

**Financial and Banking Services Market**

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**PROSPECTS FOR APPLICATION
OF FISCAL FEDERALISM FOREIGN MODELS
IN THE CONDITIONS OF TRANSFORMATION
ECONOMY IN UKRAINE****Abstract**

Basic concepts of fiscal federalism, principles and models of interbudget relations both in unitary, and in federal countries are analyzed. The urgency of this research is conditioned by availability of several administrative-territorial levels in each country, which are having specific relations in the area of money resources redistribution (that is similar to regional budgets either receiving grants or contributing to a central budget). The priority lines are suggested to intensify the budget independence of subnational governments from the view of present day international practice of fiscal federalism and interbudget transfers.

Key words:

Fiscal federalism, interbudget transfers, federalism models, decentralization theorem, Tiebout hypothesis, spillover, «feet voting», expenditure mandates», «fly paper effect».

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Introduction

The aim of the paper is to design the proposals how to increase the effectiveness of interbudget transfers system functioning in Ukraine from the view of specific political formation, which is the combination of both unitary, and federal state (the Crimean Autonomous Republic, which is a part of Ukraine, has its own Constitution and Law). The urgency of this research is conditioned by the fact, that the majority of the world countries have several administrative-territorial levels of their contemporary state formations, i.e. the central government responsible for reaching the set objectives and settlement of some tasks on the level of the state as a whole, and other levels of state power functioning at regional and municipal levels. The latter are delegated the revenue powers within the frames of empowered by law the expenditure duties. The existence of such an institutional structure of state power and administration organs, irrespective of political formation of the country (table 1) originates the relevant economic branch of a public sector, which is studying its vertical pattern, i.e. fiscal federalism. The subject of the latter is a normative and positive analysis of the functions distribution among different levels of state power, as well as the ways of those levels interaction by means of such instruments as interbudget transfers [1; 2, 592–594].

The origin of the fiscal federalism theory comes back to the late 50-s of the 20th century, and is related to famous American econometric-wise economists *W. Baumol, D. Bell and W. Oats*. Very intensive searches in this respect were made in the 70-s – 80-s of the 20th century (*D. Friedman, Z. Liebenstein, R. Hill, Ch. J. Goets, R. Musgrave*).

The followers of fiscal federalism theory proceeded from the notion, that the national economy provides a multilevel system with administration functions, distributed among the levels, and juridical vertical subjugation of the latter. Therefore, the research center faces the following issues: feasibility of a number of levels for public sector management; optimal distribution of powers among them; the rate of the most effective social expenditures financing; degree of the central government intervention into financing of municipal organs of power; forms of control over resource utilities at all levels of economic management.

Federalism implies a tight relationship among individuals, groups and countries, which unites them into a persistent, though not ever-lasting union with the aim of quick achievement of common aim under condition when the integrity of all the parties will be preserved. Federalism is dealing with the constitutional diffusion of power. Therefore, under the federal formation, the component elements are together creating the common policy and administration, while the «collective» government is acting to preserve their integrity. Traditionally, the fiscal (budget) federalism means the distinguishing of taxing functions and distribution of expenditures among the levels of the state [6, 599]. In our opinion, fiscal federalism is a practice of fiscal relationships organization within the sector of public administration under condition, that the latter includes more than one level, which is peculiar for both unitary and federal

states. For example, the public administration sector in France numbers 6 levels: national, regions, provinces, departments, territories, and communes; in Poland – 4: national, wojewodstwa, powity, gminy; in Ukraine – 4, each of which is characterized by empowered certain tax and expenditures authorities: regional (oblast); cities of regional subordination and rural terrains: towns of district subordination, villages and settlements.

Table 1

Descriptions of political formations in the worldwide countries*

Political formation	Description	Advantages (+)	Disadvantages (-)
Unitary state (France, Japan, Great Britain, Denmark, Spain, Italy, Ukraine and others)	The central government exercises control over all state functions on the territory of the country (when several levels of state administration are available, they can not function independent of the center, since they are restricted to choose the pattern of their expenditures and revenues).	Possibility to guarantee the unity of the process of state administration throughout the country (equal opportunities for businesses and citizens to have public services irrespective of place of performance)	Poor consideration of local needs peculiarities of citizens and firms for public wealth, since territorial entities are deprived autonomy, which would allow them to respond to local differentiations in the demand pattern
Federal state (Austria, Brazil, Canada, USA, Russia, Mexico, Switzerland, UAE and others)	The distributed authorities between the Federation and its constituents are secured by the Constitution (i.e. central and regional governments) in a wise to preserve independence and authorities of each of them (main political decisions are taken as a result of negotiations between the center and the state constituents; therefore, the responsibility for taken decisions is distinguished).	Consideration of territorial distinctions in the pattern of demand and interests of different minorities (national, religious, etc.), increase of local bureaucracy's responsibility before the people of the region, and risks reduce related to innovations in the sector of public administration.	Duplication of the public entities functioning and control reduction in the country («price» for federalism), asymmetric development of federation.

Note. Developed on the basis of [3, 7–10; 4, 3; 5, 388–389]/

At the moment, the most accepted approach to theoretical models development of public finances is *L. Syoderstrome's* approach, which separates three typical models of fiscal federalism [3, 13–14]. They include the following:

1. Fragmentary local model based on the following principles: the government is succeeding, and it is approximated to citizens; the citizens have the right to vote for selection and amount of local government services. Under those conditions the government provides only national public goods, while the local public goods are financed by municipal governments.

2. Centralized model, according to which the main objective of the state is the nation's wealth maximization, and the subnational authorities are the agents for carrying out that task. The center (principal) makes incentives by issuing grants for subnational governments. The role of the latter in provision of services is minor, and their participation in redistribution is insignificant. The given approach is traditional for the majority of concepts of fiscal federalism, according to which the authorities of subnational governments refer to the area of allocation versus distribution.

3. Pragmatic cooperative model, which provides an average version of two prior ones, since it allows the local governments to pursue the policy of redistribution. But in this case the problem arises of interregional tax competition; therefore, the pragmatic local model can not ensure the optimal redistribution. The State can carry out redistribution in the following ways: 1) independently, having left the financing of those services which could be paid by the users (clients), to subnational governments; 2) to support the redistribution actions at the local level, budgeting the local governments (nobody can avoid the participation in redistribution).

So, the Scandinavian countries (Norway, Finland and Sweden) took the pragmatic model for the basis, trying to reach the vertical justice among people within the same community, and horizontal – among different ones. The vertical justice is secured by the taxation in conformity with the principles of solvency (local individual profit tax is proportional, but some exceptions), while horizontal one is due to graduated taxation levied by the principal government. In Ukraine, like in the majority of countries in Eastern Europe and CIS, the interbudget relations are tending to the centralized model, since the subnational governments' portion in expenditures and incomes of the public administration sector, despite its minor ratio, is tending to shrink [3, 80].

Most of the countries in Eastern Europe and CIS have «vertical disbalance», i.e. disparity between expenditure authorities and incomes of subnational governments, which is the grounding for subsidization of subnational (local) budgets on account of the national one (intensification of subnational governments external dependence).

