

MASTER THESIS

Course code: BE300E

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THE PARADOX OF THE FORMATION OF MUNICIPALITIES' (HROMADAS') BUDGET REVENUES IN UKRAINE

Date: 18.05.2021

Total number of pages: 80

Abstract

Decentralization reforms are held throughout the whole world with the goal to make public sector more transparent, efficient and less dependent on state transfers. However, the ongoing decentralization reform in Ukraine, along with the positive changes, made some local governments even more dependent on the state. The purpose of this study is to contribute to the existing literature on the public sector decentralization reforms and issues of budget revenues of amalgamated municipalities (called ‘amalgamated hromadas’ in Ukraine) and investigate the possibilities of decreasing these municipalities’ dependence from state’s budget transfers.

For the purpose of the thesis, I collected both qualitative and quantitative data in Ukraine – official statistics from the website Decentralization, and semi structured interviews with central and local officials. I used abductive reasoning and institutional theory to analyze the collected empirical material. I found out that although there are no direct evidence that the central government before implementing the decentralization reform established rules, that made amalgamated hromadas financially dependent on the central budget transfers, the central government used its financial power (central budget transfers and grants) over local governments to get more political power and stayed in local communities.

Further, the central government does not seem to be planning on giving full independence to local communities. This has resulted in a decentralization reform in Ukraine paradox – when municipalities on the one hand have got full political rights and official power to choose the development strategy of local communities, but on the other hand local hromadas got responsibilities that made them more financially dependent on state’s budget transfers, that to some extent hinder local officials’ possibilities in representing their local people’s interests.

Key words: amalgamation, decentralization, (in)capable territorial community, municipality, state transfer, self-governance, Ukraine.

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List of Acronyms

AH – Amalgamated Hromada

EU – European Union

IMF – International Monetary Fund

NUTS – Nomenclature of Territorial Units for Statistics

PPP – Public Private Partnership

UK – United Kingdom

USA – United States of America

VR – Verchovna Rada

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I. Introduction

The main purpose of the study is to explain reasons of financial dependence of amalgamated municipalities (hromadas) in Ukraine from state's budget transfers and why does it still exist, despite implementation of decentralization reform that aims at making municipalities more self-sustainable and independent from state. To find answers, I analyze information about the source of income for amalgamated municipalities in order to have better understanding of tools (tax, charges, other income) that local community can use and main expenses of Ukrainian amalgamated municipalities.

According to the European Charter of Local Self-Government, which was approved by the Council of Europe on 15 October 1985, local self-government means the right and ability of local self-government bodies within the law to regulate and manage a significant share of social affairs within their competence in the interests of the local population (Council of Europe 1985). In order for municipality's council to fully represent the interests of their people, held independent politics about their territorial development, municipalities must have enough financial resources to manage it (De Vries & Nemec, 2013). Therefore, capacity is a key characteristic of local self-government.

According to Kozina (2015) capable territorial communities are territorial communities of villages that, as a result of voluntary amalgamation, are able to independently or through the relevant local self-government bodies to ensure an adequate level of services, in particular in the field of education, culture, health care, social protection, housing and communal services, taking into account human resources, financial support and infrastructure development of the relevant administrative-territorial unit. To be considered a capable territorial community, local government must fulfill all its obligations and provide services and management of their territory. To do this, they need money.

Looking at Ukrainian official website *Monitoryng*, there is evidence that almost half of local budgets come from states' transfers. Having 50% of their expenses paid by central government, local government could not fully be considered as independent entities and thus, it is hardly believed that they can have independent policy of development.

Although Umanets (2018) claims that the situation of hromadas is improving, the growth of income is not enough to cover all their expenses, thus it is important for local governments to find new resources of incomes.

The main research questions of this thesis are:

- ✓ *Why and how is the decentralization reform held in Ukraine?*
- ✓ *Why are Ukrainian municipalities financially dependent on the state's budgets transfers despite the decentralization reforms?*
- ✓ *How can Ukrainian local communities become more financially independent?*

To answer my research questions, mixed method is required. Quantitative and qualitative data are required, because official governmental statistics and official documents cannot answer all my questions and thus interviews from officials who work in central and local government are needed to see the perspective from central government view and local government view.

The main theory of this research is institutional theory. I chose it, because some actions of the central government cannot be explained through economic means and institutional theory helped me to analyze actions of the central government and its institutions with social, political and legal factors, which led to central government behavior (passed laws, decrease of central budget transfers, promotion of central government political party in municipalities, etc.).

To answer research questions, I built bellow structure of the Master Thesis (Fig. 1.1). Chapter 1 include introduction and background of the master thesis research. Chapter 2 provide readers with the theoretical background and chosen theory. Chapter 3 describes methodology of my research. Chapter 4 and 5 show the empirical findings. The analyzes is provided in chapter 6. Chapter 7 demonstrates conclusion part of my research including further openings for the future research.

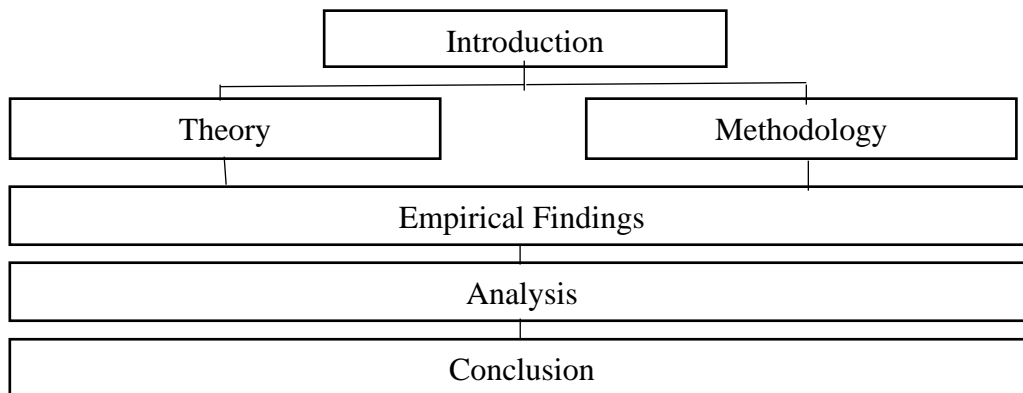


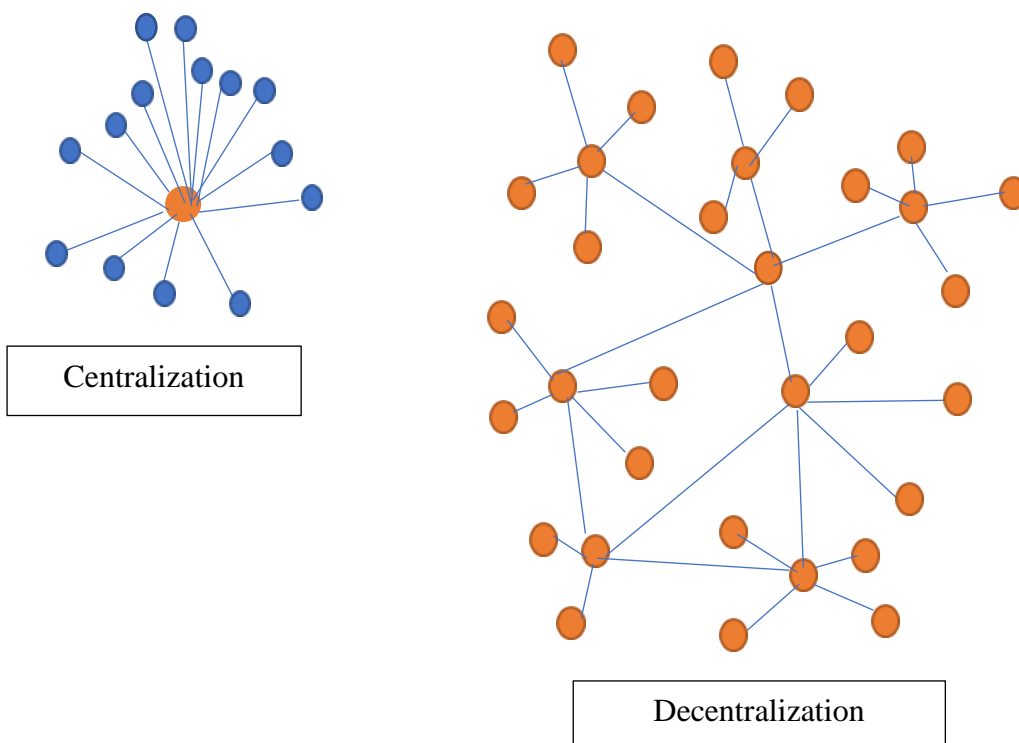
Figure 1.1 Structure of the Master Thesis

II. Theory

2.1 Decentralization

2.1.1 What is Decentralization in the public sector?

Decentralization is defined as the “transfer or delegation of legal and political authority to plan, make decisions and manage public functions from the central government and its agencies to lower-level functional authorities, autonomous local governments, or nongovernmental organizations” (Rondinelli 1981, p. 137). In other words, decentralization is the process in which central government transfers/delegates some of its power to local authorities or nongovernmental organizations. Decentralization as the process is viewed positively by many governments, think tanks and ordinary people. International organizations highly promote it and claim that implementing decentralization will improve efficiency, public participations, democracy, transparency and anti-corruption and regional development (Kaiser 2011). Bradley (2018) mentions that in some sense decentralization as the reform has become an ideology among many politicians who believe that implementation of decentralization will bring better understanding of local condition, improve efficiency and bring better allocation of resources in local government. To better understand the definition of decentralization, see figure 2.1.1.



Figures 2.1.1 Centralization VS Decentralization

The orange circle represents the government's entity which has political and financial power. The branches/lines between the circles represent their connection to each other. Blue circles represent government entities, that do not have financial or political power.

The left part of the figure 2.1.1 illustrates decentralization. The orange circle in the center of the left figure is connected by blue lines to blue figures. This represents that one governmental entity (orange circle) is in a higher position than the other governmental entities (blue circles). Blue circles are only connected to the orange circle, which means that one governmental entity dictates to other financial and political decisions and other entities are dependent financially on one entity, which illustrates a characteristic of centralization.

