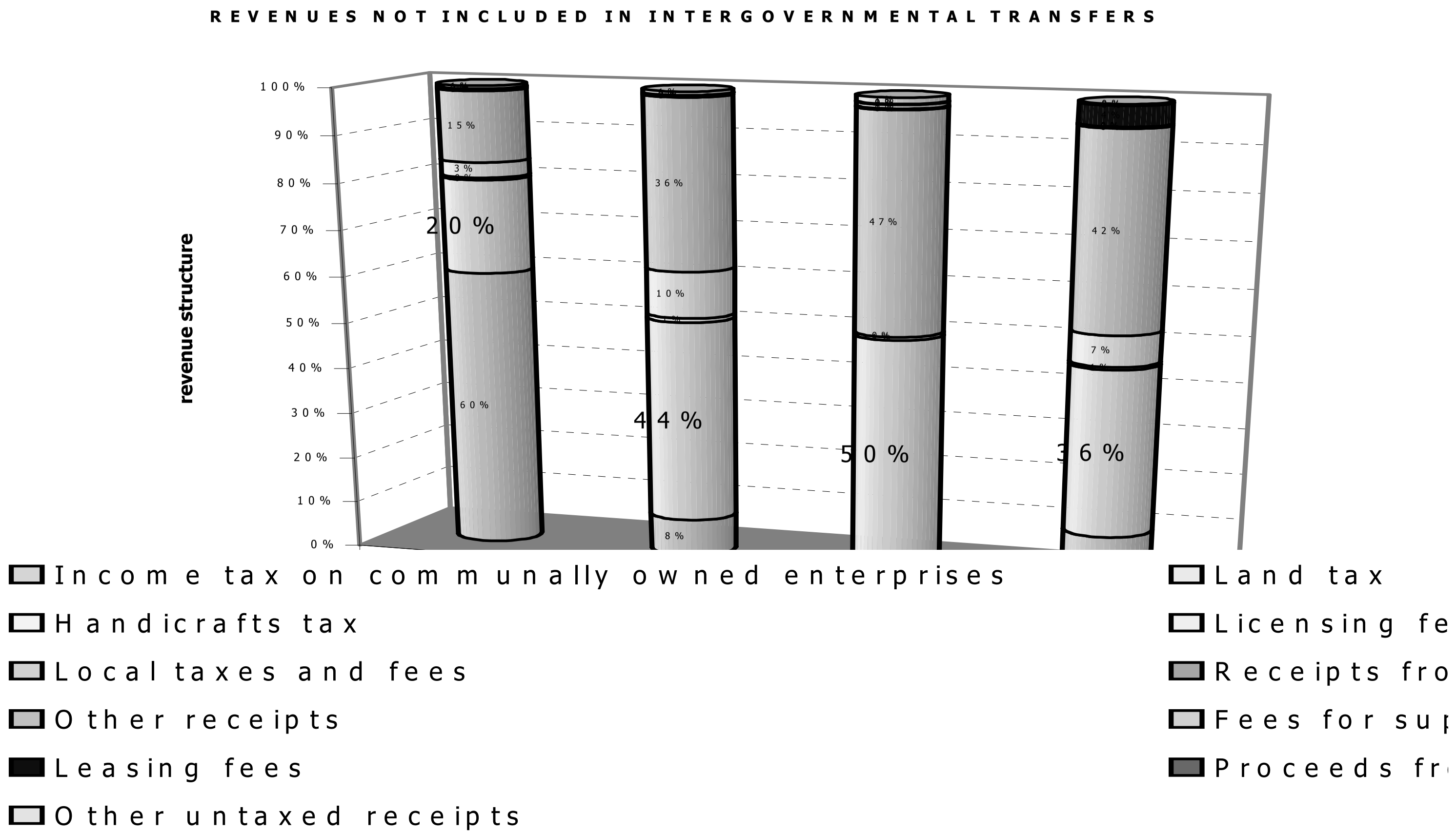


Figure 14 Capital budget structure

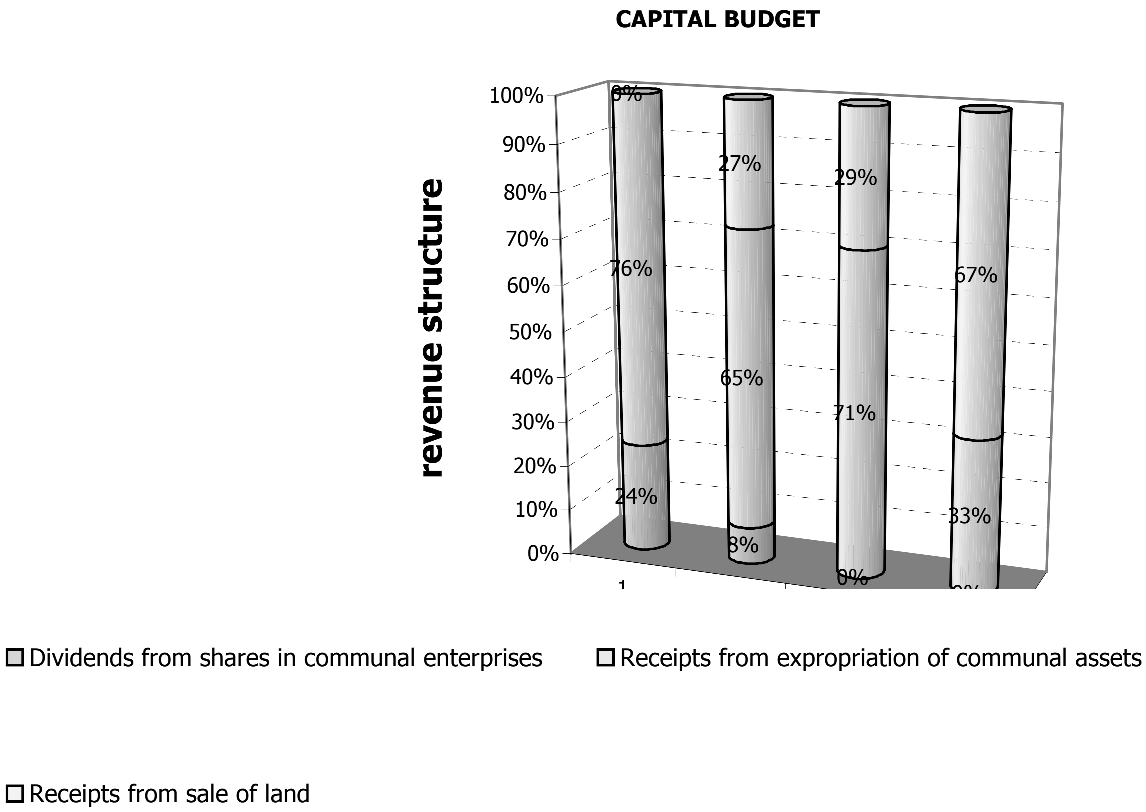


Figure 15 Soecial fund structure

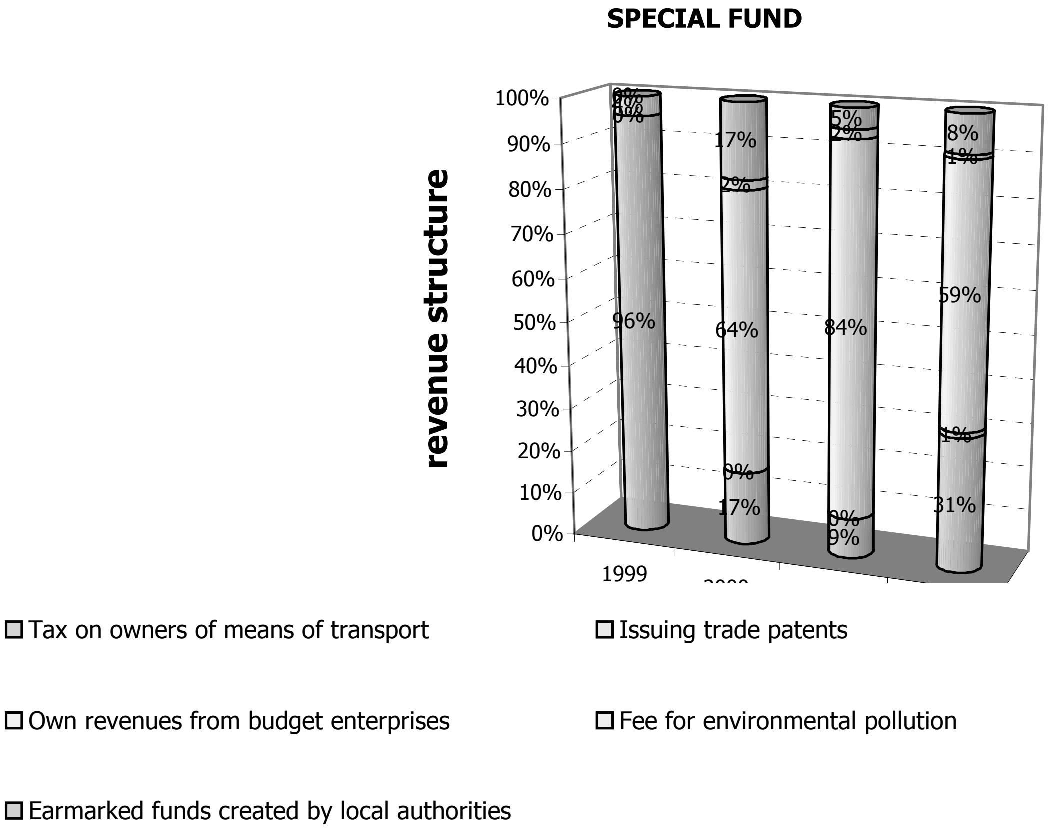
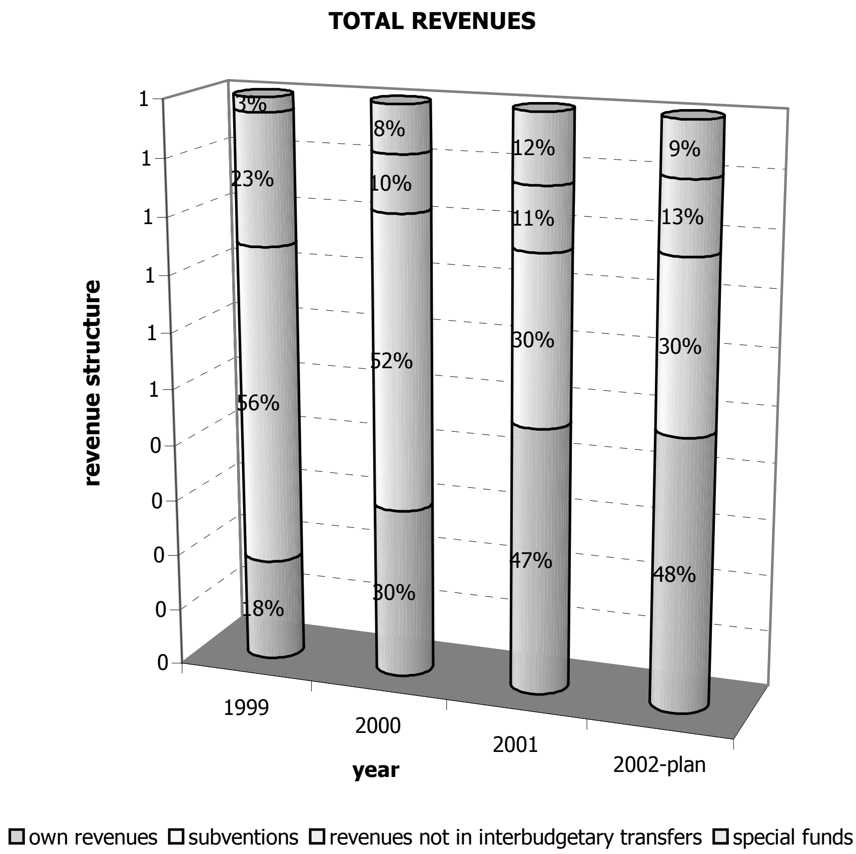


Figure 16 Revenues structure



Analysis of City of Lutsk budget expenditures from 1999 to 2001, as well as planned for 2002

183. Expenditures, just as municipal budget revenues, are divided into a general fund and a special fund.

General fund expenditures are:

1) Expenditures assigned to the city budget and taken into account in calculating intergovernmental transfers.
2) Expenditures carried out using earmarked subventions from the central budget.
3) Expenditures not included in calculating intergovernmental transfers.
4) Special fund expenditures.

