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FINANCIAL CAPACITY OF LOCAL BUDGET AS A BASIS FOR SUSTAINABLE FUNCTIONING OF A TERRITORY

Abstract. The level of local budgets' financial capacity plays an important role in sustainable socio-economic development providing to the region. Financial capacity of a local budget is capability of the local governmental bodies to exercise local budget expenditures in a timely and proper way, in full conformity with their own direct authorities and delegated authorities, in order to achieve tactical and strategic objectives of social and economic development in a region through accumulating sufficient amount of financial resources.
Financial capacity of the local budget consists of three components: financial potential, financial autonomy and financial sufficiency. In the article, the authors have proposed a methodology for financial capacity of the local budget evaluating by calculating the integral index, based at coefficients usage. The proposed approach is of practical importance. It allows making an adequate analysis of the local budgets' financial capacity in Ukraine, timely identify the problems, determine the causes of their occurrence, reserves and ways to improve efficiency of financial relations at the regional level.
Keywords: Financial Ability; Municipal Budget; Financial Autonomy; Financial Potential.
JEL Classification: H70; H72; R51

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ФІНАНСОВА СПРОМОЖНІСТЬ МІСЦЕВОГО БЮДЖЕТУ ЯК ОСНОВА ЗАБЕЗПЕЧЕННЯ СТАЛОГО ФУНКЦІОНУВАННЯ ТЕРИТОРІЇ

Анотація. У статті досліджено концептуальні підходи до визначення сутності фінансової спроможності місцевого бюджету в контексті забезпечення соціально-економічного розвитку регіону. Авторами запропоновано методику оцінки фінансової спроможності місцевого бюджету на основі розрахунку інтегрального показника, що базується на використанні системи коефіцієнтів. Цей підхід має важливе практичне значення для здійснення адекватного аналізу фінансової спроможності місцевих бюджетів України, оскільки дозволяє виявити не тільки фактичний стан, а й можливі резерви зростання фінансових ресурсів регіону.
Ключові слова: фінансова спроможність; місцевий бюджет; фінансова автономія; фінансовий потенціал.

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ФИНАНСОВАЯ СПОСОБНОСТЬ МЕСТНОГО БЮДЖЕТА КАК ОСНОВА ОБЕСПЕЧЕНИЯ СТАБИЛЬНОГО ФУНКЦИОНИРОВАНИЯ ТЕРРИТОРИИ

Аннотация. В статье исследованы концептуальные подходы к рассмотрению сущности финансовой способности местного бюджета в контексте обеспечения социально-экономического развития региона. Авторами предложена методика оценки финансовой способности местного бюджета на основе расчета интегрального показателя, который базируется на использовании системы коэффициентов. Данный подход имеет важное практическое значение для осуществления адекватного анализа финансовой состоятельности местных бюджетов Украины, поскольку он позволяет выявить не только фактическое состояние, но и возможные резервы роста финансовых ресурсов региона.
Ключевые слова: финансовая способность; местный бюджет; финансовая автономия; финансовый потенциал.

1. Introduction

The increasing role of local finances in implementing national social and economic policies has become a critical factor for the effective development of Ukraine. Economic relations now are characterized by the strengthening role of local governance bodies in economic and social functioning of territorial units. Significant impact on the sustainable development of the region has a level of its financial capacity, which is defined by the condition of the financial providing of local budgets.

Therefore, there is a necessity to solve problems concerning increase of the local budgets financial capacity, which is determined by the adequacy of financial resources accumulated in local budgets.

2. Brief Literature Review

Problems of financial capacities of a local budget sustaining and increasing have been dealt with in scientific studies. The problem of budgeting and budget allocation at local level was studied by distinguished Ukrainian economists: Y. Balackiy, I. Vakhovich, O. Vasylyk, V. Heiets, Z. Herasymchuk, A. Yepifanov, M. Yermoshenko, V. Oparin, M. Chumachenko, S. Yuriy. For a long time much attention was paid to researching of the problems of fiscal decentralization, which contributes to strengthening of the financial autonomy, sufficiency and potential of local budgets in the works of the foreign authors, such as Martinez-Vazquez Jorge, and Robert McNab (2003) [1], Prud'homme Remy (1995) [2], Thiessen U. (2003) [3], Bird, R. M. and Slack, E. (2006) [4] and others.

However, a number of problems related to optimization of the financial support for territorial units operation still remain unresolved, due to limited scopes of financial resources in local budgets as a result of their excessive centralization.

3. Purpose

To analyze of theoretical approaches to interpretations of the meaning and mechanisms of the local budgets financial capacity and its constituent components.

4. Results

The category of «financial capacity» at regional level in Ukraine requires theoretical rethinking, substantiation and effective means of implementation.