The right part of figure 2.1.1 illustrates decentralization. In the right part, all circles are orange, which means that all governmental entities are equal between each other. There is no one above them (orange circle), who will dictate them how these governmental entities should develop and no one controls them through financial means and thus these entities are equal, no one is the boss, but only partners. These orange circles are connected to each other in different ways, which shows that they (governmental entities with political and economic power) can cooperate between each other, not like boss and subordinate, but as partners on equal footing. All governmental entities under decentralization have political and economic rights and they decide on their own how they should use their own financial resources and with political power each orange circle (governmental entity with political and financial power) chooses how they should develop themselves.

2.1.2 Types of Decentralization

Political decentralization aims to redistribute political power, give provincial government voice in parliament, give people or their representatives more power and influence to create and promote new rules and regulations inside the country and create new mechanisms and tools that allow local representatives have political power on central government. The main concept of political decentralization is that local people will better know their local representatives and those representatives will better understand their local voter's demands, so more efficient representation of local people is held under political decentralization.

Fiscal (budget) decentralization is the process of distribution of functions, obligations, and financial resources. In other words, the central government gives part of the financial resources to local government, but at the same time part of central government functions and obligations are transferred to local government. Fiscal decentralization can be considered as the most important type of decentralization. The main reason is that local government needs

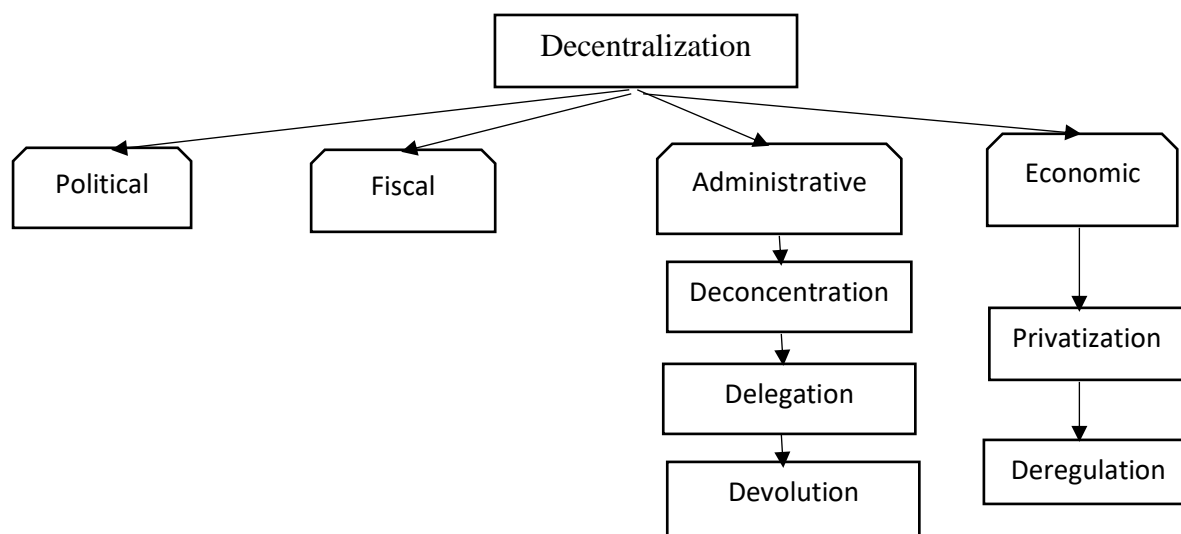


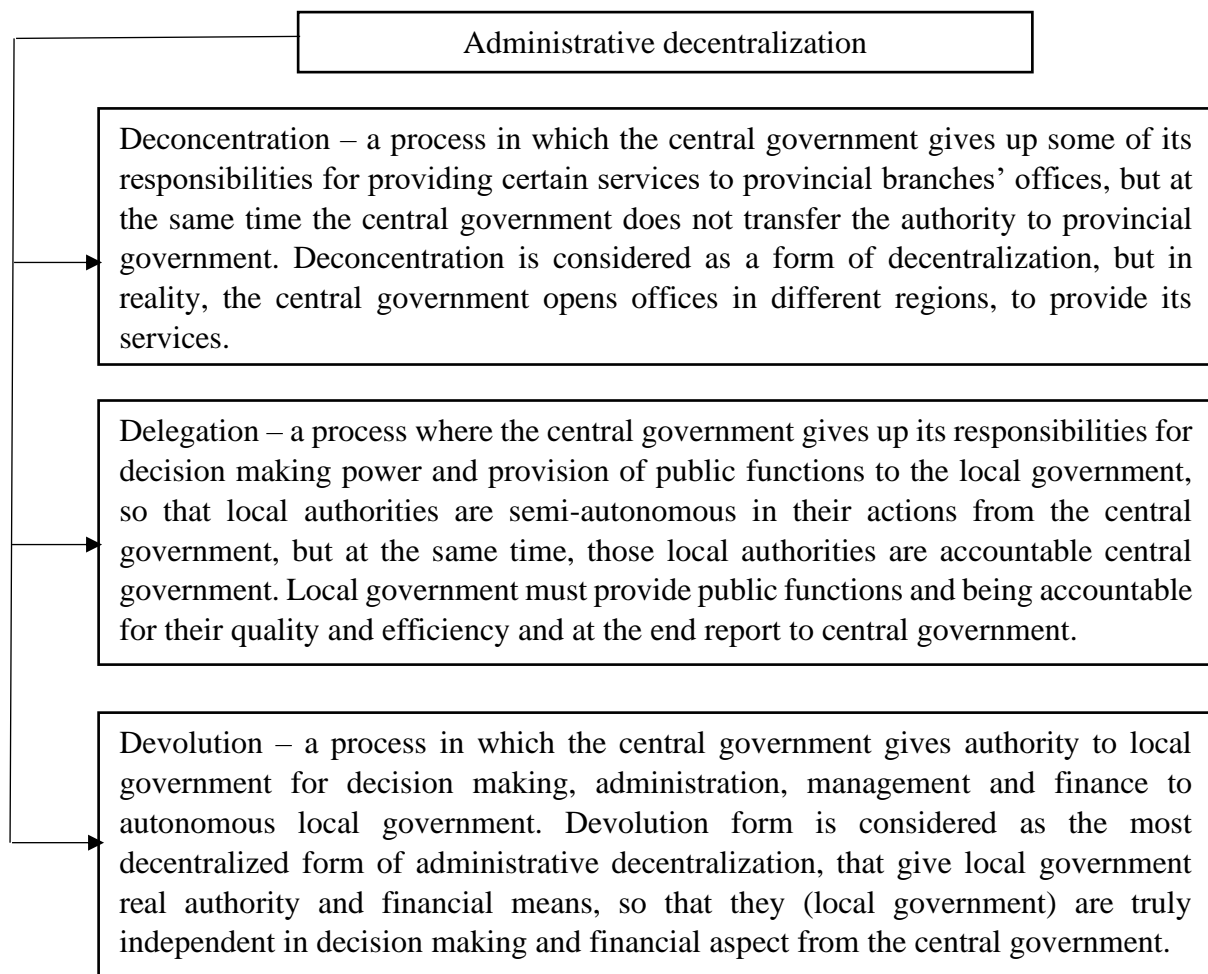
Figure 2.1.2 Types and forms of Decentralization (based on Stacey, 2011)

financial resources to operate and develop their territory. Without fiscal decentralization, local representatives may have political power, but without money, nothing will be accomplished including the development of their territory. The main purpose of this decentralization is to make local government financially sufficient (independent), so that they will have financial resources that can be used more efficiently and people in local territories will be able to get better services from local government. To do so, when fiscal decentralization is implemented, the central government may allow local government to collect user charges, transfer revenue from property and sales tax to local government and allow local government to take loans for different projects.

Administrative decentralization is the process in which central government transfers some of its functions and authority to local government, so that local government will be able to give services to its population. To simplify, the central government gives management rights, planning rights and financial rights to local government, so that local government will be able to provide and improve public services to its people.

In total, there are three major forms of administrative decentralization: deconcentration, delegation and devolution (Table 2.1.2).

Table 2.1.2 Forms of Administrative Decentralization (based on Stacey 2011)



Economic (Market) decentralization is the most decentralized form of decentralization from the central government’s view. This type of decentralization happens when the central government allows to transfer its public functions to private business, non-governmental organizations, private voluptuary associations or community groups. So, some of central government’s functions and services are given to private sector or other entities. Privatization and deregulation can be implemented in economic decentralization, but sometimes these mechanisms are not used.

- Privatization – a scope in a process in which central government may live its responsibilities for providing some services and products to the private business (radical) or can form PPP (Public Private Partnership) where private business and the government will work as partners to provide better quality services and products to people.

- Deregulation – a process in which central government decrease legal regulations or some laws on private business, so that less bureaucracy will be needed to allow private companies provide some services and goods to local government.

2.1.3 Decentralization trend in the world and the results of the decentralization reforms

Decentralization of power and strong local self-government are generally characterized by western, liberal-democratic traditions. In addition to improving the effectiveness of management, this approach contributes to greater involvement of citizens in the management of public affairs, the distribution of responsibility for the state of affairs in the state, the preparation of new generations of politicians and managers. Conversely, local self-government is absent in China and African countries, in Russia, most heads of communities are appointed by the government, and Belarus has preserved the Soviet model of vertical subordination of councils.

Rich countries are also more decentralized. According to Allain-Dupré (2016) Organization for Economic Cooperation and Development (an international organization that brings together 34 countries of the world, most of which are high-income countries and are considered as developed), the share of expenditures carried out by subnational governments among its members is 40% of all public expenditures, while in the world the average is much lower and is 24%. At the time of the survey, Ukraine's figure was 31%.

More democratic countries have made changes to administrative or financial decentralization over the past three decades. Their reasons are different. In Eastern and Central Europe in the 1990s, this was a reaction to the failure of a rigidly centralized communist regime policy over previous decades. To some extent, a similar reason prompted the countries of Latin America and even Western Europe. In some countries, such reforms are carried out to prevent interregional conflicts or, conversely, to rebuild regions after such conflicts, to mobilize local resources, etc. Pressure from international, donor, financial institutions (The World Bank, International Monetary Fund, European Union), expert community should also be considered.