184. In accordance with laws on the Central Budget of Ukraine for 1999, 2000, 2001 and 2002 and the Ukrainian Budget Code, municipal budget expenditures reserved to the municipal budget and included in intergovernmental transfers from 1999-2001 and in accordance with plans for 2002, are the following types of expenditures:

Table 9 Budget expenditures, years 1999-2002 thousand hryvnia (UAH)

	CITY EXPENDITURES	1999	2000	2001	2002-plan
A	**Total delegated expenditures**	**32 602**	**40 247**	**41 481**	**44 134**
1.	Local government bodies	1 670	2 181	2 450	2 110
2.	Education	12 959	15 225	19 453	24 853
3.	Health care	11 566	13 758	14 456	14 813
4.	Social protection and social security	4 817	7 476	3 649	716
5.	Culture	710	672	720	837
6.	Physical fitness and sport	880	934	753	803
B	**Subventions**	**54 330**	**52 426**	**24 753**	**30 986**
C	**Expenditures not included in calculating intergovernmental transfers**	**10 722**	**12 259**	**15 149**	**12 144**
1.	Special shelter for children	20	20	20	40
2.	Local fire brigade	50	50	50	162
3.	City watch	39	31	38	110

4.	Extracurricular education	682	801	1 024	758
5.	Development of housing sector	400	316	572	600
6.	Communal sector management	6 672	8 838	10 385	6 680
7.	Programmes of local importance in support of culture and art.	710	672	720	900
8.	Local mass media	38	45	83	150
9.	Spatial land use plan and regulation of land ownership relations	-	-	-	400
10.	Compensation of losses of the municipal transport enterprise due to the introduction by the City Council of reduced rate fares	1 949	1 320	1 674	600
11.	Water rescue activities	-	-	-	23
12.	Contingent (reserve) fund	104	45	547	500
13.	Other expenditures	58	113	36	173
D	**Total special fund expenditures**	**1** **210**	**7 098**	**7** **632**	**9 132**
	Capital budget, of which:	1 138	2 044	1 375	3 000
1	Investments	1 138	2 044	1 375	3 000
	Special fund, of which:	72	5 054	6 257	6 132
1	Reconstruction, repair and maintenance of roads	-	583	563	1 955

2	Special funds for budget enterprises	-	3 525	5 198	3 604
3	Environmental protection fund	72	22	200	58
4	Earmarked funds created by local government authorities	-	924	296	515
	Total special fund expenditures	**1 210**	**7 098**	**7 632**	**9 132**
	TOTAL EXPENDITURES	**98 966**	**112 584**	**89 854**	**96 396**