From broader perspective, the category «capacity» refers to the condition of an entity and its capabilities to be involved in actual processes and phenomena, its material capability for operation. In the Large Explanatory Dictionary, the notion «capacity» is interpreted as: capability for doing something; availability of conditions favorable for something, circumstances fostering something, an opportunity. In the Large Explanatory Dictionary of Economics, capacity is defined as a precondition, inclination and ability for an action.

The category «financial capacity» tends to be interpreted from the standpoint of a set of characteristics derived on the basis of system evaluation of the financial performance at macro- or microlevel, which means evaluation of the financial performance of an entity under consideration and possibilities for change in this performance to come out with the sustained development.

The researchers' conceptions of the financial capacity problem regarding various entities under study can be combined into four groups: characterization of the capabilities of a studied entity for adequate financial support; characterization the financial capabilities for effective utilization of resources available with a studied entity; characterization of the financial soundness of a studied entity; a multifaceted notion

encompassing a mix of essential characteristics outlined in other approaches. A scheme summing up interpretations of the notion «financial capacity» is given in Figure 1.

Bearing in mind the existing approaches to interpretation of the category «financial capacity», we believe that financial capacity of a local budget should be defined as the capability of local governance bodies to exercise local budget expenditures in a timely and proper way, in full conformity with their own authorities and delegated, in order to achieve tactical and strategic objectives of social and economic development in a region through accumulating the sufficient amount of financial resources.

We consider that financial capacity of the local budget consists of the three components characterizing its various dimensions: financial sufficiency, financial autonomy and financial potential (see Figure 2).

Financial sufficiency of a local budget constitutes an input parameter of the region's development, because it means the balance between financial capabilities and needs of a territorial unit, and the capability for optimal allocation of the local budgets financial resources.

Financial autonomy is a qualitative parameter of the financial capacity of a local budget, which characterizes its security in terms of internal financial resources, being largely dependent on the structure of financing sources for regional development and the reliance on centralized financing sources, which necessitates flexibility in management of financial resources in a region [15].

Financial potential, as a component of the financial capacity of a local budget, determines the capacity to generate financial resources in future, to sustain the long-term development of a territorial unit.
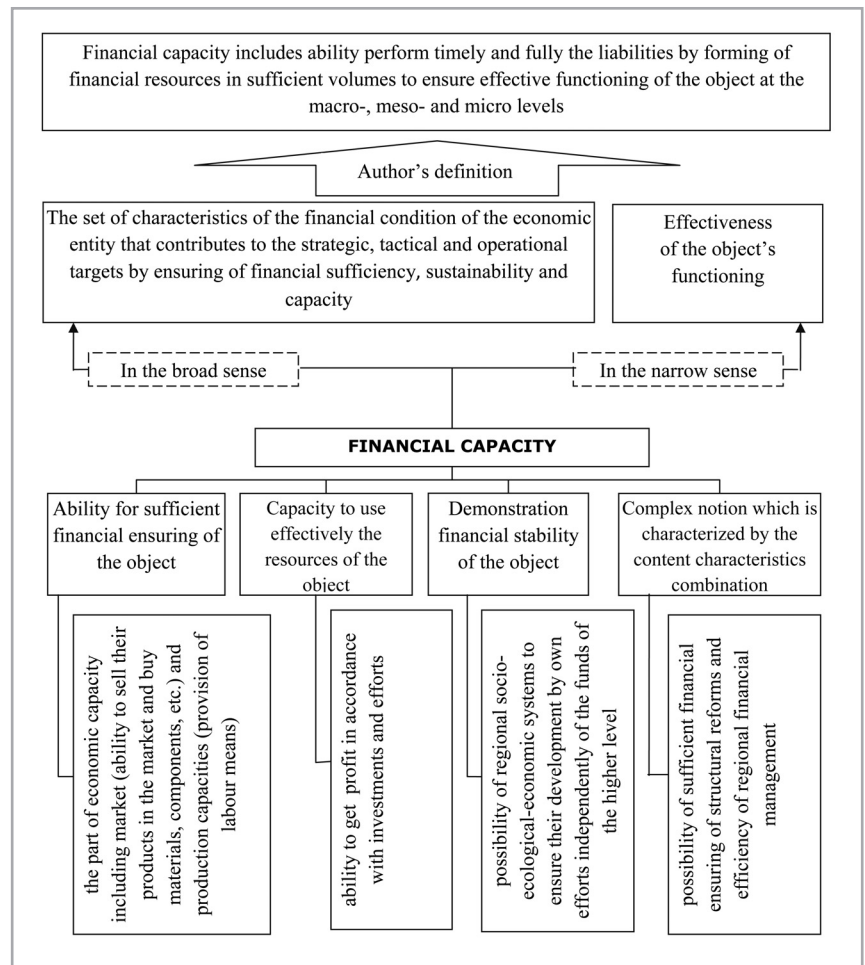