1. Description of Principal Fiscal Federalism Models

The hierarchy levels of public administration are inevitably facing conflicts respective empowered authorities on the expenditure and income rates. *R. Musgrave* formulated some basic principles of fiscal federalism [7], including: 1) correlation principle (the decision on public goods production should be taken by the citizens of the terrain which will benefit and where the payments will be collected for financing of public goods); 2) centralized redistribution principle (changes in distribution depend on principal government, who has the required leverages for implementing the distribution policy); 3) fiscal equalization principle (under absence of adequate policy of individual distribution the principal government should provide certain grade of fiscal equalization of subnational governments with different budget saturations); 4) principle of national desired goods (the principal government by aid-in transfers can promote the provision of certain local public goods, since the production of the latter is described by spatial external effects, either they are of specific meaning from the national viewpoint).

Traditional theory of fiscal federalism is grounding on the analysis of functional authorities distribution among the levels of state power, as well as it is based on the analysis of fiscal instruments distribution required for carrying out those authorities [8]. The main concept, flowing from the analysis, is the conclusion that at the level of central (national) government should be concentrated the authorities in the area of macroeconomic regulation, and those respective redistribution of income among individuals by means of poor people support. Nevertheless, there are some public goods, which could be provided only at the subnational level, but due to those goods the maximal level of social welfare could be reached. As *D. Rubinfeld* notes in his researches [9; 10], the scope of wealth growth gained from decentralized provision of public goods is in price inverse relation to the demand elasticity for public goods.

American theoreticians in fiscal federalism *W. Oats*, *R. Shwab*, *R. Gordon*, proceeding from the analysis of effective pattern of tax authorities distribution among different levels of state power, came to the conclusion, that the subnational organs of power should not levy taxes on economic units which are highly mobile [11; 12]. At that, *R. Boadway* and *M. Keen* assert in their studies, that in a contemporary federal state the decentralization process is attended by both benefits and losses, which acquire three following main forms [13; 14]: 1) decentralization of authorities brings about interregional differentiation of net fiscal benefits, i.e. divergence between the scope of benefits from subnational public goods and paid tax rate (such a differentiation causes motivations for firms and individuals to move into other regions, and brings about the violence of the principle of horizontal justice); 2) high rate of decentralization is described by presence of horizontal fiscal external effects, primarily caused by subnational

authorities' wish to hit their own targets on account of other regions (for example, unfair tax competition, export of tax pressure); 3) vertical fiscal external effects are also peculiar for the federal state. Those effects consist in subnational power organs' wish to transfer the tax and expenditure load to national authorities.

Partially, the role of balance regulator between decentralization benefits and losses are played by constitutional and legal principles on the separation of the competence among the levels of state power. Nevertheless, the most important role for meeting the effective functioning of public finances belongs to fiscal arrangements [15]. They are as follows: 1) support of certain vertical disbalance of budget system via direct instructions of the center to other sectors of public administration concerning certain expenditures; 2) vertical and horizontal coordination and harmonization of fiscal policy among the power organs of different levels; 3) intrabudget transfers directed at the compensation of external effects originated by the benefits resulted by the activity of power organs of some administrative-territorial formation transferred into some other administrative-territorial formations; leveling of subnational budgets revenues; eliminating drawbacks of tax system.

To provide a better understanding of peculiarities and principles of fiscal federalism, the theoretical economists developed two principal approaches: normative and positive.

The normative theory of federalism is focused at the problem of optimal size of administrative-territorial entity, and peculiarities of the preference considerations of the citizens in small communities (base position of federalism formation). To illustrate the principles of normative federalism model, we assume, that a certain region consists of two agglomerations *A* and *B* with 50.000 residents in each (totally – 100.000 votes). Two projects *X* and *Y* are to be discussed. 55.000 people voted for project *X* and 45.000 – for project *Y*. If two agglomerations consolidate, then, respectively, by the majority project *X* will win. So, by the majority of votes the preferences of almost half of the population (45.000) will be ignored. Under different equal conditions those shortcomings could be leveled to some extent, by voting those projects in each separate agglomeration. According to the distribution of preferences shown in table 2, in agglomeration *A* 30.000 will support the project *Y*, and 20.000 will be against, and in agglomeration *B* 35.000 will vote for project *X*, and 15.000 – against. Consequently, the preferences of only 35.000 people (20.000 + 45.000) versus 45.000 will be ignored.

With intensification of preferences similarity within a certain agglomeration the possibility to ignore someone's advantages reduce. Under complete intraregional homogenization the decisions are taken unanimously. In other case, if, in spite of administrative-territorial distribution, in both agglomerations the project *X* versus *Y* is supported, then the number of ignored preferences will be identical with the first result. Moreover, the federative system creates additional conditions for discovering and implementation of advanced practice. If, for example, the project *X* comprises proposals on introduction of progressive school system,

while project Y – conservative, then under federal system they both will be experimental. Proceeding from the practice of those two systems approbation, one could determine which of school systems is more efficient, and develop proposals respectively reformation of educational system as a whole. Thus, federalism is an instrument for search of institutional innovations.

Table 2

Consideration of individual preferences under federative and centralized administration systems [2, 595]

People	Projects	
	X	Y
Region A	20.000	30.000
Region B	35.000	15.000
Total	55.000	45.000

Following those concepts, *W. Oats* in 1972 formulated the decentralization theorem, saying that if there exists in isolated territorial entity the possibility to provide a public good, which marginal costs are equal its average production costs in each of the entities, no matter either those costs were centralize or decentralize – wise financed, the provision by the local authorities of that good, meeting the real demand, will always be more effective than the provision by the government in fixed amount (on continuous basis) [8]. On the basis of this theorem *Sh. Blankart* is making the following conclusion respectively political formation of a country [2, 597]: financial and political responsibility for projecting the revenue and expenditure parts of the budget should be rested, primarily, on local authorities adverse to supraregional government or principal state, since only under those conditions the needs of the citizens residing in the territorial entities are completely met. *W. Oates* theory is based on the concept, that every administrative-territorial entity is financing its expenditures at the expense of its own resources, i.e. local expenditures are financed at the regional level, while national – at the nationwide (adherence to the principle of institutional congruity).

The principle of institutional congruity implies accordance between the users of public goods, political and economic decision makers, and tax payers within a certain administrative level. Nevertheless, the benefit from public goods rendered to a certain community usually is not limited with its territorial boundaries. Thus, the so called effect of benefit spillovers or spatial external effect arises, which means the «spillover» of beneficent effect or public service expenditures beyond the limits of that territorial entity's jurisdiction, the activity of which became the source of benefit spillover [3, 266].

The spillover effect could be demonstrated on the example of the recreation and entertainment park located in a large city and financed by tax payments to its budget. But that park can be visited by the residents from the suburban communities (who do not pay for that public benefit). In Germany, for example, each federal land is alimenting on its own account Universities, where not only young people who lived and went to schools in that land, could study, but also those from other lands. Consequently, the benefit from the public good of «study at the University» is spilling over the boundaries of the federal land (table 3).