Figure 17 Delegated expenditures - structure

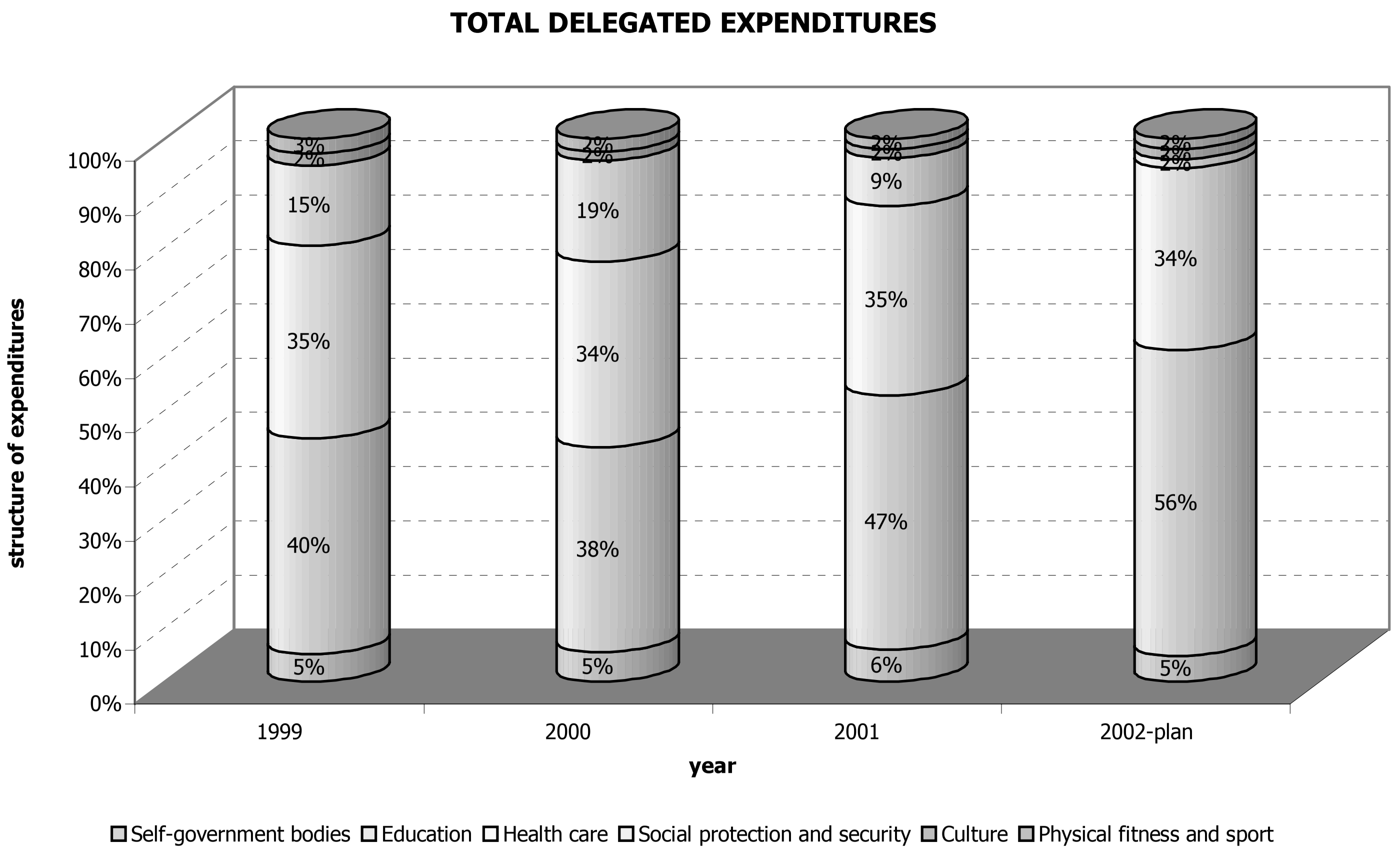


Figure 17 Expenditures not indicated in intergovernmental transfers

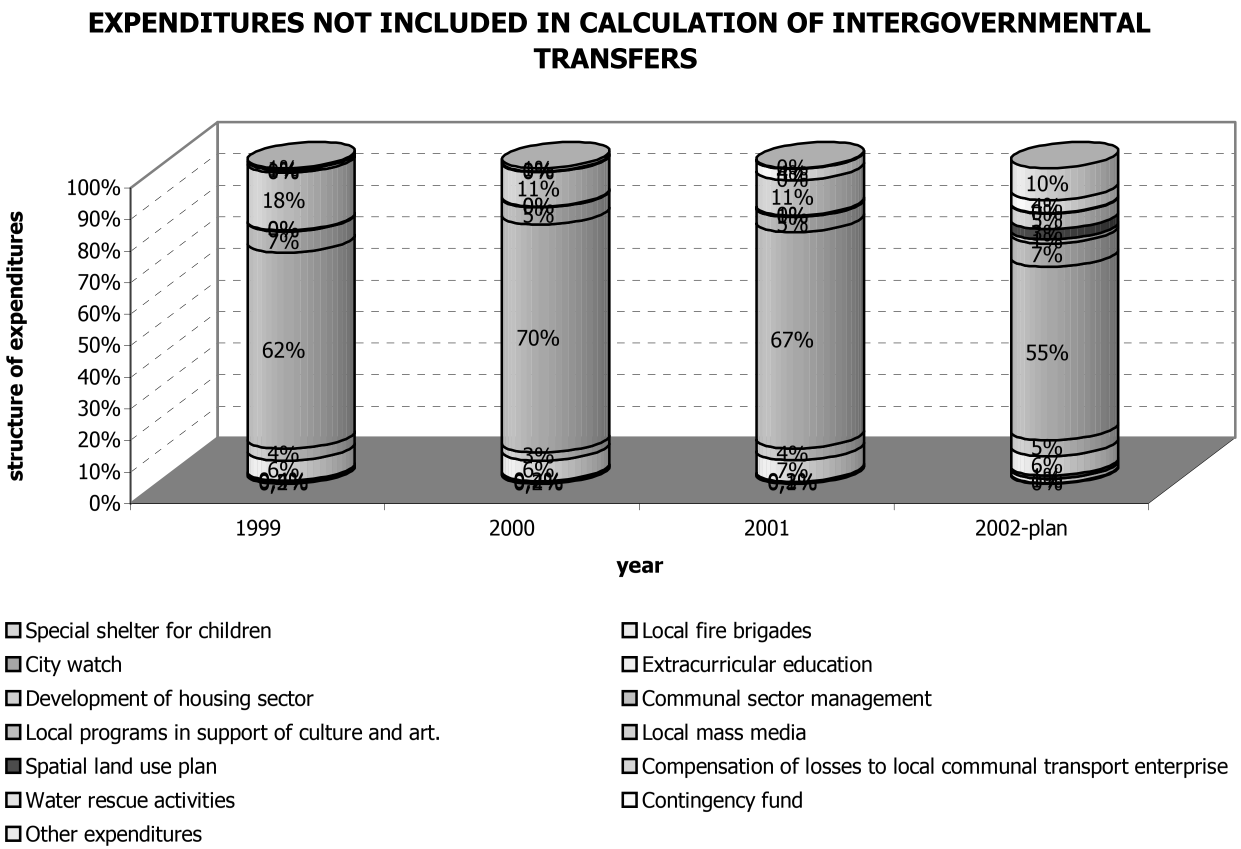


Figure 18 Special fund expenditures – structure

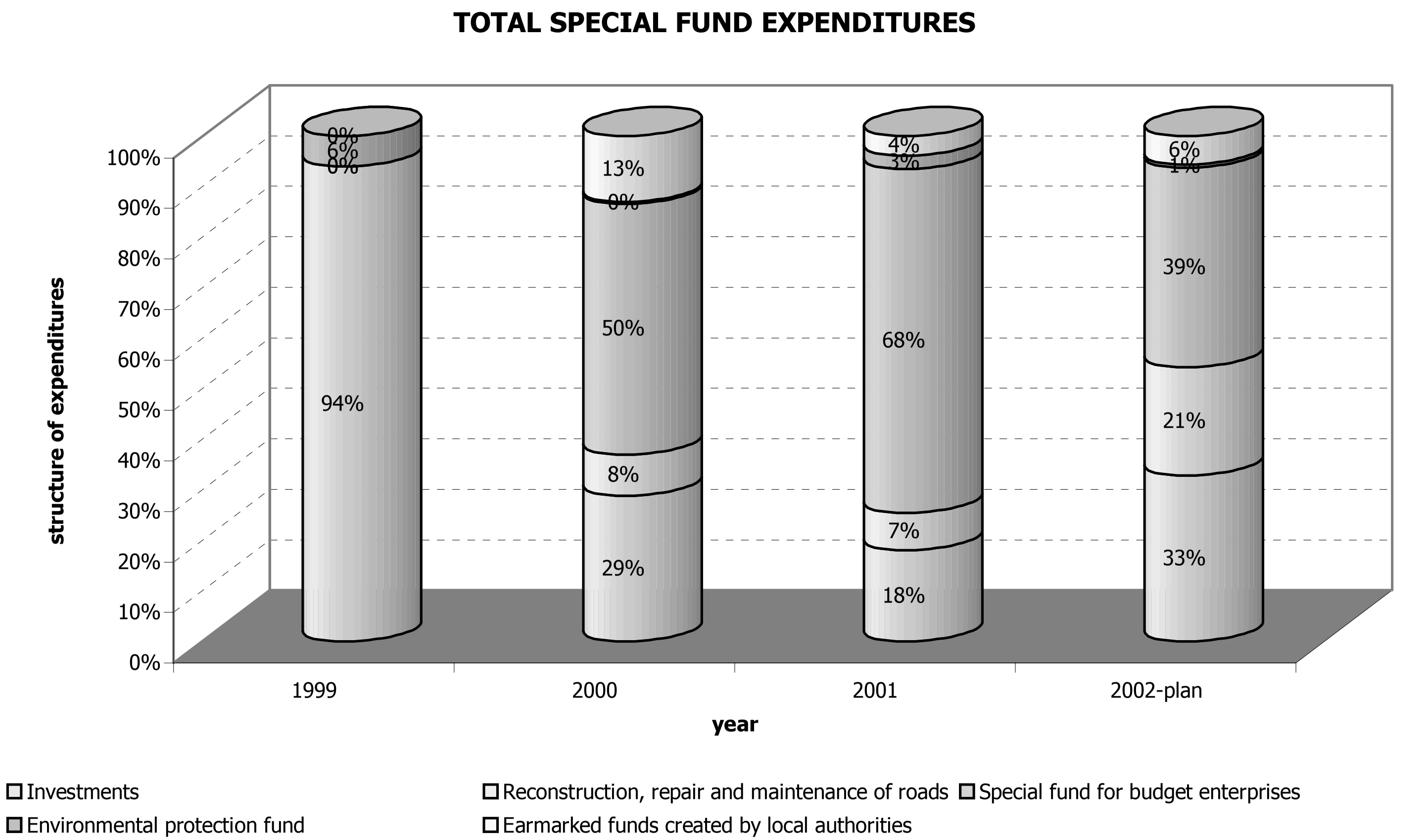
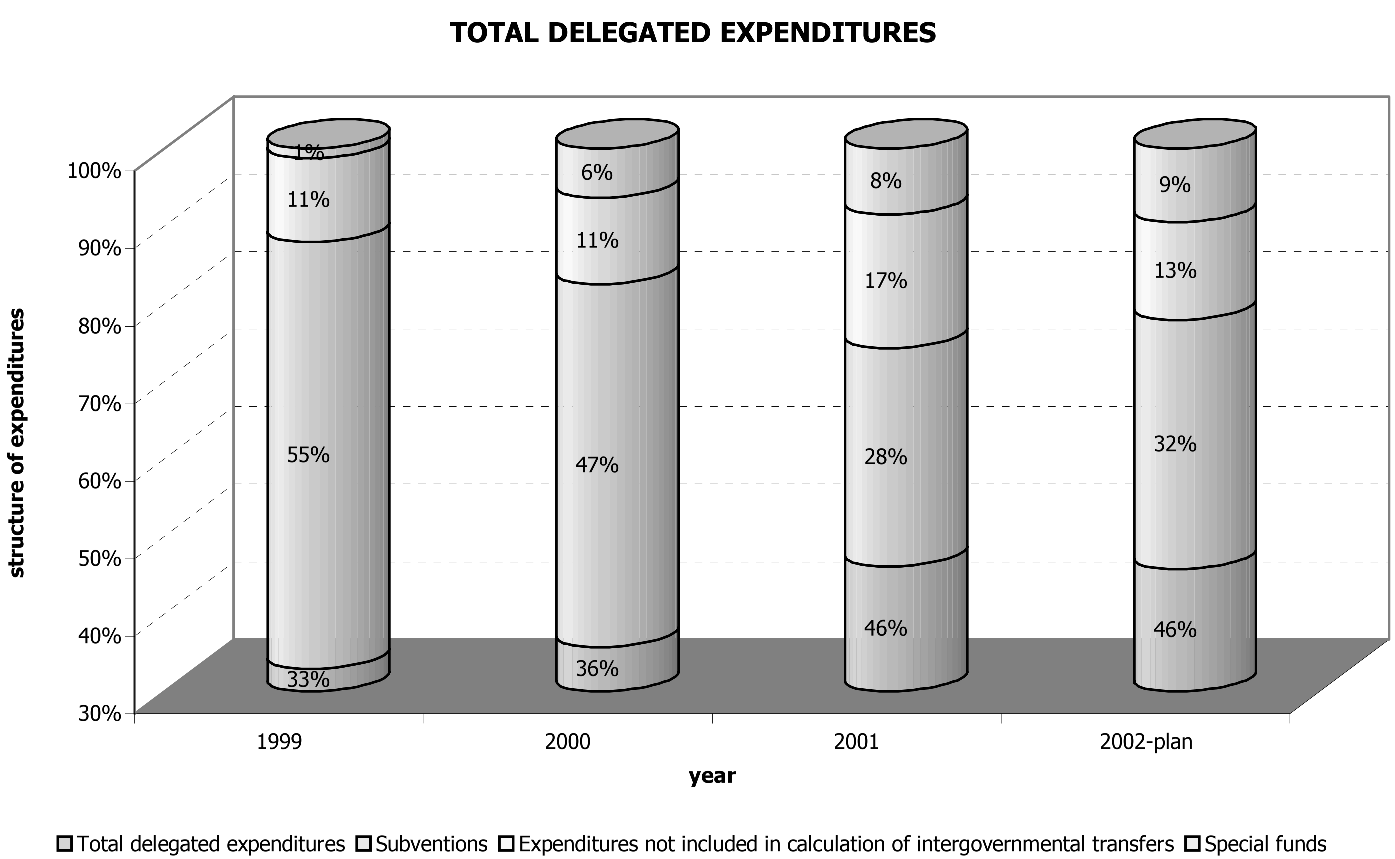


Figure 19 Delegated expenditures - structure



Main investment problems

185. Investment problems in the City of Lutsk afflict all municipal sectors. Problems affect the condition of water mains, the wastewater treatment system, the manner in which municipal solid waste is treated, as well as heating generation and distribution. Apart from these issues, the City of Lutsk could become a very attractive tourist city due to the abundance of historic buildings (*inter alia*, castle and old town). Increasing the tourism base will require a significant amount of investment outlays toward regenerating and repairing existing assets, as well as improving the quality of roads and hotel services.

Heating system management

186. "Luckteplo" is the municipal public utility operating based on a statute approved by the city administration. The utility is subordinate to the City Executive Board through the Housing and Communal Management Department and employs a staff of more than 1 150. The enterprise provides central heating and hot water supply services to the city residents – to 41.5 thousand and 51.9 thousand clients, respectively – and has signed 128 contracts with budgetary organisations and 542 contracts with organisations that operate based on business accounting.

187. The enterprise owns 66 boiler houses and 46 main heat exchangers. The boiler houses use natural gas for heat production. In the heat exchangers stations, the heat carrier circulating in the central distribution network travels through heat exchangers, which heat water in the buildings' heating systems and water from a water-dividing channel used for supply of hot water. The central distribution system constitutes a network of mains pipelines of a total length of over 169 kilometres.

188. The surplus capacity of boiler complexes results in the production of heat in amounts exceeding actual customer needs. At the same time, in some districts, clients complain about an insufficient amount of heat. The effectiveness of the heating management system can be increased through decentralization of heat production in some city districts and its centralisation in the others. Presently, some of the main heat exchanger stations in Lutsk are located at a significant distance from the boiler houses that generate the heating energy used by those heat exchangers. This leads to extensive heat losses in the heat distribution network; those losses are particularly high outside the heating season.

189. The introduction of improved control methods in each phase of production, transportation and distribution of heat would increase the effectiveness of the heating management system and reduce energy use by 10–15 % in each phase of water supply, and by a total of 30 % or even more.

190. "Luckteplo", incorporated in 2001, provides central heating and water supply services to its clients. The main task of the municipal public utility "Luckteplokomunenergo" is exacting overdue payments and restructuring outstanding debt. As a result of reorganisation, "Luckteplo" is able to improve its financial situation and plans to generate a modest profit in 2002 (given planned revenues for 2002, about 48 million hryvnia). In order to generate that profit, however, due to reduced standards for the amount of energy required for heat supply services, the enterprise would need to increase tariffs for heat supply. Further, the 80% payment rate of fees for services means that the enterprise will experience a cash deficit for covering its operating expenses and capital investment financing.

Sewer systems

191. "Lutskwodokanal" is the local municipal public utility operating based on a statute approved by the city administration. The enterprise employs over 870 persons and provides water supply and wastewater disposal services to over 70 thousand customers (serving a total of 175 thousand people).

192. Water supply systems and sewers, constructed in Soviet times, are not capital-intensive and use a lot of energy. Water is abstracted from four water-intakes – three underground intakes and one surface intake – and is delivered to the service area *via* a pressure pipeline. Customer wastewater is transported *via* collectors to 12 wastewater-pumping stations and then pumped to the wastewater treatment plant. Treated sewage is deposited into the Styr River. The cost of electrical energy used in the process amounts to 45% of the total costs of service delivery.

193. The distribution networks (mostly concrete and iron pipelines) were built in the 1960s and at present, have almost certainly exhausted their useful life. Excessive pressure in the networks accelerates the deterioration of the pipelines and results in frequent bursts and significant water losses. The share of outlays for production needs and the share of unaccounted for water in the total amount of water production is estimated at 30%.

194. Presently, the utility's most important tasks are to:

(a) Reduce energy use by replacing or regulating work regimes of pumps, electric engines, aerators and other electric equipment.

(b) Reduce water losses by replacing or reconstructing obsolete water pipelines, renovating water supply systems and sanitary and technical equipment in residential buildings.

Water management

195. Potable water is provided to clients day and night. About 82% of the city residents use water supply services. The most important problems of water management are significant water losses, excessive energy use, unsatisfactory water quality and lack of water metering equipment.

196. Water is abstracted from four intakes – three underground (55 wells) and one surface (river) intake with a capacity of 6 thousand m^3 per day. Water is treated in three water treatment plots and then transported for storage in 12 clean water reservoir tanks with a total capacity of 51 thousand m^3.

197. The water supply system consists of 300 kilometres of water supply network and three second-stage water pumping stations with pumps with a total power of 5.5 thousand kW.

198. City residents use on average 280-300 litres of water per capita per day – an amount comparable with other cities in Ukraine. By European standards, however, this amount is quite high. The reason for this state of affairs is deterioration of distribution networks, valves and sanitary and technical equipment in customer dwellings as well as traditionally profligate water use by consumers.

Condition of the infrastructure

199. Water mains are constructed of cast iron, steel and concrete. Distribution networks are made of cast iron, steel and asbestos-cement pipes of a variety of diameters. The poor state of repair and excessively high water pressure in the distribution system are some of the causes of the high rate of failures such as pipe bursts and leakage. In order to prevent failures, pipes need to be replaced and renovated using the internal sealing method. Reducing system pressure and creating pressure zones can decrease the stress on old portions of the network.

Roads

200. The city services roads of a total length of 261 kilometres. These include asphalt-concrete roads – 171.7 km or 65.7 % of all the roads, crushed stone and gravel-sand roads – 67.5 km or 31 %; paved roads –

4.3 km; dirt roads – 17.5 km or 6.7 % of all roads. The total area of the roads amounts to 5 151.3 thousand m^2, including asphalt-concrete roads – 3 612.6 thousand m^2 or 70.1 % of the total road area, crushed stone roads – 1 405.7 thousand m^2 or 27.3 %. Dirt roads cover 5.6 % of the total, or 133.0 thousand m^2. Apart from roads, there are also pedestrian paths and sidewalks in the city, the total length of which is 343 km and a total area of 514.5 thousand m^2. All of them have a hard surface. There are ten pedestrian bridges in Lutsk of a total length of 60 m and area of 300 m^2. Further, there are nineteen bridges for cars of a total area of 11 600 m^2 and length of 860 m, as well as three viaducts (with an area of 13 100 m^2 and length of 660 m).