If it is talked about decentralization as a trend, it is usually understood as reforms in three areas: territorial (reorganization of the territorial structure, mainly due to consolidation of administrative and territorial units), institutional (transfer of powers and resources) and procedural (change of administrative procedures, introduction of e-governance). Such reforms were carried out by Poland, Georgia, Latvia, Slovakia, the Czech Republic, Estonia, Hungary, Greece, Italy, Portugal, Denmark, Ireland, Finland and other countries.

The change in the territorial structure mainly took place due to the adoption of legislative acts. Countries that tried to carry out the reform exclusively through voluntary amalgamation could not complete it without a "forced" stage. In the period from 1950 in Europe the total number of local self-government bodies decreased by almost 40 thousand, which is due to both urbanization processes and the focus on improving the efficiency of providing public services at the local level. Denmark in 2007 strengthened the system of local self-government by consolidation of territorial communities. The number of communes decreased from 271 to 98, and their size increased significantly - almost 75% of communities have a population of more than 30 thousand, and the average exceeds 50 thousand people. In addition, the consolidation also concerned the regions – from 14 to 5 with a population of 0.6-1.6 million people, which allowed them to enter the group of regions of the NUTS-2 level (the standard of territorial division of countries in the EU). The reform of municipal level amalgamation was also carried out in Finland (the number of municipalities decreased from 450 to 320), Latvia (out of more than 500 self-government established 110).

The main reform of local authorities in Poland took place in 1989-1990 due to the adoption of legislation that provided for the transfer of powers and resources from executive authorities to local self-government bodies. At the same time, unlike Ukraine, the territorial basis for their effective work already existed – these are those formed in 1973, during the communist regime, the basic administrative and territorial units - gmina. As of 2018, Poland with a population of 38 million. Had 2,478 gmina, while in Ukraine in 2014 there were about 12 thousand hromadas. Gmina are legal entities with the right to defend their own interests in court (including before the government), and the list of their powers is not exhaustive.

2.1.4 Municipalities' revenues formation and decrees in the share of budget transfers

Municipalities can merge due to different benefits, such as: getting more population with more work experience, increasing municipalities functionality through sharing infrastructure and solving economic deficit by merging with stronger (financially) municipality. Amalgamation can solve many problems, but it is not a universal tool that can improve everything in local community.

One of the main reasons for amalgamation is financial deficit of some municipalities, but not every strong municipality will willingly merge with financially poor municipality and thus intergovernmental transfers exist, where central government will transfer its part of financial resources to municipalities that cannot be financially self-financed.

Table 2.1.4.1 illustrates the percentage of intergovernmental transfers from the total revenue of American municipalities. This table shows that the mechanism of intergovernmental transfers is not new, and it is quite normal for American municipalities to have support from state's and federal's budgets. The peak of intergovernmental transfer was in 1975 year, the total revenue from intergovernmental transfers was 42.4% of total municipalities revenue and after there is a clear trend of decline of dependence from intergovernmental transfers. American municipalities can also use amalgamation to improve themselves, so table 2.1.4.1 proves that with the merger of municipalities in a long run, financial dependence from central budget transfers can decrease.

Table 2.1.4.1 USA municipalities revenue from intergovernmental transfers (percentage from total revenue of municipalities) 1950-2017 years
 (based on Bartle et. al. (2011) and Loay et.al. (2019))

Year	Revenue Type		
	Federal transfer	State transfer	Total intergovernmental transfer
1950	1.5%	30.1%	31.6%
1975	7.5%	34.9%	42.4%
2000	3.7%	35.7%	39.4%
2007	4.3%	33.6%	37.9%
2010	2.3%	8.7%	11%
2017	1.3%	5.7%	7%

Looking at more recent reports from Loay et.al. (2019), the trend of dependence from intergovernmental transfers is decreasing in Figure 2.1.4.

The bellow figure 2.1.4 illustrates that countries have a tendency where municipalities revenue from central government transfers is decreasing. The largest percentage of municipalities' revenues from central government funding is in United Kingdom. In 2010 year, the average British municipality had 19% of central budget funding and in 2017 this percentage was only 14%.

American municipalities made a great progress in decreasing their financial dependence from intergovernmental transfer. In 2007, average American municipality had 37.9% (Table 2.1.4.1) revenue from intergovernmental transfers and by 2017 year this percentage has decreased and in total average American municipality had only 7% of their total revenue from

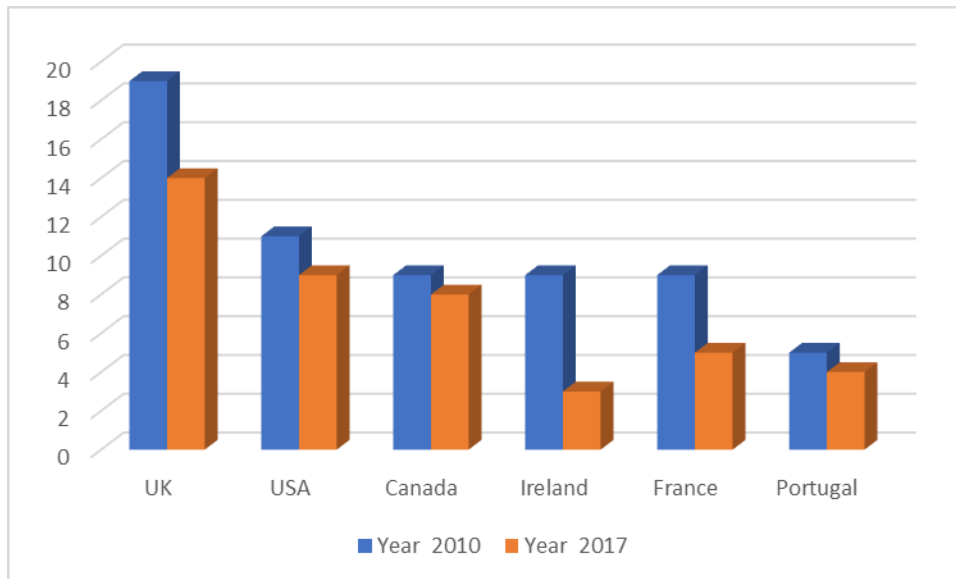


Figure 2.1.4 Share % of municipalities' revenue from intergovernmental transfers

intergovernmental transfers.

The lowest percentage of revenue from intergovernmental transfers had Ireland, which was only 3% in 2017 year. From 2010 to 2017 Irish municipalities could decrease their dependence by 6%, which is a great feat.

Using work of Gerard & Stephen (2019), I have found that the main reason for Ireland success of decreasing dependence from intergovernmental transfers lies in increase rates of local taxes and introduction of Local Property Tax.

Table. 2.1.4.2 Sources of Irish municipalities funding 2006-2017 (based on Gerard & Stephen (2019))

	2006	2008	2010	2012	2014	2017
Own source income	0.55	0.54	0.53	0.61	0.68	0.7
from charges	0.29	0.28	0.25	0.3	0.31	0.29
from taxes	0.27	0.26	0.28	0.3	0.36	0.41
Grants	0.45	0.42	0.41	0.34	0.3	0.27
Special Purpose Grants	0.25	0.23	0.24	0.19	0.21	0.26
General Purpose Grants	0.2	0.19	0.17	0.15	0.09	0.01

Looking at table 2.1.4.2, it is seen that Irish municipalities own sources of income has increased from taxes. From 2006 to 2008, there were almost no changes in taxes, but after 2008 financial crisis, Irish municipalities have increased rates of local taxes and charges and added Local Property Tax, so the sources of income of Irish municipalities have increased from 0.26 in 2008 year to 0.41 in 2017 year. Also, the source of income from general purpose grants have almost disappeared. In 2006, general purpose had 0.2 from overall municipalities funding and in 2017 year this number was only 0.01, almost non-existent. With the greater increase of revenues of Irish municipalities from local taxes and big decrease from governmental grants, Irish municipalities have insured their fiscal autonomy from the central government.

So, the overall trend in is that municipalities are decreasing their dependence from intergovernmental transfers. Municipalities are not so much financially dependent from central financing and this trend is positive to them. However, situation in Ukraine is different from the world trend. Although there is a sign of change (share of municipalities revenue from state budget transfers decreased by 2%), but this change is insignificant and almost 50% of municipalities revenue come from central budget transfers.

Amalgamation may become a useful tool which can increase the efficiency of provided public services and municipalities with financial problems can merge with other strong municipalities into one single entity. This tool may be underestimated sometimes, but world trend (figure 2.2.3) has proven that the dependence of municipalities from the central budget transfers is decreasing and the trend is continuous. With the largest percentage of 14% (2017 year) of British municipalities revenue from central budget transfers, I started to suspect that it was not a natural process for Ukrainian municipalities to have almost 50% of their budget revenue from central budget transfers.

2.2 Types of municipalities and their motives for amalgamations

2.2.1 Definitions of (in)capable municipalities

The term "municipality" from Latin "municipium" or English "municipality" means "self-governing organization". According to the political dictionary, "municipality" is a specific territorial unit, mainly considered as a city with adjacent territories (i.e., outskirts), which has one management system. The management of this territorial unit is carried out through the mechanism of representative democracy, that is, when the people elect their representatives, to whom powers and responsibility for the implementation of decisions on its behalf are delegated.