Table 3

Forms of financial regulation in Germany [2, 605]

Forms of financial regulation	Financial regulation	
	horizontal	vertical
Financial regulation on the sharing basis or on grants-in-aid	Tuition fee for one student paid by one canton to another	Land budget grants-in-aid, for example, in providing services to non-residents of the community
Free form of financial regulation	Payments among Federal Lands	Grants-in-aids

Positive theory of federalism searches for mechanisms of interaction among administrative-territorial entities under presence of alternative framework conditions.

While federalism does not exist spontaneously, and administrative-territorial entities do not perform at their own consideration, there exists a peculiar «invisible hand» carrying out the efficient distribution of functions among different administration levels. The said conclusion was made in the 50-s of the 20th century by American economist *Ch. M. Tiebout*.

In his model *Ch. M. Tiebout* studied only those benefits which are public at the local level (they could be enjoyed by the residents of a certain region, which means that the principle of exclusion is in force throughout the intercommunity space). In this consequence, the competition is arising among the citizens, since each administrative-territorial entity will try to offer the most desired (expected) package of benefits. It brings about the effect of «foot voting», that is, the citizens through migration are able to select the most effective set of local public goods and their «prices», i. e. local taxes. The *Ch. Tiebout* migration mechanism provides an additional argument for the benefit of competence decentralization in the *W. Oates* model.

The *Ch. Tiebout* model was developed in 1956 [16, 416–424]. In his research the scientist accented the possibility of migration among municipalities. Under rather large number of municipalities, the provision of public benefits at the local level is like a competitive market of private benefits. The competition among municipalities is reflected in the combination of public goods and taxes. Thus, the *Tiebout* hypothesis could be formulated as follows: under presence of a large number of territorial entities and intensive migration of the population, the budget decentralization is promoting parity- improvement, since it creates the preconditions for adequate advantages respective local public goods and the most complete implementation of those advantages. In the ideal case, the described by *Ch. Tiebout* mechanism, would function like a market mechanism, that ensures achievement of parity-optimal situations.

The following assumptions lay in the basis of the initial position of the *Tiebout* model:

- 1) all individuals, who maximize their own benefits, are having similar preferences, similar approaches, since they are consuming one and the same public good;
- 2) communities are viewed as enterprises, whose performance is aimed at maximization of profit (equivalent tax, implying fees collected for local public goods, and depends on the domicile of the individuals);
- 3) a public good can be used exclusively by the residents of a certain administrative-territorial entity – the tax payers (preserved is the principle of intercommunity exclusion, which is not in force within the limits of a separate community);
- 4) the citizens do not bear charges for migration, they chose the place for residence exclusively from the viewpoint of optimal correlation between the set of public benefits and tax rate;
- 5) there are no charges for entrance or stand out the market (formation of communities or liquidation of existing ones are neither limited nor charged).

Optimization of the process of public goods provision after the *Ch. Tiebout* restrictive model is possible, but at the weakened initial assumptions of the hypothesis the model building results could change (table 4).

After weakening of main assumptions of *Ch. Tiebout's* model, we can come to the conclusion, that even in the conditions of decentralized federal formation there exist powerful forces directed at enlargement of a number of federal levels. Nevertheless, the monopolism at the higher federal levels enables the citizens to secure by the Constitution the rules conditioning the establishment of subordinate relations among different levels of the public administration bodies.

Table 4

Results of assumptions weakening in the *Ch. Tiebout* model [17]

Assumption	Result
Assumption weakening 1	If the individuals have different preferences and different incomes, the competing communities will increase the assortment of public goods. While migrating, the individuals will try to find the community meeting in full their need for public goods. The poor people will settle down in the communities with less perfect set of benefits, while the rich – with the best benefits. Hence, alongside with the communities where there are secondary schools, policlinics and services of social aid, there will be those with higher educational establishments, theatres, concert halls and fitness centers available (segregation among poor and rich communities).
Assumption weakening 2	The communities can provide a wide range of public goods under condition of the distinguishing of the latter. If the expenditure functions for different services are significantly different, then the specialization advantages will come to the fore. Therefore, the communities will have to initiate the regional formations (for example, lands). Due to the set regional formations, the citizens can enjoy the right of free choice of residence.
Assumption weakening 3	If the principle of exclusion in intercommunity area is not in a full force, then the spillover effect arises. The visiting citizens, who do not pay taxes to the communal budget, in this or that way consume its public goods. That is why, the equilibrium will not be parity-optimal. The negotiations of the communities concerning elimination of the spillover effect is likely to be disputable, since the expenditure rate for the negotiations is rather high.
Assumption weakening 4	Mobility charges are mitigating competition between the subnational governments. The local authorities have the opportunities for monopolistic actions. The taxation rate at profit maximization will exceed the marginal expenditures for change of place of residence, while a number of public goods – being far from optimal. As a rule, the migration mechanism in <i>Ch. Tiebout's</i> model is effective only in appliance to short distances. At the federal level the migration charges are so high that they almost do not influence the competition between certain regions.
Assumption weakening 5	The services provided to the communities are of infrastructure character, since the specific investments made by them, are irrevocable. Thus, access to the market, likewise the standing out of it need considerable costs, while the competition between those communities is not perfect. In case of destructive competition between individual monopolists, the authorities of higher levels will get some advantages, since they have a larger area for monopoly actions. At the fixed expenditure rates for access

Assumption	Result
	and exit the market, and limited mobility of the citizens, the market monopolization is too high. Ultimately, those processes will bring about not only suboptimal provision of public goods, but also excessive centralization of the competences.

Naturally, there are not a few factors hindering the effects of described *Ch. Tiebout's* model. First, change of place of residence is connected with expenditures (money expense for move, possible losses in wages, welfare fall conditioned by loss of regular milieu, communication, climate conditions). Second, the expenditures are not completely transferred to those, who take decision on change of place of residence (external effects are available, which do not intensify allocation effectiveness, i.e. departure and arrival of a large number of people could rather change the expenditures rate while it is shared with the local residents). Third, the benefits localization from the public good can never be absolute, and thus, it conditions the externalities (improvement of public order security in an individual residential point influences to some extent the situation in the region, as a whole). Fourth, the individuals are lacking sufficient information required for taking optimal decisions. Fifth, the quantity of potential places of residence for the individuals is not endless. Therefore, the parameters of the public sector development could hardly be differentiated as much as the consumer advantages are. Sixth, correlation of administrative-territorial distribution and budget authorities with economically optimal conditions of local public goods production is a great challenge because of both historic and political reasons, and a variety of goods the benefits of which are provided within different limits.

Thus, *Ch. Tiebout's* hypothesis disputability originated a number of empiric researches of that theory, out of which the most distinguished are those by *W. Oats, R. Shwab, M. Edel, E. Sclar, B. Hamilton, K. Kollman, J. Miller* and *S. Page*. So, *W. Oats* and *R. Shwab* detected correlation between real estate estimation, local taxes on real estate, and expenditures [18]. The researches develop their model of competition grounding on neo-classical approach, to find out how the local authorities attract new capital into municipalities, having employed a tax rate and quality of local infrastructure. The conclusion made on the basis of their econometric researches refers to the fact that the municipalities have to raise the tax rates on capital when they are not able to finance the public goods by means of undistortionary taxation. The *Oats-Shwab's* model asserts that when the advantages of the citizens are homogenous and with majority voting, the choice of a municipality is optimal (tax on capital equals zero, while the marginal infrastructure improvement costs are corresponding to the marginal agreement to pay). When the municipalities are non-homogenous and the tax rate is positive, then the decisions of subnational governments fall under distortions. There are three following sources of distortion in the process of decision making [19; 20]: absence of access to efficient tax instruments; ignorance of the electorate's will; non-homogenous agents within the municipality.