201. This infrastructure – roads, bridges, and sidewalks – requires ongoing servicing and financial outlays. About 40% of the roads require capital and operating repairs. Due to increase automobile use, many roads require capital reconstruction, and in particular expansion of existing and construction of new pedestrian paths and sidewalks, as well as the paving of dirt roads with asphalt.

Waste management

202. The municipally owned enterprise "Luckspeckomuntrans" deals with disposal of solid waste. The enterprise provides services for the entire housing fund, both state-owned and co-operatives, residential and communal enterprises and the private sector (39 thousand people). Further, 558 agreements on providing services to industrial enterprises were signed in 2002, and the on-going sale of single-service coupons for waste disposal is conducted. Three thousand eight hundred single-service coupons were sold in the first eight months of 2002.

203. All solid waste is transported to special grounds in the village of Bryszcze located 15 kilometres from the city. "Luckspeckomuntrans" also operates the grounds, which began operations in 1990 (with an estimated operating period of 12 years). The grounds cover an area of 8.09 hectares.

204. Presently, the second part of the grounds is undergoing reclamation. A cost estimate for 2002 (totalling 500 thousand hryvnia) has been prepared and approved. Apart from the issue of completing reclamation, there is also the problem of purchasing 300 solid waste containers for the private sector. The present price of one container is 1300 hryvnia, therefore, the sum required for purchase of all containers is 390 thousand hryvnia. In order to install the containers, it is necessary to construct special yards at a cost of 40 thousand hryvnia.

205. Another pressing problem is the purchase of specialist trucks for disposal of construction waste given that the currently used vehicles do not have the capacity to transport such loads. One specialist truck costs 360 thousand hryvnia.

MIP FOR THE CITY OF LUTSK

Organisation of work and division of responsibilities

206. For the City of Lutsk, apart from the Executive Committee, the following contributed to work on this Plan:

- Valentyna Czermysh
- Lubow Golopa
- Svitlana Kohaniuk
- Raisa Kikavska

207. The following consultants provided services on behalf of OECD:

- Rafał Stanek (SST-Consult)
- Adam Stachel (SST-Consult)
- David Toft (SST-Consult)

208. Furthermore, a computer software product was developed under this project to support the introduction of the MIP. The following consultants worked on this product:

- Piotr Kubala and Mariusz Uchwat (SST-Consult)

209. On behalf of the Lutsk Executive Board, V-ce Mayor Sergiej Tarasyuk co-ordinated and on behalf of OECD EAP TF, Dariusz Śmiałkowski co-ordinated and directed the entire project.

210. Development of the Multi-Year Financial Plan for the City of Lutsk began with the consultants' first visit in February 2002. It was not possible, however, to commence work before Ukrainian local government elections. In essence, therefore, more intense work began in earnest during the next visit in May 2002, during which three city employees participated in MIP training in Poland. This training yielded a division of responsibilities among working groups for MIP implementation. Further, an action plan was then approved (below).

Multi-Year Financial Plan methodology for the City of Lutsk, 2003 to 2007

Procedure or document	Effect	Deadline for completion	Responsible person
1. Establish procedures and method of conducting work, as well as format of documents and tools necessary to complete work	-----------	By 30.08.2002	Consultants
2. Multi-Year Financial Plan (MYFP) for the City of Lutsk a) Analysis of past budgets and separating out the investment from the operating budget b) Develop and agree macroeconomic assumptions used for financial planning c) Budget forecasts through 2007	Plan for city investment sources	By 15.09.2002	Finance Group
3. Define investments planned for implementation a) using computer tools to plan investments b) characteristics and description of planned investments: - Characteristics of investment task - Timeline for implementation of investment - Source of investment financing - Impact of investment on operating budget - Evaluation of investments	List of planned investments	By 15.09.2002	Investment Group
4. Define evaluation criteria for each investment and assigning a weight to each criterion	Methodology for evaluation of investment	By 20.09.2002	City Board (Executive Committee)
5. Prepare final MIP document	MIP Document	By 26.09.2002	Each group individually
6. Supervise final version of the MYFP and the MIP	MIP Document	By 26.09.2002	Consultants
8. Approve MIP	Approval of MIP (if possible, Resolution on passing of the MIP)	By 30.09.2002	Executive Committee
9. Complete report and compose final recommendations; conference	Report	By 30.12.2002	Consultants

211. The MIP includes a Multi-Year Financial Plan and a list of investment tasks with a description of their scope and sources of financing for each year of the plan. The main objective of the financial plan was to forecast the City of Lutsk's revenues and expenditures in order to estimate the level of the city's own revenues that will be available for investment financing. Below, we review findings from the five stages of Multi-Year Financial Plan preparation, as applied for the City of Lutsk.

Stage I – Analysis of past data

The goal of this stage was to analyse the City's past budgets in order to establish a baseline for the forecast of revenues, current (operating) expenses, external financing sources and for defining the amount of funds available to be spent on investments.

212. The analysis employed data from actual city budget revenues and expenditures from the years 1999, 2000 and 2001, as well as data on planned budget revenue and expenditure indicators in 2002. Thus, the table comparing the general fund presents data on revenues reserved for the city budget, those included in the scope of inter-budgetary transfers as well as data on grants and subsidies. In the data on the special fund, receipts to the development budget and the special fund are shown separately.

213. In analysing some budget revenue positions, we observe a permanent trend: no significant difference exists in payments into the budget of such revenues as the personal income tax, the rates of which are growing steadily. This was due to the repayment of debt for salary arrears from past years, pay raises for teachers, an increase in minimum salaries and other factors.

214. Thus, if in 1999 the total amount of personal income tax paid into the budget was 12.2 million *hryvnia,* it increased by more than two-fold in 2000 to 30.2 million. In 2001 compared to 2000, 5.6 million *hryvnia* more was paid into the budget. In 2002, however, revenues from personal income tax paid into the city budget are expected to grow by only 4 million *hryvnia* compared to 2001.

215. An analogous increase is evident in the case of other revenues and non-tax budgetary receipts. With respect to local taxes and fees, the growth in revenues is related to an increase in receipts from the fairground fee due to introduction of new rates for that tax in 2000, 2001 and 2002. Over a three-year period (1999-2001), an increasing trend in receipts from land tax was evident. In 2002, however, that rate fell due to a reduction by 25% of the norm for the amount of that tax paid into the city budget.

216. Many positions in city budget revenues, however, do not show evidence of a tendency for steady increase. For instance, in 1999, the fee for granting licenses and certificates was paid to the city budget; starting from 2000, the City Executive Board has ceased granting those licenses, since that function was taken over by the District Council. Moreover, budgetary receipts from the handicrafts tax have been decreasing gradually: 112 thousand *hryvnia* in 1999 and 65 thousand *hryvnia* according to the plan for 2002. In 2002, compared to 2001, a more than three-fold reduction in receipts from the acquisition of municipally owned assets was planned. At the same time, the plan for receipts from sales of non-agricultural land was increased by 70%. An analysis of actual 2002 budget performance for the five-month period from January to May shows that the plan for receipts from repurchase of property (those funds are paid into the development budget and used to finance investment outlays) has already been exceeded by 220.8%. That is, the annual plan was achieved and exceeded by 1791.3 thousand *hryvnia.* The five-month plan for receipts from land repurchase was exceeded by 78.7 thousand *hryvnia.*

217. The analysis of expenditures for 1999-2001 was conducted in a similar fashion and in accordance with the 2002 plan (examples).

Stage II – Forecast of revenues and expenditures

218. The second stage of the MIP preparation involved a forecast of revenues and expenditures for the City of Lutsk over the period from 2003 to 2007. In preparing the tables, data on revenues from previous years the following periods – 2003/2002, 2004/2003, 2005/2004, 2006/2005, 2007/2006 – were used to define baseline values of revenues, *i.e.* the chain comparison method was applied.

219. Each of the planned revenue positions was assigned an indicator calculated using base values and inflation rates. Planning some revenue positions, however, (state registration fee, income tax and land tax) involved defining criteria for payment of those taxes to the budget in the forecast for 2003-2007. In a similar fashion, through application of inflation rates and base values from previous years, city budget expenditures for the period from 2003 to 2007 were planned.

Stage III – Determining amount of money available for investment

220. After defining baseline values for revenues and expenditures, Stage III of the multi-year investment planning was initiated. This stage involved defining the amount of funds available to the City for investment financing during the period from 2003 to 2007, after prior payment of all due financial liabilities (credits and loans). Due to the fact that the City did not take out any loans or credits from 1999 to 2001 and no credits or loans were planned for 2002, the City currently carries no debt.

Stage IV – Defining the actual amount of money earmarked for investment

221. After having planned revenues and expenditures for the coming five years, we moved on to Stage IV of MIP preparation for the City of Lutsk – defining funds that the City may assign toward investment financing over the period from 2003 to 2007. Based on conducted revenues and expenditure forecasts, we may determine theoretically how much can be programmed for investment financing over the next five years.

222. According to Art. 71 of the Ukrainian Budget Code, the basic sources in the local government budget of own costs for investments are those funds included in the development budget. Other sources include the tax on vehicle ownership and licensing fees for petrol filling stations that are used for road renovation and maintenance, as well as environmental protection fund financial resources, 20% of which go into the City budget. As a result, the City may program the following amounts from the development budget for investments: in 2003 – 3,750 thousand *hryvnia*, in 2004 – 4,612.5 thousand *hryvnia*, in 2005 – 4,981.5 thousand *hryvnia*, in 2006 – 5,380 thousand *hryvnia*, in 2007 – 5,649 thousand *hryvnia*. The total amount for the period is 24,373 thousand *hryvnia.*

223. Finally, Stage V follows, which involves the development of investment selection criteria. From the list of all of the planned investments, the best ones should be selected first. That is, those projects that would ensure that the local public participates in the investment process and that would guarantee the best economic effects should be selected as first priorities.

Financial plan

The aim of the financial plan of the city budget was to investigate the city's ability to finance investment implementation of the course of several years.

Macroeconomic indicators27

Organizations that monitor and project socio-economic trends in Ukraine.

224. In Ukraine, there are several organizations that prepare and publish macroeconomic indicators, analyse Ukrainian economic trends and perform monthly, quarterly, biannual and annual projections. Among these are the following:

International Center for Policy Studies.

225. Publication: Policy Studies – journal established by the center in January 1999. It represents results of policy research carried out by ICPS experts, partners, and other think tanks. The Open Society Institute finances the publication. The ICPS prepares monthly, quarterly, annual and biannual predictions.

Ukrainian –European Policy and Legal advise Center (UEPLAC).

226. Publication: Ukrainian Economic Trends. Publication is financed by European Union's Tacis Program, which provides grant finance and know-how to foster the development of market economies and democratic societies in Eastern Europe, the Caucasus and Central Asia (EECCA), including in Moldova. UEPLAC analyses current economic trends in Ukraine. UEPLAC does not make forecasts. The last issue of Economic Trends appeared in April 2002. The project is currently closed.

Ministry of Economy and European Integration of Ukraine

227. Publication: Konsensus prohnoz/Consensus Forecast - outlook for national economic development in 2002 – 2003 - a quarterly publication of the Ministry of Economy and European Integration. The publication is prepared with technical assistance under the Project of Economic and Fiscal Reform in Ukraine. The first issue appeared in March 2002, but to date no further issues have been published. The publication relied on data from:

- Ministry of Economy and European integration of Ukraine.
- Finance Ministry of Ukraine.
- National Bank of Ukraine.
- International Monetary Fund.
- International Centre for Policy Studies.
- Institute of Economic Forecasting of the National Academy of Sciences of Ukraine.
- ING Barings Bank.

228. The Ministry of Economy and European integration of Ukraine is the only organisation that performs five-year projections. In addition, Minecon prepares projections of the key macroeconomic indicators for the purpose of:

- Development of the National Budget of Ukraine.
- Development of the annual State programme of economic and social development of Ukraine.

[27] Alyona Babak, PADCO, Inc. Report under Contract: JA00016060, ENV NMCD # 526.