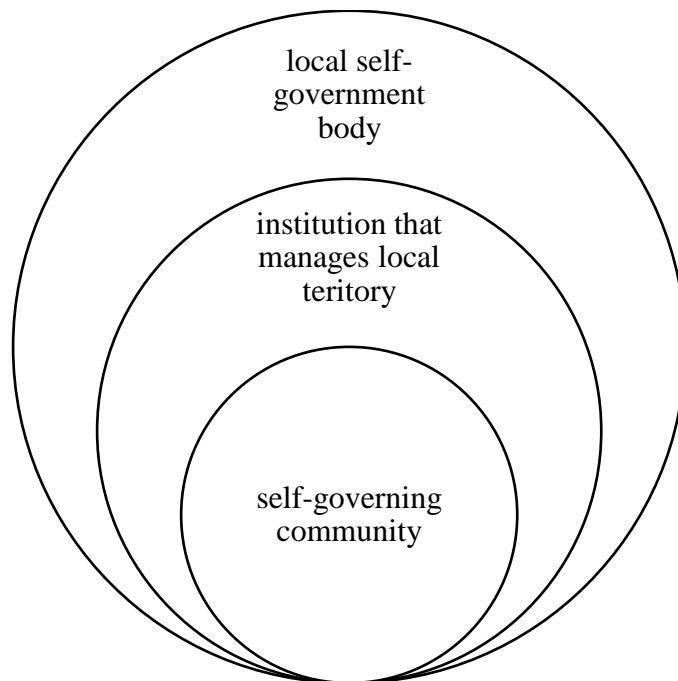


Figure 2.2.1 Three circles of Municipalities

Municipality is a political entity, which is formed (organized) by people who live in the borders of the municipal territory and its main purpose is to provide residents with public services. A municipality has at least the following characteristics:

1. A distinct geographic territory;
2. Formal organization;
3. General and specific powers to exercise;
4. Public officials who are elected ;
5. Specific functions to perform or services to provide;
6. Legal authority ;

7. A distinctly public character.

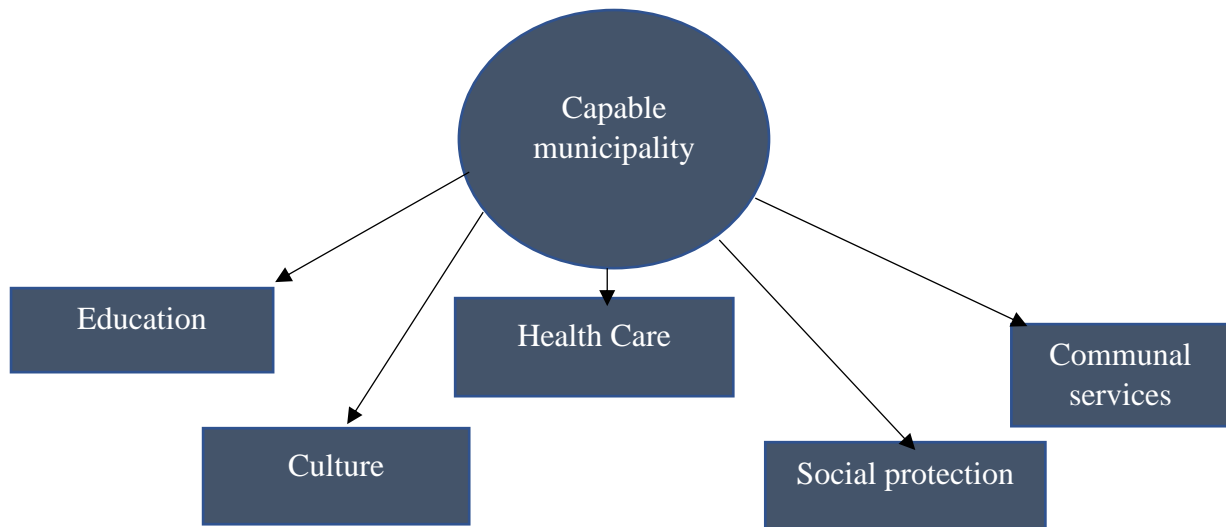


Figure 2.2.2. Services that Capable Municipalities must provide

Capable municipalities, are municipalities that are self-financed or have enough financial resources to provide qualitative services to its resides in the field of: education (For example: repair school, pay for electricity and water in education facility, etc.), culture (organize culture events for its residents, promote local culture through different activities), health care (build new hospitals, repair old ones), social protection (put cameras in public places, hire police, pay for police equipment) and communal (clean streets, transport waste from community). So, in order to be called a capable municipality, it should have enough financial resources for providing public services for its residents and have enough money to develop its own territory. If municipality cannot be self-financed or due to other reasons is incapable to provide public services to its residents, than this municipality is considered to be incapable.

2.2.2 Amalgamation and its motives

Jason (2020) defines amalgamation as an action in which two or more entities form a single entity. Amalgamation is a merger of two or more institutions (local government) into one institution.

There are different reasons for amalgamation among municipalities, such as: public service delivery motives, local democracy motive, political motives, structural motives and other motives (see table 2.2.2).

Public service delivery motives

Leland & Thurmaier (2014) mention in their work that one of the reasons of municipalities amalgamation is due to the sharing of service responsibilities. According to them, amalgamation of municipalities helps to create a foundation for creation of a platform through which members of amalgamated hromada (municipalities) can form a cooperation in sharing their responsibilities for providing public services and goods.

Table 2.2.2 Motives for Municipalities Amalgamation (based on Nanci et al., 2019)

Motives	Author/Year	Specific Motives
Public Service Delivery	Leland & Thurmaier (2014)	Sharing of service responsibilities
	Vojnovic (1998)	Effectiveness and efficiency of service delivery
	Swianiewicz (2018)	Improve public service provision
	Allers & Geertsema (2016)	Bring specialization to public labor market and improve division of labor
	Steiner & Kaiser (2017)	Decrease the cost of public services through different mechanism of provision (ex. Privatization)
	Dollery & Yamazaki (2018)	Decrease the cost of public services and improve their quality
Local Democracy	Tajbakhsh (2000)	Increased local political voice
	Suzuki & Sakuwa (2016)	Higher political trust among local people Increase participation rate of people in local elections
Political	Leland & Thurmaier (2014)	Policies of sustainable regional development
	Farid (2018)	Increased urbanization rate in amalgamated municipalities
		More logical land planning
	Miyazaki (2018)	Central government is more persistent in demanding provisions of public services from local government
	Strebel (2018)	Strong local council
Better informed central government		
Structural	Drew et al. (2017)	Larger Scale
		Improved infrastructure
		Better condition of economic and political structures
Other	King (2008)	Improved response to natural disasters

Vojnovic (1998) proved that when the sharing of responsibilities is happening in municipalities, effectiveness and efficiency of service delivery is improved greatly. Swianiewicz (2018) mentions in his work that some municipalities are too small and as the result they do not have enough financial resources and strength in managing waste, financing infrastructure, have enough capacity or providing services and finance some welfare services. Due to these reasons, amalgamation is the only way for municipalities to ensure their fulfillment of responsibilities. Allers & Geertsema (2016) mention that large municipalities have specialization and improved division of labor. With amalgamation, the local governments get bigger population and as the result local governments have more choices in hiring, which allow them to hire better educated workers or those who are already trained and have experience.

Steiner & Kaiser (2017) talk about amalgamation as a chance for municipalities to rebuild current mechanism of delivering public services and even have a privatization to allow private enterprise to provide those services. It should increase the quality and decrease the price of providing those public services, so amalgamation will aid municipalities in decreasing the cost of delivering public services and increase their quality for local population (Dollery & Yamazaki, 2018). So, local authorities and residents are interested in amalgamation, because it improves provided public services. After amalgamation, municipalities have more financial resources, which could be used to repair the existing infrastructure and build new infrastructure, to provide better quality and at the same time. The cost for municipalities will decrease, due to combination of existing infrastructure and newly build infrastructures.

Local democracy

Population size is one of the most important factors for amalgamation. Local representatives of municipalities want to have power to have a voice and power in changing national policies and to do so, according to Tajbakhsh (2000), local government merges with each other to get bigger voice in national politics. There are opponents to the idea of amalgamation and their main argument is that when municipalities merge, people tend to focus more on its functionality and neglect its local people demands. On the other hand, Suzuki & Sakuwa (2016) agree that the amalgamation make municipalities larger in size and population, which at the beginning makes local representatives focus on its functionality and ignore some demands of their voters, but at the same time large municipalities increase voters trust, makes them more motivated in participation of local politics and thus amalgamation brings more positive results to the local community than harm.

After the amalgamation, the number of residents will increase, which in turn will increase the political power of the municipality. The more people live there, the higher the voice of municipality in the eyes of central government. The second benefit for local democracy is that after amalgamation, more people will participate in local elections, because their trust is improved.

Political motives

The first benefit that amalgamation brings in category of political motives to municipalities is that the amalgamation makes it possible to have policies of sustainable regional development. Leland & Thurmaier (2014) in their work prove that larger municipalities are better equipped compared to their smaller counterparts and as the result their bigger size can make them sustain regional development. Farid (2018) has the same opinion and his research prove that the larger the size of municipality can improve its urbanization. The increase of municipalities size makes local council face more responsibilities and larger pressure, which as the result force them to use their resources more efficient and thus plans of using land (land planning) are more professional and logical. So, amalgamation can bring to local council a sustainable regional development and urbanization.

The size of municipality does not only benefit local politicians and bureaucrats, but it brings some benefits to local people. The larger municipality the bigger responsibility of a municipality, but in some cases in bigger amalgamated municipalities if something goes wrong, local community can blame the central government instead of the local council or their representatives. Due to this reason, according to Miyazaki (2018), if local representatives cannot fulfill their obligations and responsibilities to local people, central government may interfere and put pressure on them and demand that they provide obligated services that local government is responsible, otherwise central government may even make such incompetent municipalities merge with a bigger one, which is more responsible and have better management, in other words, destroy incompetent municipality and fire incompetent local official through the amalgamation process.

The last political motive which promotes amalgamation is that the merger of municipalities can bring stronger and stable local councils. Strebel (2018) emphasized that in those territories that have population who speaks different languages it is common for municipalities to unite with other municipalities who have the same culture, common history and population that speaks the same language. It will bring more stability and efficiency to local

area and at the same time central government will better understand the needs of different population in their country.

For the political motives, the main benefit after amalgamation, can be considered the sight of the central government. The central government will demand from the representatives of amalgamated municipality, to provide better quality of public services. Due to amalgamation, the number of residents will increase and if something goes wrong, those residents will blame central government and because of that, central government will put more pressure on amalgamated municipality.

Structural motives

Economical structure, political structure infrastructural structure will greatly improve through amalgamation (Drew et al., 2017). The increase of municipalities territory and population will greatly improve municipality's resources. More people usually mean more collected taxes and better political structure in local area. With more resources, local government can better finance and upgrade local infrastructure as the result the urbanization process is smoother; amalgamation increase the scale, so more human resources are available, which can increase efficiency, because with the increase of population, there should be specialist or more well-educated employees who can improve the overall structure of municipalities.

After amalgamation, the combined financial and human resources should improve the overall structure of municipality. The increase of population of amalgamated municipality will bring higher experience workers and more financial resources due to the increase of local government's territory.

Other motives

For the other motive category, natural disasters are mentioned by King (2008). In areas where natural disasters often happen, small municipalities are simply incapable to deal with them, so small municipalities have to merge with other municipalities to better deal with future natural disaster and in some countries, central government even encourage those small municipalities to merge, so better efficiency and less casualties will happen in those municipalities after natural disasters.