M. Edel, E. Sclar and B. Hamilton consider that the local taxes could be viewed as prices paid by the agents for local public goods. Accordingly, the price for housing as the cost of taxed commodity is not related to incomes and expenditures [21; 22]. *K. Kollman, J. Miller and S. Page* deal with the problem of «assorting» in the *Tiebout's* model [23]. Their researches demonstrate that the political institutes differ by their capability to effectively «assort» the citizens (mostly, by welfare level).

2. Peculiarities of interbudget transfers employment at the concept implementation of fiscal federalism

Necessity to use the interbudget transfers for the implementation of fiscal federalism concept follows from the reason that the public finances at the said distribution of taxes and functions among the state levels, face vertical and horizontal imbalances. The latter could be overcome specifically by state budget transfers to the local budgets.

Transfers (lat. *transfere*) describe the process of turning the properties over to economic subjects on irreversible and free basis. Irreversibility of a transfer implies it to be unnecessarily repaid (the transfer issuer losses his/her property rights on finances, but gets non-monetary benefits connected with certain behavior of grantor). A free transfer means that the employment of received financial resources is not charged. In addition, the transfers rather do not bring about the development of public welfare, as far as the assets are turned over from one economic subject to another, though the employment of transfer funds could promote the welfare increase.

The instruments of state policy in interbudget transfers are grants (positive transfers) and contributions (negative transfers) [3, 25]. The dominant instrument is grants. They are practiced in any country with several sectors of public administration, while the contributions is the instrument, which is more often employed in transformation economies. The grant is a financial award (beneficial), issued by the establishment – grant manager to the grant holder with the aim of certain activity support [24; 25, 276; 26]. Different researches determine different types of grants. One of the widely spread types is the classification after *E. Gramlich* presented in table 5.

Some foreign economic researches [29; 30; 31, 156-182; 32] point out the following reasons motivating the state's use of the interbudget grants: necessity to correct the external effects of subprincipal public goods; impossibility of local administration to provide the taxation to meet in full the theoretical demands, and to sufficiently budgeting of the local governments; difference in financial security among the geographic regions, which the state regards to be equalized;

priming of desired public goods production; need to ensure the minimal standards of services provision; political factors (for example, attempts to guarantee the loyalty of regional and local elites by means of financial aid, and to ease the antientral trends in the country.

Table 5

Typology of interbudget grants (after E.Gramlich)*

Type of grant	Description
Grant-subsidy	The central government's co-financing of subnational authorities on the production of public goods within the territorial formation when there is an obvious transfer of benefits (positive external effect)
Grant-allowance	Redistribution of the income transferring them from rich to poor regions, or allocation of some parts of tax payments which are more effective at national level, into subnational budgets (change of amount of incomes of lower levels of power)
Grant-in-aid	Availability of political responsibilities according to which national authorities should provide a minimal (standard) level of public services in the country, no matter what budget is financing the production of the public good (produces an effect both on relative prices of public goods for subnational authorities, and on the level of their incomes)

Note. Formed on the basis of [27, 219–239; 28, 373–377].

The traditional classification of interbudget transfers is their division into direct and indirect. Those two categories of interbudget transfers have different functional implications. The indirect transfers are the most effective instrument for vertical financial equalization, while the direct ones are mostly applied as an instrument for horizontal equalization and a tool for stimulation of the expenditures of subnational governments.

The direct transfers are also called «official transfers» which are realized via broad scope of instruments including so called «expenditure mandates», i.e. direct instructions of the center given to lower levels of public administration sector concerning some specific expenditures; incentives for fulfilling those instructions (in-aid transfers in different forms); budget equalization through direct grants; credit guarantees of higher level governments to those of lower levels etc. The variety of direct intrabudget transfers allows to classify them according to a great many of characteristics, including the following: appropriation of funds,

in-kind form, direction of flows, description of restrictions for utilization of funds, mechanism of transfers exclusion (table 6).

Table 6

Types of direct transfers*

Criterion	Type of direct transfer	Descriptions
1. Appropriation of funds	General	No limits for the funds utilization
	In-aids	The funds are appropriated for special aims
2. Material form	Monetary	The government – granter should have an exclusive right to employ the state funds, appropriating them in other subjects of public sector, i.e. governments of lower levels (those transfers are included into the expenditure part of its budget)
	Real	Free transfer of benefits and services among administrative entities of public administration sector
3. Direction of funds flows	Horizontal	Arise among the entities of the same level and allocated for the internationalization of external effects for provision of public goods
	Vertical	Arise among the entities of different levels and allocated for equalization of both vertical and horizontal imbalances
4. Nature of constraints for use of funds	Unconstrained	Complete absence of constraints (for example, equalization subsidy)
	Block-wise	Wide constraints for utilization of funds (e. g., for investments, local development, educational programs)
	Category-wise	Strict constraints for funds employment (e. g., project grants)
5. Mechanism of exclusion of transfer volumes	Full (fixed in amount)	Subnational governments receive from other budgets fixed amount of money, which cover their expenditures for provision of a concrete public good
	Matching (share, interest)	Subnational governments receive a partial compensation of expenditures, the amount of which is fixed by law

Note. Formed on the basis of [3, 39–44; 33; 34, 74].

Unlike direct, the indirect transfers are not received by the governments of a certain level from those of some other levels (the first ones are guaranteed a certain portion of the budget revenues of public administration sector of other level).

The indirect interbudget transfers in the in-kind form are divided into real and monetary transfers.

The indirect real transfers are those when a certain unit of public sector really performs the duties for another one, which is responsible for those duties, without complete cost compensation made (e. g., recompensing the transport organizations for providing beneficial city fares, obligatory wage rise of certain categories of budgeted employees). That phenomena is called in economic literature as «non-financed expenditure mandates», which implies that the interbudget transfer holder abstains from immediate performing the task shifting it to other subnational governments. As a result, the latter become the transfer issuers (those transfers are forced, since they are legislated by national law).

The indirect money transfers occur when one unit of public sector takes on account of another unit financial liabilities for the benefit of the third party (for example, credit guarantees), or grants the other party the right to receive the revenues, refusing from the latter in total or partially (e. g. split taxes).

We can distinguish three basic types of indirect money budget transfers:

1. Credit guarantees, i.e. warranties given by a superior government to a lower-level one for performing the taken responsibilities (in case of failure the guarantee is in charge).