Fig. 1: **Singling out the approaches to the essence of «financial capacity» interpretation**
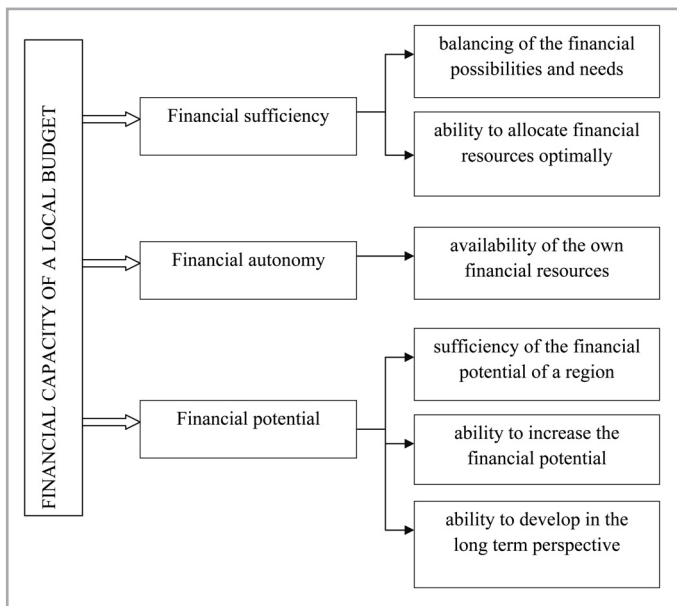Source: Compiled on base [5-14]

Fig. 2: **Model of the local budget financial capacity formation**
Source: Own research

The financial capacity of a local budget, therefore, determines the competitiveness of a region and secures the effective implementation of its economic objectives. In the regional context, it shows the feasibility of financial security of regional development in its conformity with the national policy objectives, regional resources and interests; in the national policy context, it shows implementation of functions and authorities in conformity with the existing legal system.

It should be noted that the critical factors for financial capacity of local budgets are the following: balance of revenues and expenditures for development; legal rights of local governance bodies for autonomous decision-making on local budgeting and financing of local objectives, to ensure good conditions for vital activities of residents in territorial units; capabilities of local governance bodies for full-scale supply of the local residents with high quality public goods and services.

Diagnostics of the financial capacity of a region calls for analytical study with evaluating its constituent components, which are financial sufficiency, financial autonomy and financial potential. This evaluation aims to find out problems, factors

behind their occurrence, reserves and ways to enhance the efficiency of organization of financial relations at regional level.

As a result of our studies, we worked out the set of ratios for evaluation of local budgets financial capacity, given in Table.

With the purpose of the financial capacity of a local budget evaluation on the basis of the input data set, generated for a certain period of time, and the priority determination by experts for each of the index (the sum of priorities should be equal to one), it is necessary to bring the indicators to comparable form. It is worthy to mention that for stimulators, destimulators and indicators with a normative value, a special method of normalization should be used (stimulators, destimulators are based at natural normalization and indicators with a normative value – with special formulas).

If the indicator is a stimulator, the rule for normalization is:

$$\tilde{x}_{ij} = \frac{x_{ij} - x_j^{\min}}{x_j^{\max} - x_j^{\min}}, \quad i = \overline{1,m}, \; j = \overline{1,n} \;, \tag{1}$$

where $x_j^{\min} = \min_i x_{ij}$; $x_j^{\max} = \max_i x_{ij}$; m – quantity of the studding objects; n – quantity of indicators; x_{ij} – the value of j-th indicator to i-th object (a component of the financial security).

If the indicator is destimulator, the rule for normalization is:
• if the indicator has a normative value, the rule for normalization is:

$$\tilde{x}_{ij} = \frac{x_j^{\max} - x_{ij}}{x_j^{\max} - x_j^{\min}}, \quad i = \overline{1,m}, \; j = \overline{1,n} \tag{2}$$

• if between x_j^{min} and x_j^{max} there is point x_j^{nom}, where the best value of the indicator is achieved, then:

$$\tilde{x}_{ij} = 1 - \frac{\left| x_{ij} - x_j^{nom} \right|}{\max\left\{ \left(x_j^{\max} - x_j^{nom} \right), \left(x_j^{nom} - x_j^{\min} \right) \right\}}, \quad i = \overline{1,m}, \; j = \overline{1,n} \tag{3}$$