So, in areas where the rate of natural disasters are high, small municipalities cannot survive, due to insignificant financial resources and the lack of personnel. Amalgamation is the

only way for that territory to develop and in case of natural disaster happen, the rate of survivors will be higher in the amalgamated municipality, because of above reasons.

2.3 Institutional theory as approach chosen for this study

The institutional theory (other names: institutionalism or institutional economics) is the branch of economic theory, but unlike its counterparts, this theory explains processes and reasons of actions of companies, government or institutions using in its base not only economic factors that lead to actions, but institutionalism in its analysis connects actions of main parties with social, political, ethical, legal, factors as a basis to explain the behavior of institutions (government, company or institutions) (Scott, 2008).

Institutional theory tries to focus on more resilient aspects of social structure. It focuses on processes by which structures, including schemas, rules, norms, and routines, become established as authoritative guidelines for social behavior and in this research is like the social norms that society tries to follow unconditionally without knowing it. Institutional theory tries to find how these elements are created, diffused, adopted, and adapted over space and time; and how they fall into decline and disuse (Scott, 2004).

To better understand the reasons for dependence of Ukrainian municipalities from central budget's transfers, despite implementation of the decentralization reform, I decided to use old institutionalism theory and new institutionalism theory. These two ideas of institutional theory may explain the overall situation in Ukraine.

In 1968 Weber provided a definition of institutions as "involuntary associations". One of the followers of old institutional theory Selznick's (1949) work mentions that each institution has its period of life and society as a whole should resist complete control of the institutions, including government agencies. In his book he mentions that each institution should pay attention to external environment and to ensure institutional safety and stability, institutions must absorb new people with novel ideas and those leaders should have means of bringing changes to the institution in accordance with external demands.

After Selznick's institutional theory, new institutional theory has occurred. DiMaggio & Powell (1991) mention in their works that new institutionalism pays more attention to the unity of the whole institution/organization (homogeneity of organizations and stability of institutional components). Mayer & Rowan (1977) mention about institutionalism as a process in which all aspects are taken as a rule like status. They mention that it is necessary to do so in order to bring some rationality into organization. If the institution absorbs new people and

changes, due to some people's unreasonable demands, the organization will be in chaos, there would be no productivity and due to internal divide, the institution/organization would have no ability to fulfill its obligations, so as the result ideas of unity, following scripts, orders and the same routine were formed. According to Scott & Meyer (1983), institutional theory explains the elaboration of rules and requirements to which organizations must conform if they are to receive support and legitimacy. Meyer & Rowan (1977) mention that that institutional theory helps to better understand the behavior of certain organizations in the use of strategies that can ensure superior performance in regulated environment. The first component of institutional theory is limited rationality (Alexandr et. al., 2015). According to functional analysis, components of a system must be integrated in order for the system to survive, in other words changes on one part means that all parts must be changed. Functional rationality assumes that changes in one component will force changes of other components and it will happen when dysfunctions of structural arrangements outweigh their functionality (Farah & Dieter, 2020). This limited rationality is one of features of institutionalism.

Limited rationality may explain why people in Ukraine want to change everything in government and using decentralization reform, society expected to take power from central government and give it to local authorities. On the other hand, limited rationality can also explain the actions of Ukrainian central government and their believe that changing everything in government immediately is not rational and can bring more harm, so the central government implement decentralization reform step by step.

The second feature of institutionalism is the external environment. Tolbert & Zucker (1996) mention in their work that external environment can bring pressure to institution, which may force changes in it or desistance to the pressure. In this case the external environment is people's demands of reforming central government and giving more focus to local development.

The third element institutionalism is the attenuated consciousness. Zucker (1983) in his work mentions that people in society are taken for granted the work of certain institutions and the participants do not always understand the important role of certain institutions. People's demands from government to bring changes and live like other people in EU, made them belief that decentralization is the key of bringing prosperity to society and this belief made central government build new governmental institutions such as: hromadas/municipalities.

The final element of institutionalism is symbolism. Powell & DiMaggio (1991) mention that institutionalism plays greater role to the symbolism than the informal interactions and its

functionality. Giving legal and financial power to local communities can be considered as symbolism of decentralization (giving power and financial means of sustainability to local communities).

2.4 Summary of theoretical findings

The key point of implementing decentralization reform is to improve the wellbeing of local people. To make sure that the wellbeing of local people can be improved, decentralization brings local government some autonomy and power to manage its own territory. The second benefit, is that after decentralization, villages, towns and cities get the legal rights to form voluntary municipalities with other entities (villages, towns and cities), which as the result should improve the quality of public services, decrease the price for local people on this public services and due to combination of public infrastructure (after municipality is formed), the cost to manage those infrastructure should decrease and the efficiency of management is increased, because of higher human resources (municipalities have more experienced workers compared to villages or towns). Finally, local democracy is improved and people have more trust in local and central government.

Figure 2.4.1 illustrates the process of decentralization. Due to external environment, in most cases the overall demand of population, using local and central elections, people can demand from government to implement decentralization reform. Moreover, local central governments can also have Public Service Delivery Motives, Local Democratic Motives, Political Motives and Structural Motives that will make the government agree in implementing decentralization reform.

Villages, small towns and even cities may not have enough financial resources for providing public services. The implementation of the decentralization reform allows villages, towns and cities to form municipality, new governmental entity that combines all of its members financial resources. After municipality is formed, it has more financial resources than its separate member and this resource can be used by municipality to build new infrastructure (for example, build new water pipelines), which can improve the quality of the service and decrease the price of provision for municipalities (Swianiewicz, 2018; Drew et al., 2017).

Also, after municipality is formed, the local community become larger in size and its population. According to Suzuki & Sakuwa (2016), due to the increase of the size of the community, local people have a higher motivation in attending local elections, which increase participation and as the result more people trust local government.

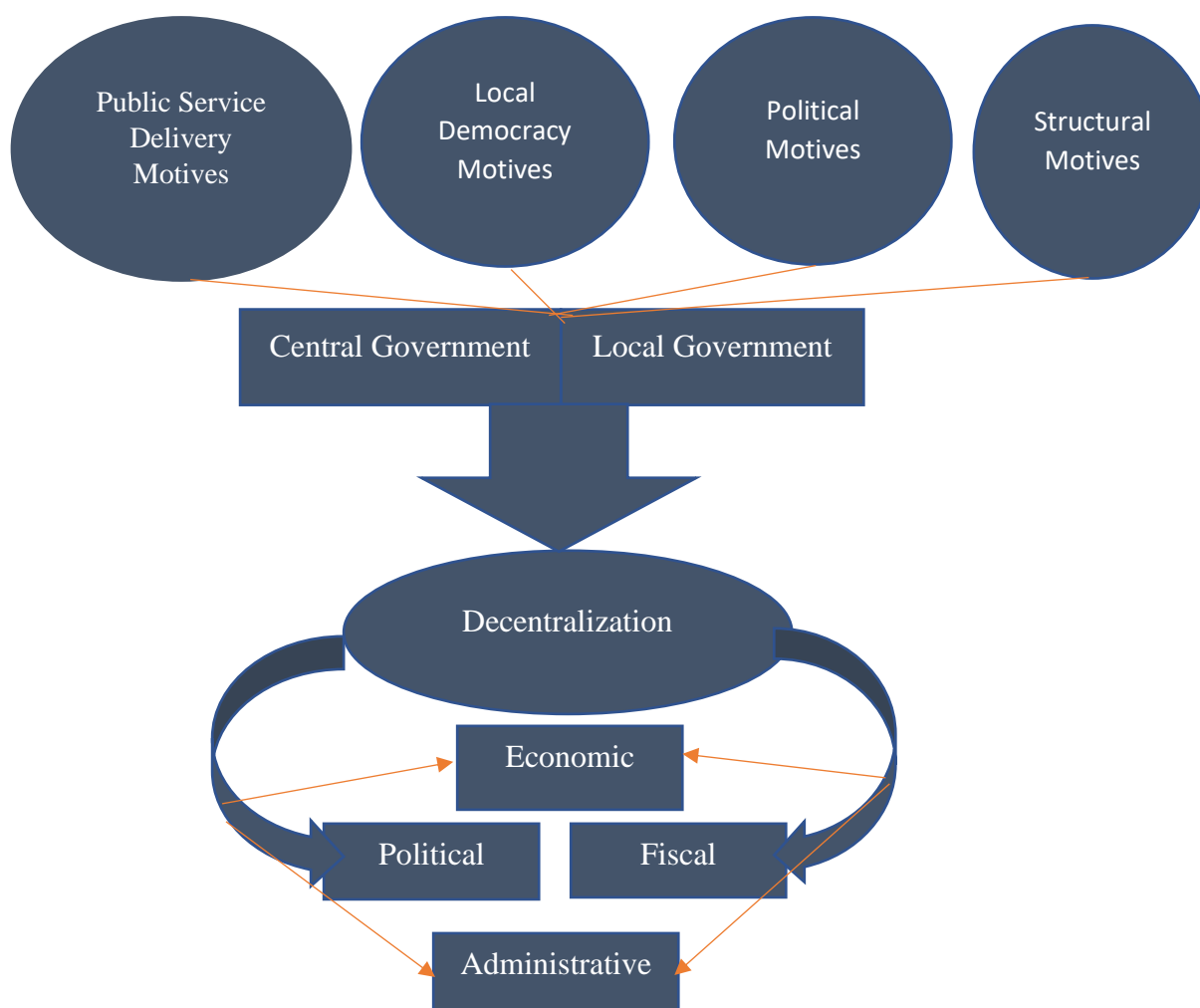


Figure 2.4.1 Decentralization Process

Miyazaki (2018) also proved in his work, that the central government check more local government in providing public services, if the local community has higher population. For example, compare to an ordinary village, central government will pay more attention to municipality, because it has higher number of residents and if something goes wrong, the local people will blame central government than the local government. So, central government has high interest in ensuring that municipalities have fulfilled their responsibilities in providing public services to local residence due to large number of local people.

Due to the above reasons, both central and local government have enough motives in implementation decentralization reform and after government chose in implementing this reform, it has to choose, which type of decentralization reform it will implement.