Key assumptions for 2002-2004 forecasts

229. The Ministry of Economy and European Integration of Ukraine and ICPS conducted a forecast of major macroeconomic indicators for 2002-2004. Both forecasts produced very similar outcomes. The differences that did occur, however, are noted below.

230. The most recent sources of forecast information are:

- Cabinet of Ministers Decree "On projections of economic and social development of Ukraine for 2003" №851 (17 June 2002).
- "Quarterly Predictions"#20, ICPS (5 August 2002).
- Estimates of the Ministry of Economy and European Integration of Ukraine for 2002-2006 (not publicly available). Correspond fully to the conservative scenario outcomes, cited in the press release of Ministry of Finance related to the submission of the Draft National Budget of Ukraine to Verkhovna Rada (14 September 2002).

231. The projections were based on the following assumptions:

- 2002 (data have been incorporated into the State programme of economic and social development of Ukraine for 2002).
- Implementation of active social policy assumed to lead to higher rates of wage increase that the growth rate of GDP (increase of the minimum wage to 165 UAH/per month, continued repayment of wage arrears and social payment to residents, setting social guarantees level of the state social assistance to low income families at 23.5% of the established minimum substance level).
- Enforcement of VAT collection and amendments of the current Tax Laws and regulations, enabling a decrease in profit and income tax rates, is expected to legalize revenues of the enterprises and citizens. The Ministry of Finance estimates that these measures should increase budget revenues both in 2002 and 2003; expectations are high for 2003.
- Increase of production is expected to be at 6% due to an increase in household incomes with dominating internal consumption. The key industries fueling this growth rate are: light industry (10% growth rate), paper industry (28%), production of timber goods (25%), machine building (10%). Overall GDP growth is forecasted at 4.8% (ICPS-4.5%).
- Good prospects are expected from the export of goods and services with leading agricultural industry, food industry, machine building and metal processing, chemical industry. A positive trade balance is expected by the end of 2003.
- Stable currency (5.45-5.38 UAH/USD) is expected to hold due to the positive trade balance and planned volume of external financing.
- Nominal increase of the monetary base is anticipated due to currency market activities. At the same time, NBU will be continuing its policy of encouraging an increase in loan financing and a decrease in the costs of credit.
- ICPS forecasts that consumer inflation will jump to 5% by the end of 2002, in view of raised tariffs for public utilities, electricity, transport, and communications, increased producer prices, and higher inflationary expectations among households.
- The government's CPI year-to-year index is forecasted at 3.5%. The key factors of such a projection are: stable exchange rate of hryvna, expected increase of prices for energy resources (up to 28 USD per barrel), Russia's decision to increase export taxes and cancel export quotas for oil on the world market. Increase in production volumes in agriculture, light and food industries will lead to sufficient supply of products that is assumed to allow their stable prices compared to 2001.

232. Data from 2003 have been incorporated into the Government draft of the National Budget of Ukraine for 2003, which was submitted to the Verkhovna Rada on September 14, 2002. Year 2003

economic development projections are estimated in three scenarios: conservative, target and optimistic. The Draft National Budget of Ukraine is based on the results of the conservative scenario.

233. The scenario assumes the following:

- No internal change of economic activity conditions compared to the previous year.
- External policy is aimed at increasing diversification of international trade and development of high technology productions. Re-establishment of links with markets previously penetrated by Ukrainian producers. Price-quality strategy is the key for such market expansion. Specifically, Middle East, NIS, Africa, Asia are target markets for export of energy, oil refinement, gas supply and irrigation equipment. Trade balance is expected to be positive.
- A key factor of the conservative scenario is absence of Verkhovna Rada's support of Tax, Tariff and Social Reforms (no increase of minimal salary base to 176 UAH, no decrease of income tax rates, continued system of social privileges, continued use of tax privileges).
- This is expected to slow down the increase of budget revenues, levels of internal investment that will limit increases of production capacities and production volumes.
- Average nominal wages will increase by 8 % (compared to 2002). The consequence of this is a minor increase in household income, lower demand, slower sales volumes of food, agricultural pressing and light industry producers – 3%, 3.5% and 10% respectively (target is 6%-10%).
- Barriers to implementation of tariff reform in housing and communal sector will slow the inflation rate – CPI index (year-to-year = 106).
- Increase of production is 4.5-5%, increase of import is 6.9%. Overall real GDP growth will be lower than under target scenario and will reach 4% (target is 6%).

234. Data from 2004 have been extracted from the ICPS press release ("ICPS dampens its economic forecast for 2003 — 2004" on 5 August 2002).

235. Whether Ukraine's economy will continue to develop depends on its capacity to penetrate increasingly international markets, as well as to satisfy the increasing needs of national consumers. In the mid-term, one of the key issues of foreign economic policy pursued by Ukraine's government will be accession to the World Trade Organization (WTO), which we expect to happen at the end of 2003. In this issue, we have evaluated the factors of the current goods structure of Ukrainian foreign trade, as well as assessed the potential implications of WTO accession for the economy on the whole and for agriculture in particular.

236. The problem of exhaustion of production capacities is getting more crucial in terms of development of national production of domestic goods and services. Over the first three years following economic recovery, as a response to increased demand, enterprises intensified the capacity utilisation that had been underused during the transformation recession. We believe that, nevertheless, enterprises can continue to expand production by investing in creating new production capacities, which requires more funds. Since domestic investment sources are limited, propping up a high GDP growth rate attracts more foreign direct investments. Nevertheless, we have adjusted downwards our investment forecast for 2003 — 2004, in view of the risks of political instability and incoherent public policy, particularly in the privatisation and taxation areas.

237. Although tax reform in Ukraine has been the order of the day for many years, coherent mutually co-ordinated changes in regulation have not been introduced yet. The Verkhovna Rada rejected the government proposal to introduce changes in taxation and intends to work out proposals for tax legislation with its own resources. Until parties start to seek compromise regarding the comprehensive tax reform, however, hope for progress seems dim. We assume that the government will reduce personal income tax rates starting in 2004.

238. Given these facts, we have dampened our forecast for Ukraine's economic growth in 2003 and 2004. Ukraine's GDP will improve by 5% in 2003. The acceleration will be triggered mainly by continuing galvanisation of the international business activity, as well as recovered investment growth after the 2002 failure and an increased propensity to consume boosted by more optimistic expectations regarding long-term development prospects. In 2004, the GDP will pick up by 5.5%, following accelerated household consumption after lowered tax rates and stimulation policy on the eve of the presidential elections.

Forecast for 2005 -2007

239. In Ukraine, no official forecast reports have been prepared on this period. The data were developed for internal use by the Ministry of Economy and European Integration of Ukraine. Key indicators were recalculated in accordance with Minecon methodology for prices, macroeconomic projections and wages. The staff of these departments revised the data in September 2002, which is presented in the Table 11.

240. No organisation forecasts indicators for 2007. Only two figures: CPI and PPI indexes were developed by Minecon and presented in the table at the request of PADCO, Inc. under the "Tariff Reform and Communal Enterprise Restructuring Project".

241. The Ministry of Economy and European Integration made a forecast of major macroeconomic indicators prior to the submission of the Draft of the National Budget of Ukraine to the Verkhovna Rada. The outcomes of two scenarios were presented. The target scenario assumes implementation of national programs on social, tax and tariff reforms.

242. The table does not contain data for 2007; therefore, extrapolation of 2006 data is considered to be the most reasonable assumption.

Table 10 Projecion of the macroeconomic indicators

Indicator		2002	2003	2004	2005	2006
GDP						
Real	%	106.0	106.0	106.5	106.5	107.0
Nominal	UAH mln	225 000	260 000	293 500	326 500	362 000
GDP Deflator (inflation)		1.051	1.090	1.060	1.045	1.036
Prices						
CPI						
year average	%	103.5	107.7	106.4	105.0	104.0
year to year as of 31.12	%	106.5	106.7	105.8	104.5	104.3
PPI						
year average	%	103.5	107.7	106.4	105.0	104.0
year to year as of 31.12	%	109.0	105.8	105.5	103.9	103.0
Wages						
Average nominal wages of workers, administrative personell and employees in agricultural sector *	UAH	381	463	536	630	739
Real wages of persons, apc**	%	20.3	12.8	8.8	11.9	12.8

Data source:

- Department of Macroeconomic Projections

- Department of Wages

- Department of Prices

** apc = annual percentage change

Budget revenues in years 2003-2007

243. Basic macroeconomic economic and social growth indicators for Ukraine in 2003 and data available on the economic situation in Ukraine for the first half of 2002 were used in the process of planning budget revenues for 2003 and subsequent years:

- Gross domestic product (GDP) – 260 billion hryvnia.
- GDP annual growth rate – 6%.
- Average annual price index for foodstuffs – 110.2%.
- Increase in real income of the population compared to the previous year by 9.9%.

244. Further, the actual amount of revenues received from 1997 to 2001, the plan and actually executed revenues for the first eight months of 2002 (some revenue sources) and expected actual revenues realised for all of 2002 were also used in the revenue planning process. In forecasting the amount of receipts from personal income tax, in 2003 a tax rate of 16.34% is expected[28]. Based on this forecast, the total amount of personal income tax for 2003 will amount to 47 446.7 thousand hryvnia; this is more than the expected level of receipts from this tax in 2002 by 8 974 thousand hryvnia (23.3%) and by 17 239.7 thousand hryvnia (57.1%) compared to 2001.

245. A very important revenue line in the general fund is the land tax. In 2001, the city budget received 5 007 million hryvnia from land taxes. In 2002, receipts are expected at a level of 4 483 thousand hryvnia (according to the plan, 4340 thousand hryvnia). Based on the Ministry of Finance's forecast of 16 August 2002, in 2003 this position was planned at a level of 3 750 thousand hryvnia.

246. The forecast of other tax and non-tax budget revenue sources for 2003 was conducted based on the law in force and with consideration toward the realisation of these revenues in the current year 2002 and the planned rate of inflation.

247. Revenues reserved for the city budget and included in inter-budgetary transfers should increase by 9 267.7 thousand hryvnia or 12.3% compared to 2002.

248. Over the period from 2004 to 2007, an increase in the aforementioned revenues is forecast compared to the previous year by 2.6, 3.9, 2 and 3.8%, respectively.

249. In addition to an increase in revenues from personal income tax, all sources of revenues are expected to increase, with the exception of fees for commercial licenses, which in the plan for 2003 are expected to decrease by 8.5% compared to 2002. This is due to the fact that in 2003, an increase in the number of small businesses is expected; these are small enterprises that will take advantage of a simplified tax system that assesses a sole tax and waves the licensing fee. At the same time, in 2003, revenues from the business tax are expected to increase compared to 2002 by 624 thousand hryvnia (18.1%) and from 2004 to 2007 by 4.3 to 5.4%.

250. According to forecasts, revenues not included in extra-budgetary transfers are expected to increase in 2004, 2006 and 2007 compared to earlier periods. On the other hand, the forecasts anticipate that the years 2003 and 2005 will decrease by 2 147.7 thousand hryvnia (17.7%) and 359.4 thousand hryvnia (3.2%), respectively, due to decreased revenues from land tax and local taxes and fees.

251. Taken as a whole, according to forecasts for 2003-2007, revenues to the general fund are expected to increase annually by 8.2, 3.5, 3.1, 2.9 and 3%, respectively. Forecasts of revenues to the special fund for 2003-2007, including the development budget, lead to a slightly different conclusion. The increase in development budget revenues is expected according to plan for only 2003 and 2007, while from 2004 to 2006, a decrease is expected in receipts from expropriation of municipally owned objects by 9.6, 10.5 and 10.7%, respectively. Inflows to the development budget from the sale of agricultural land will constantly increase.

[28] In accordance with the Ukrainian Cabinet of Ministers' Executive Order in force with amendments of 26 December 1992 on "Personal Income Tax" and in accordance with macroeconomic indicators.

252. Special fund revenues are expected to increase year after year with the exception of 2003, in which receipts into the special fund are expected to decrease by 148.1 thousand hryvnia (2.4%) compared to 2002.