2. Division of tax base – delegating the right to subnational state levels to get incomes from the base via the mechanism of additional to national tax rates (marginal tax rates are legislated by law, a tax base is also determined at the national level). While dividing the tax base the subnational governments can use administrative resources of the higher-level governments for getting incomes, and due to the latter to save the essential expenditures for tax administration (local and national taxes are paid concurrently). The national government by controlling the national taxes payment automatically is controlling the discipline and accuracy of tax payments to local budgets. That type of indirect transfers is rather flexible, since it provides the subnational government the opportunity to maneuver in choice of tax rates. The most appropriate types of public revenues to be included for tax base division is the individual profit tax and consumption tax. The division of tax base could be either perfect, when all the elements for its determination are similar for both national taxation, and subnational surtax, while the national level takes responsibility for administration; or imperfect, when the determination of the base could rather differ (e.g. for account of local exclusions of tax base), and the local governments take part in tax administration [3, 29].

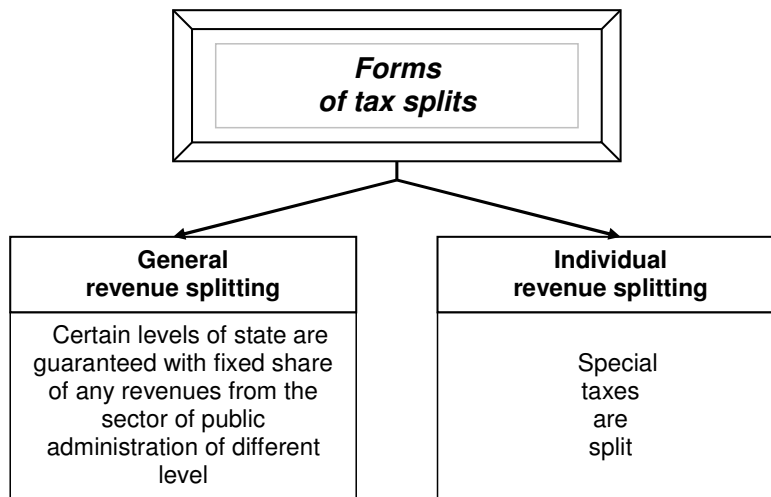
The foreign practice encounters the tax base division at both super level of public administration, and lower (local). Thus, the local taxes on sale in the USA are usually attached to the state tax base, while the state property taxes re-

fer to local tax bases. The Scandinavian countries are widely practicing the division of tax bases, where the main source of local governments' revenues are local profit taxes as the overrate of national individual profit taxes.

3. The tax splits (general financial support) – transfers from the subnational government of a certain level to the subnational governments of different levels through mechanisms of fixation of the share of the latter in certain budget revenues of the prior one. The peculiarity of this method of budget regulation consists in the following: the legislative, the administrative, and the fiscal sovereignty of some incomes of the state are at the level which is taking decisions on tax splits, while the holders of tax shares enjoy unlimited sovereignty exclusively concerning the revenues from the share taxes (fig. 1).

Figure 1.

The acquired forms of tax splits



Application of the system of tax splits implies that the certain level of public sector gets unlimited access to the prior determined share of tax revenues of another one (usually, of higher level). *Ch. Goetz* substantiated the application of tax splits for regulation of vertical and horizontal fiscal imbalances by the following principles [35, 13–28]: 1) effectiveness (centralized collection of the most significant national taxes, the base of which is characterized by spatial mobility of a taxed subject, and allows to reduce the taxation avoidance, likewise to avoid undesired economic consequences which could arise at tax collection at differ-

ent level of public administration sector); 2) economizing (from the view of expenditures the fiscal organs of the central government unlike the subnational governments can collect tax revenues with less administrative expenditures); 3) impossibility (failure) to cover the subnational governments expenditures on account of their own taxes, because the tax revenue potential, which according to all criteria belong to subcentral, usually is insufficient; 4) redistribution, since the linkage between the available tax base of subcentral governments and their revenues is growing weak.

There can be practiced the following three subsidizing mechanisms with tax splits as a means for subnational budgets financing: 1) limits for fund expenditures (mostly, is rarely applied); 2) creation of fund source for subsidizing (quota of budget revenues to be split); 3) mechanism of revenue distribution of tax pool, i.e. legislated list of state taxes, the revenue quota of which is for creation of the direct transfers fund (table 7).

The funds of state revenue pool can be distributed either according to the source principle (taxes are channeled to the budgets of the tax base location, or to the equality principle (taxes are divided in direct proportion to a number of residents of territorial community). Depending upon the format, the tax splits produce different effects on financial results of both subnational budgets, and the state central budget.

Table 7

Aspects of tax pools*

Criterion	Aspects	Description
1. Completeness of revenue coverage	Complete	Covers all or major part of the revenues of the government of a certain public level (e. g., in Japan, South Korea, Venezuela, Philippines, and Columbia the aggregate tax revenues of the state budgets are split)
	Partial	Covers only some taxes
2. Mode (technique) of fixation of allocation standards	Constant	Fixed are the allocation standards of some elements of tax pool for a long period (e. g., it is practiced in the Constitutions of Germany, Columbia, and Brazil)
	Variable	The standards of splittings are fixed only for several years (e. g., it is practiced in Poland, Czech, Armenia, Georgia, Kazakhstan, Russia, and Ukraine)

Note. Formed on the basis of [3; 10; 24].

3. Effectiveness of Interbudget Transfers: International Practice and Potentials for its Implementation in Ukraine

Large-scale researches of intergovernmental transfer effects started in early 50-s of the 20th century in the USA, when through multiple regression the attempts were made to detect what effects different factors produce on the expenditures of local governments. But the first attempts failed, since they were not grounded on theoretical concept of subnational government's behavior.

In late 60-s of the 20th century the models were developed, basing on the hypothesis of function maximizing of local government efficiency. According to those models different types of grants are producing different effects on expenditures. Thus, general grants allow for the effect of profit, while grant-in-aids – the effect of supersedence. Application of those models allowed to distinguish the so called «flypaper effect», that is, the situation when the received from the government of higher level general transfer does not bring about relevant expected reduce of tax load on tax payers to the state budget who reside within the jurisdiction («money is sticking to the government budget in the points of tangency») [36, 5–21]. Primarily, the «flypaper effect» was manifested in such federative countries as the USA and Switzerland. Nevertheless, the researches of the 1990-s showed that the said effect was present in the unitary countries (like, Denmark, Finland, Ukraine) [37; 38].

The following versions were offered to explain the effect [39, 770]: the voters do not agree with the actual marginal expenses at the moment of availability of non-completing subsidies (marginal costs exceed average ones, and the voters are more aware with the latter against the prior ones); in a short-term period the civil servants are rather free to allocate the assigned budgets (if the officials get additional funds, the voters do not find out about it immediately, and even if they do, they have no relevant means to make the bureaucrats pay their money back); federal officials have enough free choice to hinder the funds assignment if, in their opinion, federal funds are used just to supersede the state funds.

Numerous empiric researches manifest, that the effects resulted by community income growth in a kind of grant or individual incomes growth (for example, as a result of tax privilege) do not always correlate. Proceeding from the above, we can conclude that the received grants do not make politicians and officials lower (reduce) a tax load versus the existing models based on the preconditions of maximizing of public welfare.