Using local and central deputies each political party can put pressure to implement the decentralization reform, that they think is better. For example, one of the party has a majority in central government, opposition parties can use local elections and governments as a platform to promote the vision of their reform. So, both sides will be heard and a compromise will be reached.

A simplified analytic model and proposed research questions (Figure 2.4.2) illustrates the logic of studying decentralization reform in Ukraine and its consequences for local and central governments.

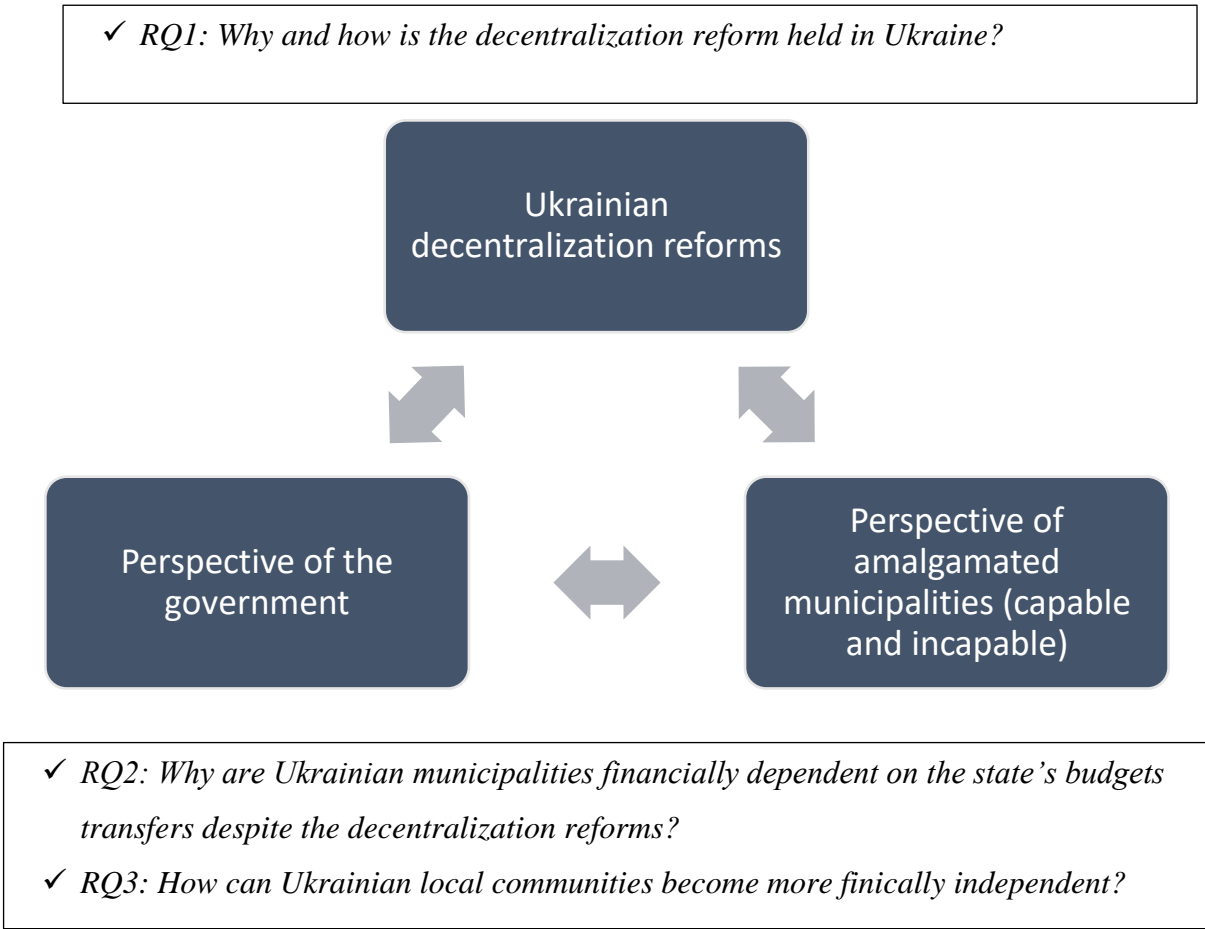


Figure 2.4.2 Analytical Model

The main purpose of decentralization reform in Ukraine is to give to local government political and economic power, so that the local area will develop better under the decentralization reform. It was expected that implementation of the decentralization reform, would increase local revenue and Ukrainian municipalities would become self-financed or at least decrease their dependency from central budget transfers (from international experience, figure 2.1.4).

Ukrainian paradox is that with the implementation of decentralization reform, the average Ukrainian municipality get 50% of their revenue from central budget transfers and this figure is too large. To answer my research questions, institutional theory is used. Instead of only using economic factors as a reason to explain actions of the central government, which logically cannot be explained using economic reasons from my perspective, I focus more on political, social and legal factors, to explain this paradox (interviewing officials from the central and local government to see their reasons and opinions from both parties).

III Methodology

In Methodology chapter, philosophical assumptions, research design, data collection and analysis techniques, as well as ethics and quality of the research design are discussed.

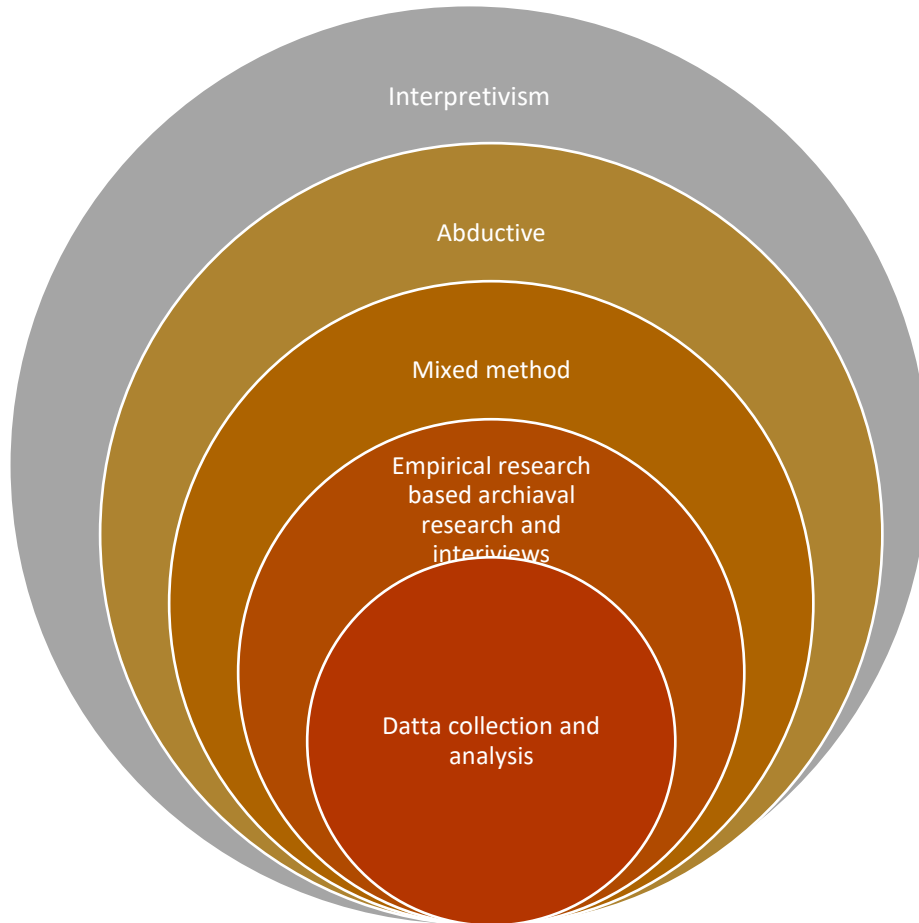


Figure 3.1. Illustration of the research project methodology (based on Saunders et al., 2015)

3.1 Research Philosophy

The term research philosophy refers to a system of beliefs and assumptions about the development of knowledge (Saunders et al., 2015). According to Burrell & Morgan (1979), researchers make conscious or subconscious assumptions. Those assumptions can include human knowledge (epistemological assumptions), realities researchers may encounter in their research (ontological assumptions) and the extent and ways researcher own values influenced by her or his research process (axiological). Crotty (1998) mentioned in his work that these assumptions inevitably shape how researchers understand their research questions, the methods they use and how they interpret their findings.

Those sets of assumptions will influence researchers, their philosophy, methodological choice, research strategy and data collection techniques. My assumptions also shaped me and because of those assumptions I decided to use interpretivism as part of my research philosophy.

Interpretivism philosophy proclaims that humans are different from physical phenomena because they create meanings, and those meanings are studied by interpretivists (Saunders et. al., 2009). The main idea of interpretivism is that human beings and their social worlds (in other words behavior or actions) cannot be researched in the same way as physical phenomena, and thus there should be a differentiation between social sciences research and natural sciences research, instead of studying human behavior under one standard approach.

Positivism tries to study the behavior of different individuals, who come from different cultural background, different age group, people with different belief and so on and tries to formulate one universal law of their behavior that can be applied to everyone. The main purpose of interpretivist research is not to simplify actions, behavior and what is happening under one universal law, but to enrich research with new knowledge, complex reasoning and understand social behavior of different individuals (Saunders et. al. 2009).

During my research, I have made the assumption that the main reason for municipalities dependence from the states' budget transfers is that the central government wants to keep financial power and its influence over local government. Crotty (1998) mentions that assumptions form research philosophy and in my case because of my assumption, I research government from the perspective of two different entities: central government represented by Verchovna Rada's committee on amalgamated hromadas and amalgamated hromadas (local government). People who work on those two entities have different understanding of realities and reasoning of certain actions of the central government.

Understanding those two differences and reasons from the perspective of those people who work in local government and central government are important for my research, because it can be argued that official from central government live in one reality, while people who work in amalgamated hromada experience different life and see the other way, thus interpretivism philosophy seem to suit well for my research.

3.2 Approach to theory development

Abductive approach (abductive reasoning) is formed to address weaknesses connected with deductive and inductive approaches. To be more specific, deductive approach is criticized for not having clarity of how the selected theory should be tested via hypotheses that researchers formulate. Inductive approach is criticized due to no amount of empirical data will necessarily enable theory-building (Saunders et. al., 2012). Abductive approach has solved these problems by adopting a pragmatist perspective (figure 3.2).