253. In accordance with indicators forecast for 2003 to 2007, revenues of the general and special funds are expected to increase by a total of 9.1% in 2003, 3.5% in 2004, 3% in 2005, 2.8% in 2006 and by 3.1% in 2007.

City of Lutsk budget expenditures from 2003-2007

254. Basic macroeconomic economic and social growth indicators and the planned rate of inflation for Ukraine were used in the process of planning expenditures for 2003 and for subsequent years 2004-2007. (The table contains inflation rates according to plan).

Year	**2003**	**2004**	**2005**	**2006**	**2007**
Planned level of inflation	6.7%	5.4%	4.5%	4.3%	4.3%

255. Apart from this information, actual budget expenditures from 1999 to 2001, the plan for 2002 and the expected budget expenditures for 2003 (for some expenditures) were taken into consideration in planning expenditures for 2003 and subsequent years. The purpose of expenditure forecasts is to determine the amount of available resources that the city will be able to allocate toward investment projects.

256. General fund expenditures excluding grants were planned with an upward trend for each next budget period as follows: for 2003 (+8.5%), for 2004 (+3.5%), for 2005 (+3.1%), for 2006 (+2.9%) ad for 2007 (+3%). Pursuant to Article 70 of the Ukrainian Budgetary Code, however, municipal budget expenditures should be directed toward those purposes specifically stipulated in Article 88 through 91 of the Code. The Ukrainian Budgetary Code does not permit money from the city budget general fund to be spent on investment projects. Expenditure of budget resources in violation of articles 117 and 118 of the Ukrainian Budgetary Code runs the risk of criminal charges as set out in separate regulations.

257. Pursuant to article 71 of the Code, the development budget is the basic source of own revenues that may be used to finance investments. According to forecasts for 2003-2007, the new development budget is expected to amount to: thousand hryvnia

Year	**2003**	**2004**	**2005**	**2006**	**2007**
Development budget	4800	4789.2	4760.6	4748.9	4951

258. Recall that the objective of the Multi-Year Financial Plan was to determine the level of available sources of own revenue that the City of Lutsk may allocate toward financing investment projects.

259. The rates of economic growth cited above became the basis for planning budget revenues and expenditures. The following table contains the results of this plan as well as an evaluation of the financial resources that the City of Lutsk may allocate toward investment implementation. While details are presented in the final document, the following table summarises the results.

Table 11 Results of budget planing

	Position	2002-plan	2003	2004	2005	2006	2007
Revenues							
1.	**General fund**						
1.1.	*Revenues reserved for the city budget and included in extra-budgetary transfers*	75403.1	84670.8	86844.4	90203.1	91978.4	95477.5
1.2.	*Revenues not included in extra-budgetary transfers*	12144.0	9996.3	11158.0	10798.6	11946.8	11571.5
2.	**Special fund**						
2.1.	*Development budget*	3000.0	4800.0	4789.2	4760.6	4746.9	4951.0
2.2.	*Special fund*	6132.5	5984.4	6307.85	6591.3	6874.8	7170.4
	Total revenues	96679.6	105451.5	109099.1	112353.7	115546.8	119170.4
Expenditures							
1.	**General fund**						
1.1.	*Expenditures reserved for the city budget and included in extra-budgetary transfers*	75120.1	82432.2	85106.73	87525.73	89869.67	92389.17
1.2.	*Expenditures not included in extra-budgetary transfers*	12144.0	12234.99	12895.68	13475.99	14055.45	14659.84
2.	**Special fund**						
2.1.	*Special fund*	6132.5	5984.35	6307.51	6591.35	6874.77	7170.39
	Total expenditures	93396.6	100651.5	104309.9	107593.1	110799.9	114219.4
	Development budget	**3000**	**4800**	**4789**	**4761**	**4747**	**4951**

Investment plan

260. Work on developing a list of investments to be included in the plan began with a series of meetings with personnel responsible for investment planning. A form was developed – an investment task card – according to which investment proposals were defined

261. In the next part of MIP development, information on the investments was entered into the MIP programme. The MIP programme serves to forecast the city budget over subsequent years based on the Multi-year Financial Plan as well as to facilitate decisions on whether to continue with implementation of plan investment tasks. Using this programme, the city may develop many versions for implementation of investments depending on the size of grant or loan received, or other factors.

262. Twenty-eight investments that could be defined in terms of costs and effects of implementation were entered into the system.

263. The following information encompasses all investment proposals for the planning period 2003-2007 without consideration as to whether the city is able to co-finance their implementation.

- “Installation of a co-generation system for the steam turbine in the boiler house at no. 2 Karbyszewa Street”
- “Installation of a co-generation system with a gas engine in the boiler house at no. 2 Strilecka Street”
- “Decentralization of water supply from the boiler house at no. 2 Karbyszewa Street”
- “Replacement of pipes in the heat distribution network”
- “Modernization and automation of the central heat exchanger at the no. 5B Molodi Street”
- “Installation of a variable velocity electric drive in draft-and-blast equipment in boiler houses”
- “Modernization of equipment in two boiler houses”
- “Replacement of blowers in the wastewater treatment plant for municipal sewers”
- “Reconstruction of pumping stations with replacement of pumping units and automation”
- “Renovation of equipment in elevating pumping stations”
- “Reconstruction of the boiler house at the Dubnovska water pumping station by replacement of boilers”
- “Capital renovation of the cultural centre *Proswita*
- “Capital renovation of the cultural centre in the Weresnewe district”
- “Capital renovation of the centralized group of libraries”
- “Capital renovation of the Teremniwski cultural centre”
- “Capital renovation of the *Suczasnyk* club”
- “Capital renovation of the music school for children, no. 1”
- “Capital renovation of the fine arts school for children, no. 2”
- “Capital renovation of the music school for children, no. 3”
- “Capital renovation of the school of fine arts”
- “Renovation of the dental clinic at no. 6 Suworowa Street”
- “Construction of a gas pipeline on Guszczańska Street”
- “Completion of construction of the pedestrian overpass over the train station”
- “Complete reconstruction of external lighting in the City of Lutsk”
- “Completion of design work for reconstruction of a plaza next to the main commercial centre”
- “Capital renovation of the municipal hospital”

- “Completion of development of the Lubart Castle area and the Castle courtyard with renovation of structures inside the Castle and reconstruction of the orthodox church ruins”
- “Construction of a clean water tank on Wołodymyrska Street”

City of Lutsk
Investment Task Description

1. Task code and name:

2. Solution to strategic problem cited in the strategy:
(Provide the main strategic problem that the implementation of this project will address)

3. Investment task co-ordinator
(Provide name of person responsible for preparation of this task)

4. Task preparation:
(Describe project preparation status – formal and legal)

5. Description of task
(Present project scope and short desription)

6. Start date: **Completion date:**

7. Implementation schedule and source of financing

Year	Task Financing Plan			
	City's own funds	Grants	Loans	Other
Through end of 2002				
2003				
2004				
2005				
2006				
2007				
After 2007				
Total				
Total outlays				

8. Task performance indicators:
(List main effects upon task completion, e.g., identify group of citizens affected by task, reduction in city budget expenditures, etc.)

Method of investment evaluation

264. Members of the City Board developed the method of investment evaluation. The process of developing the method began with the preparation of questionnaires that were then passed on to Board members. Based on the proposals obtained, those criteria mentioned most often were selected. Further, an average weight was applied to the criteria proposals. Finally, the methodology was developed, which was used to evaluate all investments recommended for inclusion in the plan.

Table 12 Criteria used for investment project apprisal

Name of criterion	Weight
Investment progress	14
Potential of obtaining extra-budgetary grant	11
Investment generates budget revenues	12
Positive impact on natural environment	11
Investment impacts	10
Links to other investments	6
Formal and legal documentation	9
Public involvement	7
Social effects	11
Potential to divide investment into stages	5
Preferential loans	4
Total	100

1. Investment progress

265. Applied in order to favour those investments that have already begun. The greater the level of progress on the investment, the more emphasis should be placed on its completion.

Manner of awarding points:

Value of investment progress as of 31 December of the preceding year is divided by the current professional estimate of the investment costs.

2. Potential of obtaining extra-budgetary grant

266. Applied in order to favour those investments for which the city has a high probability of obtaining an extra-budgetary grant (e.g., environmental investment). Evaluating an investment using this criterion should be justified by providing the source of information based upon which we assume extra-budgetary financing is possible.

Manner of awarding points:

Planned share of extra-budgetary grant in total investment outlays.

3. Investment generates budget revenues

267. Used to favour those investments, the implementation of which increases budget revenues or reduces budget expenditures. The expected revenues or savings must accrue to the City.

Manner of awarding points:

- If, as a consequence of investment implementation, city budget revenues increase, the investment receives one point.
- If, as a consequence of investment implementation, city budget expenditures decrease, the investment receives 0.5 points.
- If neither an increase in city budget revenues, nor decrease in city budget expenditures is expected, the investment receives no points.

4. Positive impact on the natural environment

268. Used to give preference to investments that improve the state of the environment through:

- Measurable reductions in air pollution (mainly CO_2, CO, NOx, SO_2, particulates),
- Measurable reductions in water pollution,
- Improvement in solid waste management.

Manner of awarding points:

If the investment has a positive impact on the natural environment, it receives one point. In all other cases, it receives zero points.

5. Investment's impact

269. The criterion promotes investments, the implementation of which serves to meet the needs of the largest group of citizens as possible.

Manner of awarding points:

- If the investment meets public needs on the scale of the entire city, it receives 1 point
- If the investment meets public needs on a neighbourhood level, it receives 0.5 points
- In all other cases, the investment receives no points

6. Project's links to other investments

270. This criterion promotes those investments, the implementation of which is a natural requirement for the implementation or commencement of another municipal investment.

Manner of awarding points:

If the investment is linked to other investments that have been accepted for implementation, it receives 1 point; if not, it receives zero points.

7. Formal and legal documentation

271. Applied to favour those investments for which the pre-investment process has already been completed.

Manner of awarding points:

- If the investment has complete technical documentation, including construction permit, it receives 1 point,
- If the City has the full rights to the land needed for the investment, 0.6 points are awarded,
- If the investment is mentioned in the land use plan, it receives 0.4 points.

8. Public involvement

272. If local public participation in investment implementation occurred or is planned, one point is assigned. Otherwise 0 points are assigned.

9. Social effects

273. If the investment leads to the creation of new, lasting jobs, one point is awarded; otherwise 0 points.

10. Potential to complete investment in stages

274. Used to favour those investments, the implementation of which can be logically spread over more than more stage.

Manner of awarding points:

If it is possible to stage the investment, the investment receives 1 point; otherwise no points are awarded.

11. Potential for obtaining preferential loan

275. Applied in order to give preference to those investments for which a high probability exists that a preferential loan will be obtained. Evaluation of a project in this manner should be justified by providing the source of information, based upon which we assume that financing will be obtained.

Manner of awarding points:

Planned share of grant in total investment outlays.

Summary of work

276. A summary of the stages of Multi-Year Financial Plan implementation was conducted based on determining:

a) Monetary sources available to finance investments from 2003 to 2007.

b) Planned investments from 2003 to 2007.

c) Methodology and manner of investment evaluation.

277. This summary enabled the creation of a list of investments planned for implementation in the City of Lutsk.

278. On the following pages, two options of the results of investment planned are presented.

279. The purpose of Option 1 was to determine the level of city budget deficit if all 28 investments were implemented. In Option 2, based on investments of the highest priority, we present a scenario for investment implementation over the planned period. Investments evaluated as less important are postponed for implementation in the future.

280. The presentation of each option includes a list of investments, the budget impact from investment implementation and a graphical interpretation. It is worth noting that implementing all investments pursuant to Option 1 would lead to a budget deficit already in the first year of analysis (4.6 million UAH; in 2004, the deficit would reach 5.5 million UAH). Changing the scenario (Option 2) ensures budget equilibrium, but at the cost of delay of implementation of some investments into the future.

281. In essence, it may be asserted that the Option 2 scenario for investments from 2003 to 2007 is a plan that is realistic and possible to execute. A detailed presentation of investment scenarios may be found in the document entitled “Multi-Year Financial Plan for the City of Lutsk”.