Table 8

**Models of subnational authorities' behavior with accounting
for their own priorities at holding grants**

Models	Descriptions
<i>W. Niskanen's model</i>	Disparity between the results of grant holding and voters' advantages is explained by the disparity between the functions of welfare maximized by the voters and representatives of authoritative organs. The welfare of the officials is determined by wages, position benefits, reputation, amount of authorities (variables, which depend on the volume of the institution's budget). According to this model the organs of power are associated with the monopoly, that is realizing its own services either to the voters or to their representatives. The lump-sum grant, that allows the officials to reduce that tax rate and shrink the own budget, stimulate subnational organs to act in those conditions as if the grant was a contingent one
<i>T. Romer and H. Rozental's model</i>	The model implies that the subnational authorities are maximizing the volume of their own budget attracting the voters to define the volume of public and private goods production. The organs of power annually fix their own budget expenditures at a certain level if the voters did not vote at the referendum for other expenditure level. Nevertheless, the referendum on the change of the regional budget expenditures is held only in case, when actual budget expenditures are underfinanced in relation to optimal level (the referendum is hold only when the voters agree with the increase of the budget expenditures). The organs of power make a proposal concerning a new level of expenditures, exceeding the optimal one, since the latter is the only one which is to be voted at the referendum. The «fly-paper effect» is evolving when the voters incomes growth brings about the revising of the budget expenditures rates. The latter occurs only in case when optimal level of public goods consumption is exceeding the actual one. Consequently, granting any subsidy is bringing about the increase of subnational budget expenditures in a volume either equaling the grant amount or exceeding it.
<i>W. Oats' model</i>	According to this approach the subnational organs of power determine the amount of expenditures in accordance with the advantages of a median voter, but they do not provide the full information about the financial position in the region. While assuming, that the population in the region chooses the level production of public goods on the basis of their tax price (ratio of tax liabilities to the amount of public goods provision in the region), then in case when the people's and the authorities' advantages correlate, the lump-sum grant is regarded as a

Models	Descriptions
	<p>general growth of regional income. Nevertheless, there is another variant, when the regional authorities inform people on the opportunity to produce the public goods at a new (subsidized) tax price. After having got the information, the voters take the decision about the growth of public goods consumption depending on the demands for public goods at a price.</p>
<p><i>G. Break's model</i></p>	<p>This model implies that the voters of subnational formation are at the same time the voters for the national power, which distributes interbudget transfers. The subnational organs of power wishing to increase the budget expenditures under the growth of individual incomes, should mind the negative effects related to decrease of financial aid.. In this case the growth of private voters' incomes do not bring about the decision taking concerning increase of subnational budgets expenditures. Nevertheless, the equivalent increase in grant volumes mostly is channeled at the increase of the budget expenditures.</p>
<p><i>D. King's model</i></p>	<p>The additional preconditions are involved into the model regarding the targeted function of a median voter, implying that his/her task is the maximization of own benefit by optimal kit of public and private benefits under condition the taxation rules at subnational level should not bring about the wealth worsening of the poorest population in the region. In this situation the budget limits at the voters incomes growth resulted by the reduce of federal tax rates is like a broken line which does not allow to essentially increase the subnational budget expenditures. At the same time, the subsidizing produces the effects described in prior models.</p>
<p><i>E. Zampelli's model</i></p>	<p>It is asserted that if the expenditures for the production of subsidized public goods are increased above a certain level, which is not priority for power organs- grant holders, the latter decrease their own expenditures for the production of those goods channeling the exclusive funds at financing of other public goods. Hence, the grant –in- aids at the absence of limits for the grant holders' own expenditures to produce the subsidized public goods is rather complicated type of non grant-in-aids , which increase the grantees' incomes, but do not bring about the considerable change in the price relations between public and private goods.</p>

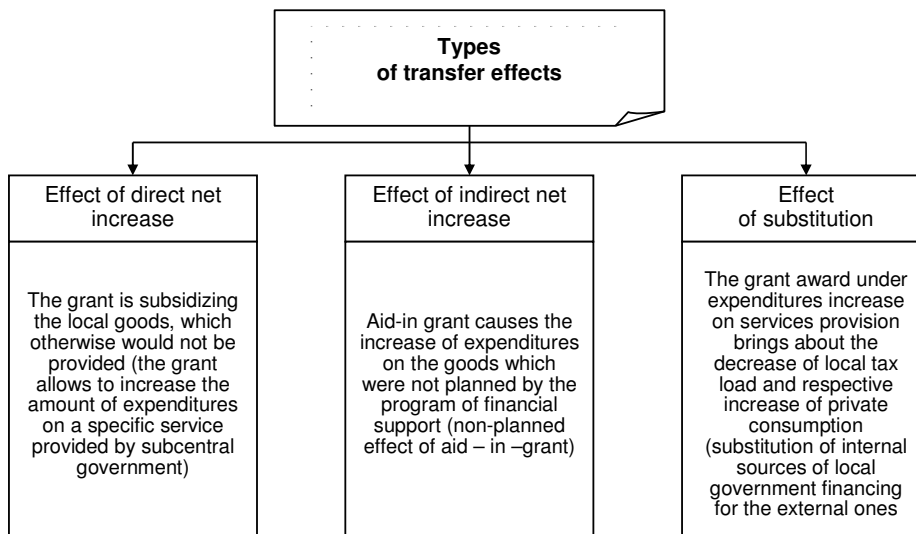
Note. Formed on the basis of [10; 27; 40; 41; 42; 43; 44; 45]

The publications of the 80-90-s of the 20th century are devoted to the grant studies viewing them as the endogenous factors, since they often provide the object for negotiations between the local governments and the central agencies [46; 47]. *E. Scott* pointed out four factors describing the response of national governments for grants. They are as follows: 1) the government likings (political interests); 2) relative prices for private and public goods; 3) amount of the government's own budget; 4) legal drawing up of the transfers [48]. That extrapolation of the theory of the consumer's behavior at the activity of the public administration sector elements presupposes that the local governments adequately represent their voters' interests in the production of local public goods. Otherwise the government will represent the interests of local bureaucratic elite, who try to maximize their benefits through increasing of budget volume and expenditures on their support (it mostly occurs in interbudget relations practice in Ukraine).

The conceptual notions for making theoretical analysis of interbudget transfers are [49]: effect of direct net increase, effect of indirect net increase, effect of substitution (fig. 2).

Figure 2.

Types of interbudget transfer effects



One of the main aims the central government sets at awarding transfers is to secure the just distribution of funds among local governments of similar level, that is fiscal equalization. If B^* – aggregate normative tax revenues, E^* – aggregate normative expenditures, and k – coefficient of equalization (at $k = 0$ there is no equalization, and if $k = 1$ full equalization occurs), the amount of grant will make [50]:

$$Gr = r (E^* - B^*).$$

The general pattern of effective fiscal equalization in practice can be of different variants. For example, the general grant could be subsidized with no tax rates taken into account throughout the given territory. At that pattern (fixed amount of equalized grant) the subnational governments are promoted to increase their own tax revenues, thus, the tax base differences do not allow to reach a complete equalization. In other case, if to apply the grant pattern related to the amount of budget revenues, the government tentatively defines the limits the expenditures of subnational governments could reach at similar efforts spent to collect taxes. The amount of grant is functionally connected with the amount of actual tax revenues in ratio to normative expenditures. Nevertheless, the challenge is that this type of financing non –directly causes increase of the tax ratio in funding the subnational governments expenditures. In addition, that financing is rather complicated to be administered.