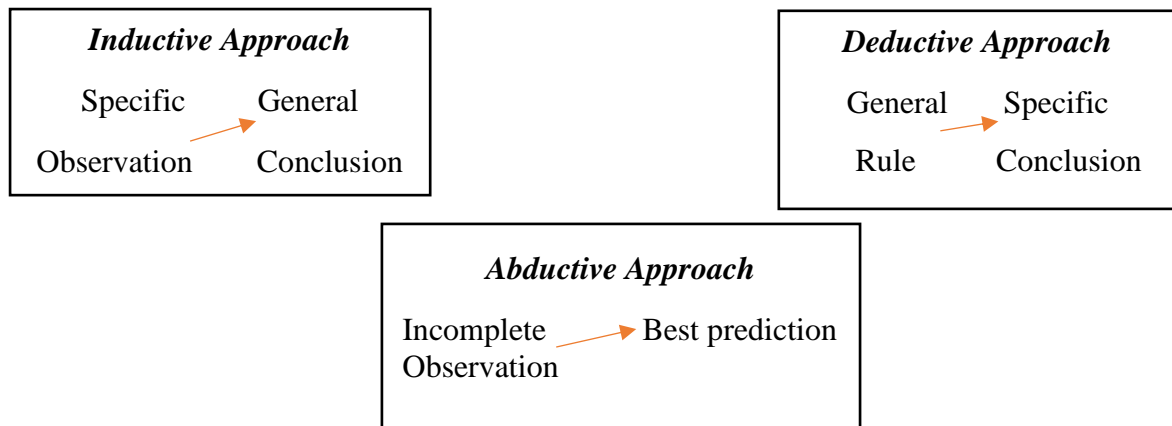


Figure 3.2 Actions and Results of: Inductive approaches, Deductive approaches and Abductive approaches (based on Bryman & Bell, 2015)

According to Suddaby (2006), unlike deduction approach, which moves from theory to data and inductive approach, where researchers move from data to theory, abductive approach moves back and forth.

Abduction approach starts with a surprising fact and then the researcher chooses a possible theory that can explain it begins with the observation of a ‘surprising fact’; it then works out a plausible theory of how this could have occurred. Van Maanen et al. (2007) claims that those theories that researchers choose, can later help researchers to easier find surprises.

The same happened to me, during my research. After I made the assumption and made a theory, between analyzing different official documents and collecting interviews, different surprises and facts were uncovered by me (mentioned in paragraph empirical findings) and it can be said that my theory was formed during the research process. I formulated one theory and later with the new information modified it back and forth.

3.3 Research Method

For choosing research method, I had a challenge. At the beginning, I only collected quantitative data, from different governmental official websites. Later, I understood that these data were not enough, and I needed interviews, from people who work in local and central government, to understand their position and different views.

The term “mixed methods” refers to the research methodology where both qualitative and quantitative data are used, or in other words mixed, of quantitative and qualitative data within the investigation of the researcher. The basic premise of this methodology is that such integration permits a more complete and synergistic utilization of data than do separate quantitative and qualitative data collection and analysis. Leech & Onwuegbuzie (2008) defined mixed method, as a research, in which researchers collect, analyze, and interpret both quantitative and qualitative data in a single study or in a series of studies that research the same phenomenon.

For my research I used explanatory design. Firstly, I analyzed governmental statistics, municipalities budget’s income, their expenditures during different period of time, hromadas budget revenues during different period of time and main components of state’s budget transfers to local communities from the beginning of the reform 2014 year till 2020 year. This analysis of numerical data was important, because at the beginning of the research, I tried to understand where hromadas get their revenues from, what are their main expenditures and if it is even possible to get new revenues for hromadas using their current available resources.

Secondly, after finding that the dependence of hromadas is not decreasing for so long and finding strange new added expenses for hromadas, I made conclusion that quantitative method was not enough, so qualitative data was also needed for getting better understanding of hromadas dependence on central budget transfers.

The main qualitative data that is used in my research come from interviewing officials from the central and local government. The opinion from central government of what are the main problems of financial sustainability of hromadas and their explanation of some laws that made hromadas dependence even deeper were needed. Moreover, interviews from representative of local municipalities were also needed to see the perspective of local government and what do they think of their financial dependence and to see if it was done intentionally by central government to keep amalgamated hromadas financially dependent from the central government.

Due, to the above reasons, mixed method was chosen in my research. Only numerical information from official documents were not enough and thus interviews and hromada's budget analysis played enormous role in understanding financial dependence of amalgamated hromadas from central budget's transfers.

3.4 Data Collection

Due to the mixed method, that I chose and presented above, the information was collected in numerical and non-numeric form. The study is mainly based on documentary analysis, official governmental statistics, structured and semi-structured interviews with officials from central and local government in Ukraine.

The collection of secondary data, which included official statistics from governmental websites and documentation was simple and fast compare to collected interviews. These official documents and statistics were a primary data and the hardest part of it was official terminology, which is used in those documents and without detailed study, some key moments could have been lost. The numerical data was simple to collect, because it is an open source, but finding needed data took some time, due to large amount of it.

In order to collect primary data for my research project, structured and semi-structured interviews with public officials from central and local government were held. When I had structured and semi-structured interviews, I used the 'five Ps' provided by Saunders et al. (2015) prior planning prevents poor performance. Therefore, interview guide (Appendix 2 for officials from central government and Appendix 3 for officials from local government) was prepared after I analyzed all documents and numerical data. These data helped me to gain knowledge about my topic and because of it, I was able to formulate specific questions that were needed for my research. Questions with central government officials were not changed, because prior to the interview all three officials required from me to show questions before the meeting, so they could prepare for the interview. With other two officials from local government, I held semi-structured interviews, because after they told me their answers, I wanted to ask some more detailed questions, to understand in more details, what was before decentralization and after decentralization (specific changes in their amalgamated hromadas) and how the central government may influence them through grants allocation procedures.

In total, five interviews were collected (Appendix 4 – detailed about official from whom I collected interviews). I planned to interview more people, but due to Covid-19 and lock down in Kyiv, some people cancelled interviews. I was able to hold 2 interview face to face (central

government official) and other interviews (one with central official and two officials from local government) were collected through the phone.

All five participants did not give me the consent to audio record them, so I made notes during all my interviews. At the beginning, when I searched people with whom I can hold interview, I sent a participant information sheet with questions attached (see Appendix 1), so all respondents were aware about questions I was going to ask and what information I was interested with. I have also assured interviewees about the possibility of anonymity to increase the level of confidence in trustworthiness and four chose anonymity.

I also sent analyzed official governmental statistics to respondents and questions about some laws, so that respondents could see why I was interested in specific questions and I also asked them to comment on this information. This helped me, because for example officials from the central government could ask their colleagues and confirm this information or add some to it and officials from local government told me in more details on what are their expenditures locally and how can amalgamate hromadas file to central government to get grants on some projects.

I collected secondary data from the following sources: official government documents, laws, statistics, central government regulatory documents, central government budgets and documents from ministry of finance.

I have analyzed secondary data before interviews and it gave me an opportunity to be more prepared for the interviews, formulate key questions and keep the conversation with respondents going on. During my interviews I have received some comments to my secondary data and with the help of this, my empirical findings were greatly strengthened.

It should be mentioned that it was no coincidence in choosing Alfa and Beta for my research. Alfa hromada is a capable Ukrainian municipality, which has enough financial resources to fulfill its obligations to its residents. It is headed by local official, who belongs to presidential political party. So, by interviewing the head of Alfa hromada, I got the perspective of local official, who belongs to presidential party and whose hromada is capable financially in fulfilling its duties to local residents.

Hromada Beta was chosen because of two reasons. The first one is that it is headed by opposition parties (whose opponent is presidential political party), they are majority in Beta hromada. The second reason of choosing to interview official from Beta hromada is that after local elections, in which opposition parties won majority, Beta hromada became financially

incapable and thus it could not provide all its services to local people. I chose Beta hromada to find reasons for sharp decline in financial resources and the viewpoint of the local deputy (Why did it happen?) and reasons for his hromadas financial dependence on central budget transfers.

So, Alfa hromada represent the case in which it is capable and headed by central government official. Beta hromada was chosen because it is ruled by opposition parties and because of their sharp decline of financial resources after opposition party came to power.

3.5 Data analysis

For the secondary data analyses, I could say that it was time consuming. I analyzed laws, official documents and statistics and later build some figures in empirical part, to visualize the data and make it simpler to understand.

To make sure that I could analyze data after interviews, I wrote detailed answers of my respondents. I was not allowed to audio record them, but they gave me enough time, so I could write their answers in more detail. After the interview I translated those answers from Ukrainian to English. After I received these primary data from my interviews, I compared it between each other using cross-case basis to find difference in opinion, similarities and links in perceptions of central and local official in Ukraine.

3.6 Ethics and quality of the research

When you interview human participants in research studies, it is no surprise that ethical issues are risen. My research process was done according to Global Code of Conduct provisions and no violation of any ethical standards has happened in it. From the Appendix 1, it is seen that the message was sent to the respondents in the process of search. It informs respondents about myself and my research project. The next action was that I got approval from the individuals to conduct the interview. Before the interview was held, I asked respondents weather I could audio record them. After that, I gave respondents anonymity options and in the end of the interview I asked them again about their anonymity.

To make sure that the anonymity was held, this research will not provide any detailed presentation of the respondents. The information that is needed for understanding analysis of my research is disclosed. During the interview, all interviewees had a choice of not answering the question they deemed not important or too sensitive and to make sure that there was no uncomfortable feeling between myself and respondents, I informed them before interview that if they do not want to answer it, just say pass and I would start next question. Besides, the interviewees had a chance to view what I wrote, comment and after they asked, some

information was deleted. With those whom I hold interview through phone, I made pictures of the paper where I wrote answers, send it and after 20 minutes called them to discuss what should be corrected and whether, I understood their answers correctly.

According to Easterby-Smith et al. (2015), reliability can be assessed by answering following 3 questions: (1) Will the measures yield the same results in different situations? (2) Will similar results be gotten by other researchers? (3) Is there transparency in how conclusion was made from the raw data?

To ensure reliability, primary data was collected from respondents who work in central and local government and have important positions there, because I needed to talk to professionals. I interviewed people who work on questions of decentralization and amalgamated hromadas in central government and two people whom I question from local government held a head position in their local municipality, so their answers are reliable could represent professional thinking and opinion.