282. The investment ranking system presented is undoubtedly an open question. Due to the “progressive” character of a MIP, the plan should be updated and checked at least once per year. Each update of the MIP should be reflected in the investment-ranking list as well as in information on the potential for implementation. Updating may expand the scope of investments to be implemented or, conversely, may reduce investment capabilities in the planned period and signal the need to seek additional financing.

283. The results of the MIP should become the basis for the process of annual budget plan creation, as well as taken into consideration in investment decision processes.

284. On 30 September 2002, the Executive Committee of the Lutsk City Council approved and accepted for implementation the Multi-Year Financial Plan through the year 2007. In taking this important step, the city confirmed its readiness to carry out the plan pursuant to its stipulations. Further, the city assumed responsibility to ensure the plan is implemented and to develop annual budgets in subsequent years that reflect the priorities found in the plan.

Option 1

Figure 20 Ranking list of investment projects – Option 1

Сальдо [тис.грн]								
	2003	-4 626	2005	-5 843	2007	4 855	2009	22 939
	2004	-5 573	2006	-2 687	2008	13 747	2010	32 131

№ п/п	Заголовок	Затв.	Код ...	Дата поч.	Дата зак.	Пріоритет	Витрати[тис.грн]
1	Встановлення паротурбінної когенераційної системи	☑	1	03.2003	11.2005	63.00	5 200
2	Завершення благоустрою Замку Любарта	☑	27	04.2002	09.2008	60.00	2 000
3	Заміна повітродувок на очисних спорудах каналізації	☑	6	04.2003	11.2004	57.00	182
4	Децентралізація теплопостачання від котельні	☑	2	03.2005	11.2006	57.00	2 550
5	Оновлення обладнання на підвищувальних насосних станціях	☑	4	04.2004	10.2004	49.40	53
6	Повна реконструкція зовнішнього освітлення Луцька	☑	13	04.2001	11.2004	49.00	3 320
7	Реконструкція котельної на Дубнівській водонасосній станції	☑	3	04.2003	10.2003	48.40	8
8	Встановлення електроприводів змінної швидкості	☑	10	05.2003	09.2003	47.00	208
9	Заміна труб розподільчої тепломережі	☑	7	04.2003	11.2006	47.00	5 570
10	Завершення будівництва надземного переходу	☑	12	04.1999	11.2003	33.00	1 700
11	Капітальний ремонт народного дому "Просвіта"	☑	18	04.2002	09.2008	33.00	415
12	Капітальний ремонт дитячої школи мистецтв №2	☑	24	04.2002	09.2007	33.00	91
13	Капітальний ремонт дитячої музичної школи №3	☑	25	04.2002	09.2007	33.00	29
14	Встановлення когенераційної системи з газовим двигуном	☑	8	04.2003	11.2004	32.00	780
15	Капітальний ремонт міської лікарні	☑	17	04.2003	11.2006	31.40	4 500
16	Реконструкція КНС з заміною насосних агрегатів	☑	5	04.2003	11.2003	31.00	65
17	Ремонт приміщення стоматологічної поліклініки	☑	16	04.2003	11.2003	30.00	95
18	Будівництво газопроводу по вул. Гущанська	☑	14	04.2003	11.2003	27.00	100
19	Модернізація та автоматизація центр.теплового пункту	☑	11	04.2003	11.2003	25.00	295
20	Модернізація обладнання двох котелень	☑	9	03.2003	11.2003	16.40	500
21	Капітальний ремонт централізованої бібліотечної системи	☑	22	04.2003	09.2007	15.00	240
22	Капітальний ремонт дитячої музичної школи №1	☑	23	04.2003	09.2007	10.00	53
23	Капітальний ремонт художньої школи	☑	26	04.2003	09.2006	10.00	151
24	Будівництво резервуару чистої води на вул. Володимирській	☑	28	04.2003	09.2004	4.00	1 000
25	Виконання проектних робіт благоустрою	☑	15	04.2003	11.2003	3.60	200
26	Капітальний ремонт клубу "Сучасник"	☑	21	04.2003	09.2007	0.00	21
27	Капітальний ремонт Теремнівського будинку культури	☑	20	04.2003	09.2007	0.00	23
28	Капітальний ремонт будинку культури в мікрорайоні Вересневе	☑	19	04.2003	09.2007	0.00	50

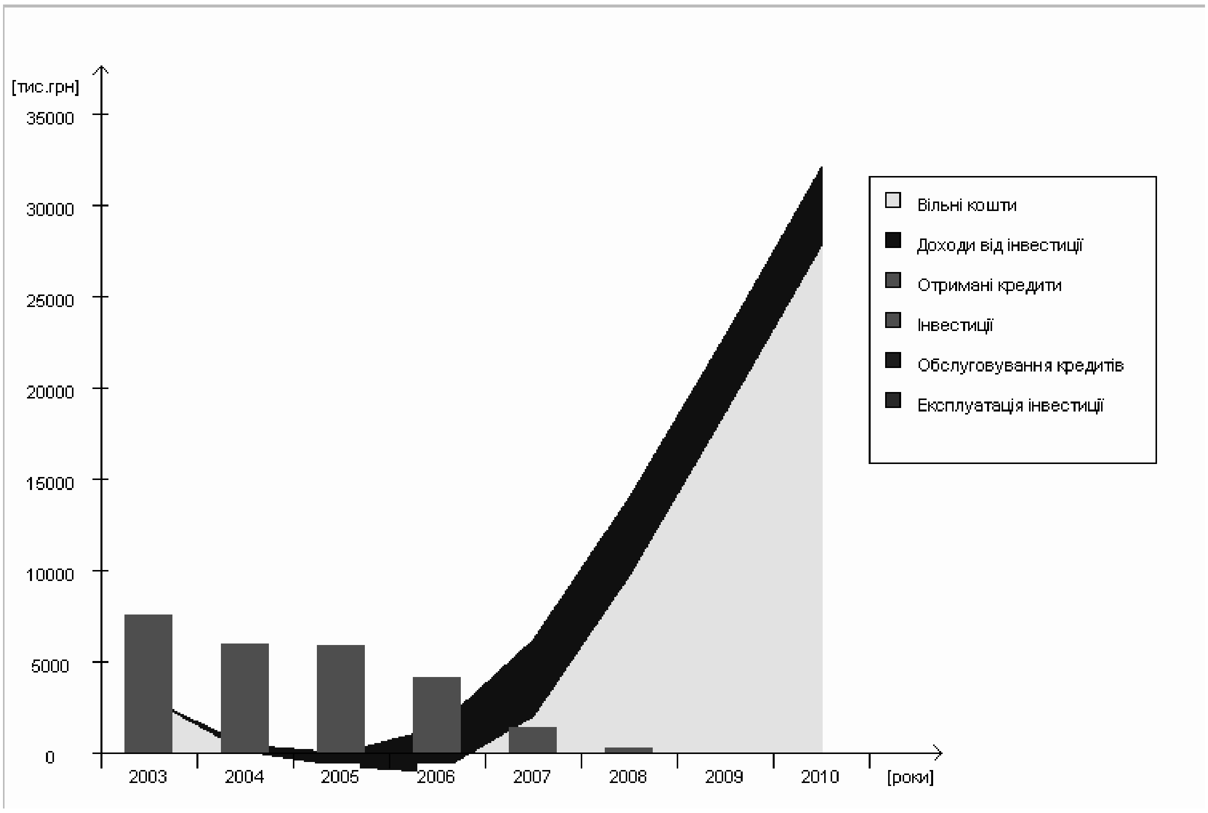
285. This option includes the selection of all 28 investments. It is clear that the city budget does not move into positive territory until 2007, meaning that in all previous years the city would have to seek supplemental forms of financing. The top section shows the closing balance (in thousand UAH) at the end of each fiscal year, assuming implementation of investments that have been selected. The first column is the consecutive number of the investment. The second column contains the name of the investment. The third column contains a check box for toggling an investment "on" or "off" to show that it has been selected for implementation and will impact budget balance calculations. The fourth column is the project code. The fifth and sixth columns show the investment starting and closing dates. The seventh column shows the priority score awarded to the investment (clearly, investments have been listed in order of their priority rank). The final column shows total investment outlays in thousand UAH.

Figure 21 Cash flow – Option 1

Перелік	2003 [тис.грн.]	2004 [тис.грн.]	2005 [тис.грн.]	2006 [тис.грн.]	2007 [тис.грн.]	2008 [тис.грн.]
Річне операційне перевищення	3 000	4 800	4 789	4 761	4 747	4 951
Сальдо на початок року	0	-4 626	-5 573	-5 843	-2 687	4 855
Капіталовкладення	8 817	6 033	5 913	4 159	1 446	300
Зовнішні джерела фінансування (бвз кредитів)	1 191	0	0	0	0	0
Надходження від впровадження інвестиції	0	286	854	2 554	4 241	4 241
Витрати на впроваждення інвестиції	0	0	0	0	0	0
Сальдо перед використанням кредитів	-4 626	-5 573	-5 843	-2 687	4 855	13 747
Кредити, позики, облігації	0	0	0	0	0	0
Обслуговування заборгування	0	0	0	0	0	0
- часткові погашення	0	0	0	0	0	0
- комісійні	0	0	0	0	0	0
- відсотки	0	0	0	0	0	0
Сальдо	-4 626	-5 573	-5 843	-2 687	4 855	13 747

286. This figure shows cash flow balance at the end of each fiscal year (see last row for totals; figures are in thousand UAH). Cash flow considers all investment outlays, as well as operating costs and revenues. The Lutsk City budget does not enter positive territory until 2007.

Figure 22 Graphical presentation of the cash flow – Option 1



287. This figure provides a graphical presentation of cash flow. The green bar shows investment outlays. The yellow cross-section is the avaiable financial sources for investments while the blue depicts revenues generated by new investments.

Option 2

Figure 23 Ranking list of investment projects – Option 2

Сальдо [тис.грн]								
	2003	0	2005	27	2007	3 607	2009	20 424
	2004	0	2006	1 298	2008	11 277	2010	29 616

№ п/п	Заголовок	Затв.	Код ...	Дата поч.	Дата зак.	Пріоритет	Витрати[тис.грн]
1	Встановлення паротурбінної когенераційної системи	☑	1	03.2003	11.2005	63.00	5 200
2	Завершення благоустрою Замку Любарта	☑	27	04.2002	09.2008	60.00	2 000
3	Заміна повітродувок на очисних спорудах каналізації	☑	6	04.2003	11.2004	57.00	182
4	Децентралізація теплопостачання від котельні	☑	2	03.2006	11.2007	57.00	2 550
5	Оновлення обладнання на підвищувальних насосних станціях	☑	4	04.2004	10.2004	49.40	53
6	Повна реконструкція зовнішнього освітлення Луцька	☑	13	04.2001	11.2004	49.00	3 320
7	Реконструкція котельної на Дубнівській водонасосній станції	☑	3	04.2003	10.2003	48.40	8
8	Встановлення електроприводів змінної швидкості	☑	10	05.2003	09.2003	47.00	208
9	Заміна труб розподільчої тепломережі	☑	7	04.2004	11.2007	47.00	5 570
10	Завершення будівництва надземного переходу	☑	12	04.1999	11.2004	33.00	1 700
11	Капітальний ремонт народного дому "Просвіта"	☑	18	04.2002	09.2008	33.00	415
12	Капітальний ремонт дитячої школи мистецтв №2	☑	24	04.2002	09.2007	33.00	91
13	Капітальний ремонт дитячої музичної школи №3	☑	25	04.2002	09.2007	33.00	29
14	Встановлення когенераційної системи з газовим двигуном	☑	8	04.2004	11.2005	32.00	780
15	Капітальний ремонт міської лікарні	☑	17	04.2004	11.2007	31.40	4 500
16	Реконструкція КНС з заміною насосних агрегатів	☑	5	04.2004	11.2004	31.00	65
17	Ремонт приміщення стоматологічної поліклініки	☑	16	04.2004	11.2004	30.00	95
18	Будівництво газопроводу по вул. Гущанська	☑	14	04.2004	11.2004	27.00	100
19	Модернізація та автоматизація центр.теплового пункту	☑	11	04.2004	11.2004	25.00	295
20	Модернізація обладнання двох котелень	☑	9	03.2005	11.2005	16.40	500
21	Капітальний ремонт централізованої бібліотечної системи	☑	22	04.2005	09.2009	15.00	240
22	Капітальний ремонт дитячої музичної школи №1	☑	23	04.2005	09.2009	10.00	53
23	Капітальний ремонт художньої школи	☑	26	04.2005	09.2008	10.00	151
24	Будівництво резервуару чистої води на вул. Володимирській	☑	28	04.2006	09.2007	4.00	1 000
25	Виконання проектних робіт благоустрою	☑	15	04.2006	11.2006	3.60	200
26	Капітальний ремонт клубу "Сучасник"	☑	21	04.2004	09.2008	0.00	21
27	Капітальний ремонт Теремнівського будинку культури	☑	20	04.2005	09.2009	0.00	23
28	Капітальний ремонт будинку культури в мікрорайоні Вересневе	☑	19	04.2005	09.2009	0.00	50