Table 9 presents the structure of current revenues of local budgets in some economically developed countries. It is illustrated, that in majority of countries 59.5% of local budgets account for their own revenues, while 40.5% – transfers budgeted by central administration. But in many countries the local budgets while forming their current revenues greatly depend on budget transfers of central administration (Portugal, Italy, Ireland, Greece, Canada, Portugal). In these countries the transfers make from 80 to 62% of current revenues. Transfer subsidizing of local budgets by central administration indicates the intensive redistribution of national income through budget channels to eliminate disproportions in the development of the regions. In those countries all basic taxes are replenishing the central administration budget, while local taxes are hardly exceeding 10% of current incomes. The main challenge of the regional economic policy, which is urgent for the countries with transfer budgeting of the territories is one of how to increase the budget redistribution efficiency, and to decrease the fiscal dependence of the local organs of power on the «center» and to strengthen the tax autonomy of the latter.

It is worth noting, that the major part of budget transfers could be found in the unitary countries (Netherlands, Italy, Greece), while in the federal ones – minor (USA, Germany). It corroborates the conclusion concerning the countries with developed market economy made in early 70-s of the 20th century in the report of the Commission of the European Community: the redistribution rate among the regions in unitary against federal countries is larger [50].

Table 9

Structure of current budget revenues of the local organs of power in the countries with market economy, % (average data for 1991–2001)
[46; 49]

Countries	Individual incomes			Regulated incomes (transfers from central government)
	Tax funds	Property and entrepreneurial income	Other incomes	
Countries with tax autonomy exceeding the average one (over 50% of own tax funds in total amount of income)				
Island	90.5	8.6	0.1	0.8
USA	88.6	3.4	0.3	7.7
Luxemburg	84.3	1.9	6.9	6.9
Spain	76.0	1.9	5.3	16.8
Austria	72.6	2.2	11.2	14.0
Switzerland	69.1	4.6	7.9	18.4
Sweden	64.6	2.4	5.8	27.2
Japan	61.4	2.3	0.4	35.9
Norway	57.1	1.5	–	41.4
Germany	56.2	5.0	6.4	32.4
France	55.9	2.3	4.1	37.7
Finland	55.3	3.3	1.6	39.8
Denmark	51.6	1.6	2.9	43.9
Countries with tax autonomy less than average one (less than 50% of own tax funds in total amount of income)				
Belgium	42.8	16.2	–	41.0
Australia	39.9	14.5	4.1	41.5
Great Britain	37.2	2.3	8.5	52.0
Canada	32.6	2.4	0.7	64.3
Portugal	29.2	3.0	6.2	61.6
Greece	14.6	12.6	1.5	71.3
Italy	10.7	1.7	8.3	79.3
Ireland	7.5	3.4	11.8	77.3
Netherlands	6.4	8.5	5.1	80.0

Theory of fiscal federalism was made the basis of the policy of the economy decentralization, pursued by the USA government in late 60-s – early 70-s of the 20th century. At that time there occurred a significant redistribution of the functions between federal and states budgets concerning funding social expenditures. The latter were authorized to allocate funds for social security, and social and cultural measures with some ratio of aid from the «center». Then the

USA budget policy was directed at intensification of states' self-financing («new federalism»).

At the beginning of 1980-s in the conditions of irretrievable budget deficits and general slump of economic efficiency the USA government turned back to the policy of «new federalism» as for social expenditures. At that period of rigid save of budget funds the strong accent was made at self-financing of social expenditures at the account of local taxes. As a result, a system of financing of local organs of power was created so far in the USA, when 92.3% of local budget revenues, including the states ones, consist of their own incomes, 88.6% out of them account for local taxes. Thus, local budgets of the USA depend upon federal government by less than 12%. As table 10 demonstrates, the similar descriptions are peculiar to some other countries.

In current situation the local councils are facing in Ukraine, it would be good to learn and apply the practice of fiscal regulation of the «center» and the «periphery» relationships in such federative market developed countries as the USA, Germany, Switzerland, and Austria. In addition, it would be instrumental to learn the practice of the unitary countries, which in the 1980-s introduced the theory of fiscal federalism and were continuously decreasing the redistribution ratio of national income via the central budget. Italy can well exemplify the unitary country. The budget system of that country, just like our national budget system is distinguished by rigid centralization. Thus, the ratio of central budget makes 79.3% in it, while actual revenues of local budgets do not exceed 20.7%, and 10.7% out of which accounts for local taxes.

Since the middle of the 1980-s Italy has been carrying out large-scale reforms as for tax autonomy enhance of local organs of power, as far as the reforms of the 1970-s decreased the level of the latter. Hence, for example, according to Law №55 the transfers to local budgets were «frozen», and the local authorities were recommended either to impose new local taxes or improve the existing ones [46; 51]. The Economic Development Plan for 1989-1991 was supplemented with the Principle on «further distribution of functions among the central, regional and local authorities in order to provide people with services of high quality». At the moment, it is planned to revise the rates of local taxes on immovable property, to improve the land cadastre in the country, and to increase rent payments. The Italian economists regard that the intensification of local budgets tax autonomy is the only possible way in addition to their own budget deficits to reduce the deficit of the state budget as a whole. Moreover, it is the path to real independence in solution of local social problems. Table 10 is demonstrating the amount of net-subsidies granted to local budgets in 2006–2007, thus presenting the situation with interbudget transfers in Ukraine.

Table 10

Transfers granted to local budgets in Ukraine (plan), mln. UAH.

Budget	2006	2007	Growth, %
Kyiv	-707	-2885	-308
Crimean A.R.	849	910	7
Vinnitsia oblast (region)	916	975	6
Volyn oblast	624	682	9
Dnipropetrovsk oblast	373	287	-23
Donetsk oblast	581	359	-38
Zhytomyr oblast	725	878	21
Zakarpattia oblast	685	893	30
Zaporizhzhya oblast	407	375	-8
Ivano-Frankivsk oblast	778	869	12
Kyiv oblast	196	688	251
Kirovohrad oblast	539	590	9
Luhansk oblast	637	760	19
Lviv oblast	1015	1216	20
Mykolaiv oblast	491	588	20
Odesa oblast	728	796	9
Poltava oblast	522	558	7
Rivne oblast	682	673	-1
Sumy oblast	529	570	8
Ternopil oblast	663	748	13
Kharkiv oblast	592	701	18
Kherson oblast	598	671	12
Khmelnitskiy oblast	757	848	12
Cherkasy oblast	668	706	6
Chernivtsi oblast	520	610	17
Chernihiv oblast	575	616	7
Total	14944	14683	-2

At the moment, the greatest challenge of subnational governments budget revenues in Ukraine is their significant dependence on the state budget. *I. O. Lunina* notes [52, 224] that the greatest ratio of budget expenditures of local organs of power accounts for delegated authorities. At present, the local organs of power are lacking sufficient financial resources to organize economic and social management at subnational level, which is conditioned by a number of reasons, like the following: high ratio of financial resources concentration in the state budget of the country, which reduces the importance of regional and local budgets in meeting vital tasks; tendency to determine the expenditures down the budget system without respective support of revenue sources, which brings subsidizing of most of the local budgets.