• if between x_j^{min} and tx_j^{max} there is a certain interval $\left[\underline{x_j^{nom}}; \overline{x_j^{nom}} \right]$, where the best value of the indicator x_{ij} is achieved, then:

$$\tilde{x}_{ij} = \begin{cases} \dfrac{x_{ij} - x_j^{\min}}{\underline{x_j^{nom}} - x_j^{\min}}, & if \; x_j^{\min} \le x_{ij} < \underline{x_j^{nom}} \; або \; x_{ij} = x_j^{\max}, \\[2mm] 1, & if \; \underline{x_j^{nom}} \le x_{ij} < \overline{x_j^{nom}}, \\[2mm] \dfrac{x_j^{\max} - x_{ij}}{x_j^{\max} - \overline{x_j^{nom}}}, & if \; \overline{x_j^{nom}} \le x_{ij} < x_j^{\max}, \\[2mm] 0, & if \; x_{ij} = x_j^{\min}. \end{cases} \tag{4}$$

Therefore, for the integral characteristics of the financial capacity of a local budget can be used next ratio (K_{int}):

$$K_{int} = \sum_{i=1}^{n} (K_i \cdot W_i) \tag{4}$$

where K_i – i-th ratio of the financial capacity; W_i – significance level of i-th ratio of the financial capacity.

Enhancement of the financial capacity of a local budget requires elaboration of measures aiming to increase the financial sufficiency, the financial autonomy and the financial potential, which are causally linked and supplement each other. The financial sufficiency of a local budget, once achieved, will have a positive effect on its financial autonomy and financial potential, whereas the increasing financial autonomy will bring higher financial sufficiency and higher financial potential.

An important means for the financial sufficiency of a local budget

Table: **Ratios of the local budget financial capacity**			
Ratio	**Calculating algorithm**	**Normative value**	**Level of significance**
Financial sufficiency			
Ratio of adequacy of own funds	Own revenues divide on expenses caused by own responsibilities	1	0,15
Ratio of adequacy of enshrined financial resources	enshrined revenues divide on expenses caused by delegated responsibilities	1	0,07
Ratio of local budget coverage	Own and enshrined revenues without transfers divide on expenses of local budget	1	0,08
Financial autonomy			
Ratio of own revenues concentration	Own revenues divide on revenues of local budget	≥0,6	0,18
Ratio of own and enshrined revenues concentration	Own and enshrined revenues divide on revenues of local budget	≥0,8	0,17
Ratio of subsidized dependency of local budget	Transfers divide on revenues of local budget	≤0,2	0,15
Financial potential			
Ratio of revenues capacitance	Local budget revenues divide on the gross regional product	increasing	0,07
Ratio of investments capacitance	Investment amount divide on the gross regional product	increasing	0,07
Ratio of municipal enterprises profitability	Profit of municipal enterprises divide on the amount of income received by entities of all types of ownership	increasing	0,06

Source: Own research

today is saving of resources, their economically sound alloca-
tion and targeted use. Implementation of these measures
requires well-thought administrative decisions and stricter finan-
cial control.

An important issue of local budgets operation in Ukraine is
about increasing of their financial autonomy through revision of
methods for formation of both revenues and expenditures of
local budgets, which is related with implementation of the strat-
egy for extending the autonomy of local governance bodies.
Strategic tasks requiring solutions can be referred to as follows:
increase the influence of local governance bodies on local bud-
geting; strengthen the stimuli to increase local budget revenues;
create conditions for exploiting market-based mechanisms to
raise additional funds for development of territorial communities.

The above mentioned tasks cannot be solved unless the
local budgets made more decentralized. Global practices show
that implementation of decentralization mechanisms is central
to the effective formation and allocation of financial resources at
the disposal of local governance bodies, which allows for boost-
ing social and economic development of both territorial units
and a region as a whole [1-4].

We believe that the following measures are required to
secure the financial autonomy of a local budget:
- to expand the competencies of local governance bodies
regarding local taxation with the increased autonomy of local
budgets in taking relevant decisions;
- to extend the internal (local) budgeting sources and enhance
their allocation efficiency;
- to enhance investment attractiveness of the regions.

Decentralization of local governance needs, therefore, to be
starting-point for further democratic transformations in Ukraine.
Local governance bodies, as the ones with the best awareness
of the citizens' needs, must render services in the most effec-
tive way, regarding them as part of the effective public adminis-
tration of territorial communities.

The financial potential of local budgets can be increased by
introducing sound territorial planning, implementing programs
on support of business sector as a whole and small business in
particular, programs for soft lending; by enforcing tax privileges
and reducing tax inspections. We believe that the above mea-
sures, once implemented, will attract capital and financial
investment to a region, as an additional source for long-term
investment in the regional economy. As they are expected to fos-
ter favorable investment climate, they will result in the increased
investment potential of territorial units due to inflow of internal
and external investment as an important components of the
financial potential.

5. Conclusion
Essential factors to secure financial capacity of a local bud-
get in Ukraine are measures taken by local governance bodies
to balance financial capabilities and needs of a region; efficien-
cy of the financial relations in society; efficiency of formation,
flows, allocation and usage of financial resources; rational
structure of financial sources within a territorial unit, allowing for
stable financing of social and economic development in the
region.

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