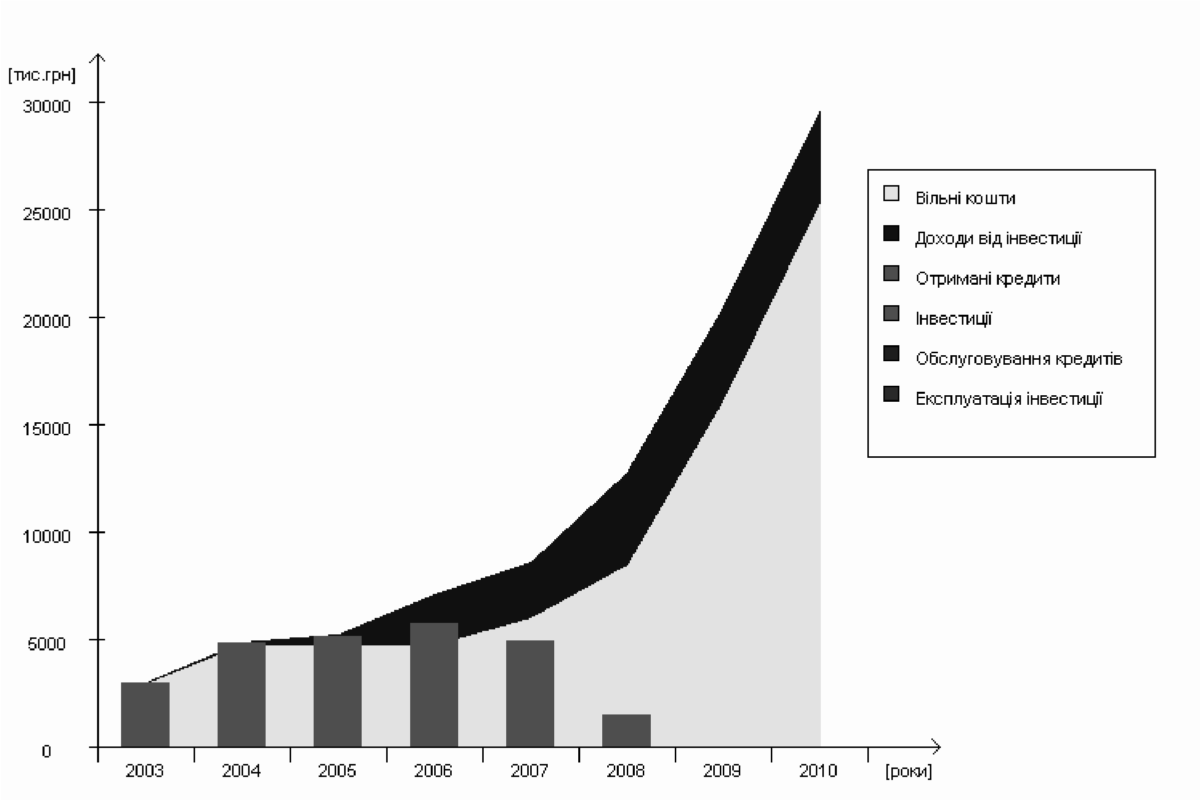
288. This option also includes the selection of all 28 investments, yet implementation of lower priority investments has been delayed. The city budget never dips into negative territory and reaches positive territory in 2005. The top section shows the closing balance (in thousand UAH) at the end of each fiscal year, assuming implementation of investments that have been selected. The first column is the consecutive number of the investment. The second column contains the name of the investment. The third column contains a check box for toggling an investment "on" or "off" to show that it has been selected for implementation and will impact budget balance calculations. The fourth column is the project code. The fifth and sixth columns show the investment starting and closing dates. The seventh column shows the priority score awarded to the investment (clearly, investments have been listed in order of their priority rank). The final column shows total investment outlays in thousand UAH.

Figure 24 Cash flow – Option 2

Перелік	2003 [тис.грн.]	2004 [тис.грн.]	2005 [тис.грн.]	2006 [тис.грн.]	2007 [тис.грн.]	2008 [тис.грн.]
Річне операційне перевищення	3 000	4 800	4 789	4 761	4 747	4 951
Сальдо на початок року	0	0	0	27	1 298	3 607
Капіталовкладення	4 191	4 902	5 199	5 817	4 992	1 522
Зовнішні джерела фінансування (бвз ...	1 191	0	0	0	0	0
Надходження від впровадження інве...	0	102	437	2 327	2 554	4 241
Витрати на впроваждення інвестиції	0	0	0	0	0	0
Сальдо перед використанням кредитів	0	0	27	1 298	3 607	11 277
Кредити, позики, облігації	0	0	0	0	0	0
Обслуговування заборгування	0	0	0	0	0	0
- часткові погашення	0	0	0	0	0	0
- комісійні	0	0	0	0	0	0
- відсотки	0	0	0	0	0	0
Сальдо	0	0	27	1 298	3 607	11 277

289. This figure shows cash flow balance at the end of each fiscal year (see last row for totals; figures are in thousand UAH). Cash flow considers all investment outlays, as well as operating costs and revenues. The Lutsk City budget enters positive territory in 2005, having nevered dipped below zero.

Figure 25 Graphical presentation of the cash flow – Option 2



290. This figure provides a graphical presentation of cash flow. The green bar shows investment outlays. The yellow cross-section is the avaiable financial sources for investments while the blue depicts revenues generated by new investments. Note the delayed implementation compared to Option 1.

Problems encountered over the course of work

291. The stages of work on development and implementation of the Multi-Year Financial Plan in Lutsk did not always proceed without incident. The following table lists the problems that occurred by work stage, as well as the manner in which these problems were addressed.

Financial plan

	Problem	**Solution**
1	No equipment available to ensure efficient work. Few computers.	Not solved.
2	Personnel working on Financial Plan did not possess basic computer skills.	Not solved.
3	Local government personnel unconvinced that work on the financial plan is beneficial given the existing and constantly changing budget planning procedures.	Presentation of local self-government experience in countries at similar stages of budget reforms, as well as effects of such planning.
4	Ukrainian local governments lack experience in similar tasks.	Not solved.
5	Problems with electronic communication using the Internet.	Not solved.

Defining investments

	Problem	**Solution**
1	Personnel involved in this stage of work held conviction that the city's infrastructure investment needs were minimal. Example: "At one of the meetings on defining investment needs in various areas, city representatives contended that there were no water supply problems."	Additional meetings and definition of problems.
2	Persons involved in this stage of work had no ability to estimate outlays required investments or to develop an implementation schedule for defined investments.	Additional meetings and addressing particular problems.
3	Lack of knowledge on investment financing opportunities.	Presentation of financing possibilities.
4	No computer base.	Not solved.

Method of investment evaluation

	Problem	Solution
1	Unfamiliarity with the methods of investment ranking and lack of conviction as to the aptness of the proposed method.	Additional meetings, addressing particular problems and developing a method of investment evaluation.

RECOMMENDATIONS

City vision

292. Representatives of the City of Lutsk have noted the unique role of their city due to its history, geographic location and industrial and cultural development. Clearly, continued development of the city is to a large extent dependent on development of the entire Republic of Ukraine as well as on the standard of living of its residents. Nevertheless, it may be concluded that decisions taken on the local level will play a large role in the development of the city.

293. The City of Lutsk is one of the more interesting cities of western Ukraine. Its development potential, however, depends to a large extent on the integration of activities aimed at promoting the city's positive traits as well as addressing its shortcomings.

294. It is especially important to emphasise the fact that moments such as the those below are rare in other Ukrainian cities, including:

- Fragments of the upper castle – defensive walls with three turrets (XIII-XIV, XVI centuries).
- Manor houses (XVIII century) and bishops' residence (XVIII century).
- Fragments of the lower castle with the Czartoryski Tower (XIV-XV century).
- Fragments of the Brigittine convent (XVII-XVIII century).
- Church of the Jesuits (1606-1610, after 1781 reconstructed into a Roman Catholic cathedral).
- Bernardine church and monastery (1752-1755, from the second half of the XIX century an orthodox cathedral).
- Monasteries: Basilians (XVII century), Dominicans (XVII century), Trinitarians (XVIII century), Sisters of Charity (XVIII century).
- Two Greek Orthodox churches (XVI century).
- Fortified synagogue ("small castle", XV century).
- Various historic homes (XVI-XVIII century).

295. Most of the listed monuments require large financial outlays for restoration or even upkeep. On the other hand, the city cannot neglect the entire tourism base in the form of hotels and restaurants, access to utilities and an acceptable level of municipal infrastructure.

Course of action

296. Successive stages of developing the Multi-Year Financial Plan for the City of Lutsk brought into sharp relief the large investment problems associated with municipal infrastructure on the one hand and the limited potential for the city to finance these investments on the other. It may be asserted that under-investment in infrastructure is a typical problem for countries and local governments in Central and Eastern Europe. Still, a general civic awareness does exist on the unique role of the history and geography of a given area.

297. Unfortunately, the image of even the most famous city cannot withstand a lack of fundamental services that can both satisfy local residents as well as facilitate the stay and engagement of tourists and investors.

298. Fortunately, the results of investment planning for the City of Lutsk, as well as the investment evaluation criteria selected for use, bespeak the huge responsibility and vision of the future for their city that local government personnel have placed upon themselves.

299. The top ten investments ranked according to the criteria of importance are those investments associated both with improvement of municipal infrastructure (heating systems, water mains) as well as cultural and historic infrastructure (old town). Upon analysis of the remaining investments, it is possible to assert that these types of actions will be favoured in the years to come.

300. It should be re-emphasised here that the city authorities accepted in full both the procedure and format in which work on the investment plan was conducted, as well as the results of these efforts. This is evidenced in the fact that the Executive Committee of the Lutsk City Council passed a resolution on approval of the Multi-Year Financial Plan. On the following page, the original version of this resolution is provided.

ЛУЦЬКА МІСЬКА РАДА
ВИКОНАВЧИЙ КОМІТЕТ
РІШЕННЯ

від 30.09.2002 № 360
м.Луцьк

Про проект Багаторічного інвестиційного плану міста Луцька (2002-2007рр.)

Заслухавши інформацію про проект Багаторічного інвестиційного плану міста Луцька (2002-2007рр.), виконком міської ради

ВИРІШИВ:

1. Взяти за основу пропонований спеціалістами Європейської організації співробітництва та розвитку проект Багаторічного інвестиційного плану міста Луцька на 2002 – 2007 роки.

2. Доручити управлінню економіки (Тарасюк С.Р.) допрацювати проект Багаторічного інвестиційного плану міста Луцька на 2002 – 2007 роки з урахуванням пропозицій членів виконавчого комітету.

3. Винести проект Багаторічного інвестиційного плану міста Луцька на 2002 – 2007 роки на розгляд сесії Луцької міської ради.

Міський голова А.Ф. Кривицький

Керуючий справами О.П. Вовчук

Виконавчий комітет Луцької міської ради Волинської області Україна ПРОТОКОЛЬНА ЧАСТИНА

Відповідно оригіналу
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Друк МП "Зоря", тел.2 40 83, 4 60 38