Unfortunately, the Budget Code of Ukraine adopted in 2001 did not settle most of the interbudget transfer problems, since the real incomes of local organs of power did not grow. As a whole, each separate type of interbudget transfer implies realization of different, often alternative objectives. Therefore, the economists are tending to criticize even those systems of transfers, which are considered to be perfect in each individual country. The problem consists in the fact, that it is impossible to hit all the targets with one transfer type, when all transfer instruments need to be applied. Consequently, there can not exist either optimal system of intrabudget transfers, or optimal system of state management. The transfer evaluation could imply only the level of aid-in accordance with this or that element of local government's financial support. The examples of «good» and «bad» issuance of interbudget transfers after *S. W. Slukhiy* are presented in table 11.

Table 11

Principles and issuing of transfers in some countries throughout the world
[3, 68]

Objective of issuing a transfer	Transfer issuing	Examples of advanced practice	Practice to be avoid
Patching the fiscal gaps	Redistribution of responsibilities Tax reductions Splitting of tax base	Tax reductions in Canada and splitting of tax base in Canada, Brazil, and Pakistan	Deficit grants, individual splitting of taxes in India
Reduction of regional fiscal inequality	General full transfer for equalization	Programs of fiscal equalization in Austria, Canada, Germany	General splitting of incomes at multifactor formula
Compensation for spillover of benefits	Open matching transfers with participation norms according to the scope of benefits outflow	Grant for instruction hospitals in the South Africa	–
Determination of national minimal standards	Conditional full block grant under condition of reaching the standard level and provision of services access	Grants for roads maintenance and primary education in Indonesia, educational transfers in Columbia, Chili	Conditional transfer for expenditures as a whole, special grants for specific cases

Objective of issuing a transfer	Transfer issuing	Examples of advanced practice	Practice to be avoid
Effects on local priorities (top urgency from national viewpoint, and low – from the local one)	Open matching transfers (at normative participation, in inverse ratio to fiscal capacity)	Matching transfers for social aids in Canada	Aid –in grants for particular cases
Stabilization	Capital grants for maintenance of projects	Limited employment of capital grants and promoting of private sector participation through securing the political risks	Stabilization grants with no subsequent liabilities concerning the maintenance of the projects

In order to improve the system of interbudget relations in Ukraine it would be good to consider some trends (e.g. application of more effective practice for splitting of national taxes, revision of actual system of local taxes and duties, as well as imposing the real-estate tax), since each of them includes a number of benefits and losses (table 12).

Table 12

Alternatives for reformation of the replenishment system of local budgets revenues

Alternative	Advantages (+)	Disadvantages (–)
Splitting of national taxes	<ul style="list-style-type: none"> • It is not necessary to form a tax base and mechanisms for its implementation • Additional expenditures related to introduction are practically absent 	<ul style="list-style-type: none"> • Probable horizontal fiscal disbalances among the regions • Unequal provision of different regions with public goods • Low probability to keep the norms of payments stable for a long period of time • Complicated design of fiscal plans

Alternative	Advantages (+)	Disadvantages (-)
		<ul style="list-style-type: none"> • Low motivation to collect particular taxes and duties
Development of the system of local taxes and duties	<ul style="list-style-type: none"> • Independence granted to the organs of local power in local taxation • Subnational governments capability to chose independently the types and rates of taxation • Strengthening of responsibility for the efficiency and lines of tax funds expenditures 	<ul style="list-style-type: none"> • Probable fiscal inequality among the regions • Weakening and limiting of fiscal effects of national authorities • Long-period necessity to create a new tax base
Imposing the real estate tax	<ul style="list-style-type: none"> • Immovable property that provides the taxation base can not be moved beyond the jurisdiction of local authorities • There is a strong interrelation between local expenditures rate for public goods and value of property • The volume of tax funds is sustained and predictable 	<ul style="list-style-type: none"> • The expenses are needed for training of highly qualified specialists to estimate the property market value • Absence of direct connections between the property value and taxable income • Unpopularity among the tax payers (impossibility to avoid the taxation through hiding the taxable unit)

In our opinion, the most perspective way to strengthen local budgets is to impose the tax on immovable property. The latter is collected in most industrial countries and is scarcely effected by the dynamics of economic conditions. That tax base is potentially intensive, and it is situated through the country rather evenly. The quantity and quality of public goods provided in any terrain are reflected in the price ratios of realty, and due to that, a clear relation is established between work efficiency of subnational governments and their capacity to accrue the relevant incomes. The realty tax rates are worth determining by two following stages: 1) at first, the subnational governments should compute the volume of incomes required for carrying out their authorities; 2) then the total amount of tax funds will be divided into the value of the municipal immovable property according to the estimation (an independent estimator will analyze the sales market and compare the price of estimated object with the prices of similar objects in the same terrain [53]).

A certain differentiation in the amount of budget expenditures, which inevitably occurs at any method of interbudget transfers funding, is rather desirable in

respect of necessity to get the local bodies of government interested in maximizing of their own incomes.

Conclusions and Proposals

The foreign practice of budget system formation and ways of financing of local organs of power allows to draw certain conclusions concerning the measures directed at improvement of conditions for local budgets formation and adaptation of foreign models of fiscal federalism to the economic conditions in Ukraine.

First, it is necessary to intelligibly divide the competences as for concrete tasks between the central organs of power and local authorities, with gradual transfer to decentralization of national finances. Thus, specifically those expenditures should be budgeted which are to meet all-national needs: e.g. defense of the country, support of legislative and executive power, development of fundamental science, structural reformation of economy. It is more rational to solve the financial problems of local level at the expense of relevant subnational budgets revenues (like, for example, tax on real estate, duties on environmental pollution, etc.).

Second, the mechanism of inter-territorial fiscal equalization needs to be improved. The practice showed, that the method of local budget regulation via exclusion of excess budget funds to the budget of higher level has a lot of disadvantages. So, apart from negative effect it produces on income base of local budgets, it also deprives the local authorities incentives to increase their incomes. Proceeding from the foreign practices, it is necessary to form special budget funds for fiscal equalization of territories. At the moment, the necessity arose to determine the substantiated standard budget sufficiency of every region, district, and city with regard to economic, social, natural and ecological state of respective territories.

Third, the practice of overseas countries proves, that for the first 3–5 years simplified charts of grant distribution happen to be sufficient. The sequence of mechanism complication for grant distribution will be like the following: national distribution of subsidies (without taking into account the number of residents) – introduction of base coefficients for equalization of financial needs with the aim of providing the opportunities to the municipalities to «cover» their expenditures (combination of the equalizing in expenditures with that in incomes) – further complication of the mechanism through introduction of additional criteria for standardized expenditures equalizing.

In general, creation of effective system of fiscal equalization of subnational budgets will contribute to increase of budget expenditures for the development and functioning the area of public goods, as well as the regional economic activity. Since the local authorities are often facing the necessity to chose

the objects which would be paid by tax funds, likewise selection of methods of management and priming of economic development, the problem of financing and budget formation of subnational governments will remain the most critical area of state finances. Therefore, it needs its further research and seek of new approaches to reformation.

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