Secondary data was collected only from official governmental agencies, such as: Ministry of Finance, Website Decentralization – all related official documents about amalgamated hromadas and laws are published there and Monitoryng source – all official governmental statistic data is published there, so the sources are reliable, because it is published by Ukrainian government.

IV EMPIRICAL MATERIAL PART I

4.1 Description of the Research Context

This chapter will provide a short overview of Ukrainian amalgamated hromadas formation, reforms of financial decentralization from 1991 till the present day, financial resources that amalgamated hromadas have and the overview of the fight of old and new institutionalism in Ukraine.

Mishyna (2019) defines amalgamated hromada (AH) as a territorial community of villages, towns or cities that is a separate administrative entity or united villages' (town's or cities') governments that are united in one/single central administrative entity. Amalgamated hromada is a separate local institution, which exists as a union of local government (villages, small towns or even cities) that tries to unite their territory in order to make the governance of amalgamated hromada more efficient and self-sustainable.

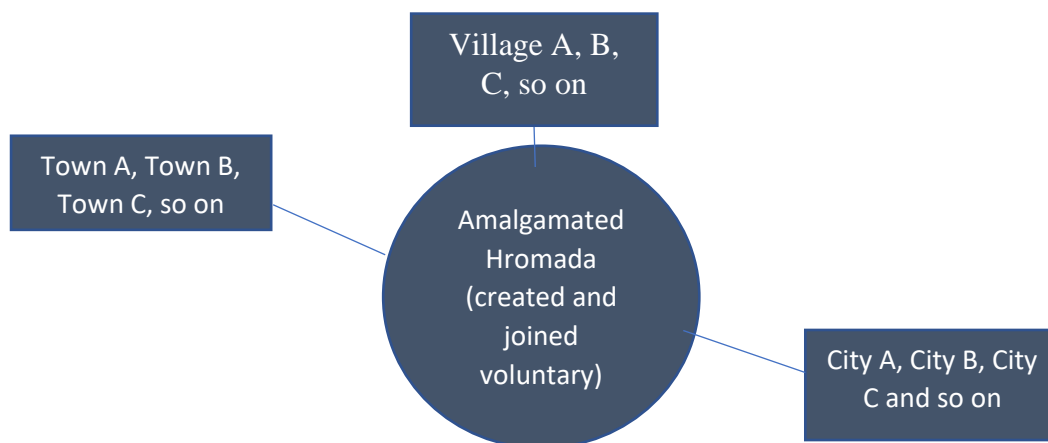


Figure 4.1 AH's structure based on Mishyna (2019)

The central circle from figure 4.1 represents Amalgamated Hromada (AH). To the central circle there are connections (villages, towns cities). In other words, the central circle Amalgamated Hromada represents the integration of different local government into one local government – AH. AH is created voluntary and joined by other towns, cities and villages voluntary. In order for a new member join AH, the majority (2/3) of its representatives should agree. This AH unifies all the resources and expenditures of its members into the one single budget and the people of the AH's territory manage their amalgamated hromada together. Before, amalgamated hromada, villages, towns and cities acted separately and manage their own revenues and expenditures by themselves. If they (villages, towns and cities) decide to consolidate their resources, they form AH and as the result, its members get one unified budget and more population in one single administrative entity. This is important, because the more

population local government has, the bigger resources are in their management and those members who have financial deficit, can solve their problems by forming AH with other local government, who has financial sustainability.

Overall, there are three main signs of Amalgamated Hromadas in Ukraine (Mishyna, 2019):

- 1) The territory of AHs is the same as the territory of its members (villages, small towns, or cities). Amalgamated hromada is an entity, which consists of different members (villages, small towns and cities), so its territory consists of territory of its members.
- 2) There is a close communication and cooperation between amalgamated hromadas' members including social connections. Amalgamated hromada is managed by the united government of all its members and AHs' representatives are elected by the people who live in this AH, so the communication between its members is very closely linked in government (territory management) and people (for example, people demand to build hospital in amalgamated hromada, so they gather together, exchange different ideas and in this case use the same hospital after it is built where they can build social connections with each other.
- 3) Members of AH are people who live permanently in a respective locality. The representatives of AH are elected by people who live in the territory of amalgamated hromada, so the residents of AH are automatically considered as members of AH.

According to member of Verchovna's Rada (VR) committee on Decentralization Reform, the main purposes of amalgamated hromada are: *"To provide citizens with basic public services, to solve most issues of people, to provide comfort and safety for a comfortable life of people. That is, to close all tasks that do not require state intervention (for example, defense, higher education, external relations, health care are national issues). Basic things should be closed by territorial communities"*.

4.2 Process of the formation of the amalgamated hromada in Ukraine

Figure 4.2.1 describes members of the territorial communities who have the rights to propose the formation of the amalgamated hromada. Article 5, R.I. Law of Ukraine "On Voluntary Amalgamation of Territorial Communities" there are only 4 groups of people who have the rights to propose the formation of the amalgamated hromada (see figure 4.2). This proposition from these four groups of people must be voluntary and no one has the rights to pressure local government to form amalgamated hromada.

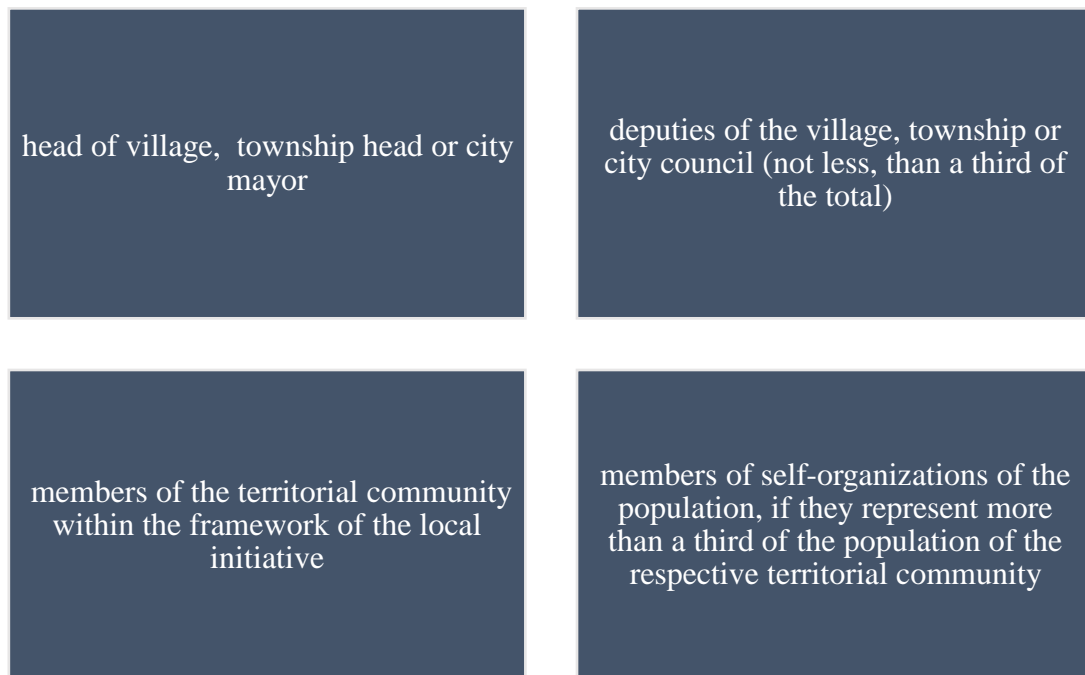


Figure 4.2.1 The initiators of voluntary amalgamation of territorial communities

In case when the initiative comes from the head of the village, township head or mayor, there are four stages that should be carried out, to form amalgamated hromada.

Stage 1 – Initiation voluntary amalgamation of the territorial communities

1. the head of village, township head or mayor should implement the initiation of amalgamation in the form of an ordinance on the initiation of amalgamated hromadas.
2. Deputy or members of the territorial community are issued an order to study proposals for initiating AHs and its public discussion is held.

The initiation proposal should contain a list of territorial communities proposed for amalgamation, indicating the relevant settlements and determining the administrative center of the AH and its name.

Stage 2 – Preparations of decisions on amalgamation of territorial communities

1. the village council, township council, city council at the first session adopts a decision "On approval of the Procedure for conducting public discussions on the issues of voluntary amalgamation of territorial communities" and actually conducts such a discussion with the preparation of a protocol;

2. village council, township council, city council from the initiator community makes a decision "On granting consent to voluntary amalgamation of territorial communities and delegation of a representative to a joint working group";
3. heads of village, township heads, city mayors are sent a proposal to grant consent of the respective territorial communities to amalgamation and delegation of a representative to the working group;
4. generalization of information on granting consent to AHs is made and an order is made on the formation of a working group on the preparation of a draft decision on amalgamation, containing a list of settlements determined by the AH administrative center and an organizational action plan for amalgamation;
5. the regional council and the regional state administration (by sending a copy of the order) on the formation of a joint working group on the preparation of a draft decision on amalgamation are being prepared and a draft decision on amalgamation is being prepared
6. the joint working group prepares a draft decision on voluntary amalgamation of territorial communities and sends it to the territorial communities that are invited to amalgamate for discussion.
7. A public discussion of the draft decision on voluntary amalgamation of territorial communities and the execution of the protocol is being held.

Stage 3 – Decision making on amalgamation of territorial communities

1. the village council, township council, city council of the hromada approves the project and decides on its adoption based on the results of the discussion;
2. in the presence of all decisions on the approval of the project from village, township, city councils within 5 days, submissions to the provincial state administration are carried out to obtain a conclusion on the compliance of the draft Constitution and the laws of Ukraine.

Stage 4 - Formation of the amalgamated hromada

1. in case of obtaining confirmation of the compliance of the draft legislation of Ukraine, the hromada, which initiated the issue of voluntary amalgamation of territorial communities, make decision to form amalgamated hromada (AH);
2. the head village, township head or mayor appeals to the Regional State Administration due to the need to make a decision on the appointment of the first elections of deputies of the village council, township council, city council;
3. Accordingly, the Regional State Administration appeals to the Central Election Commission for the appointment of elections and informs the relevant councils that have decided to voluntarily amalgamate territorial community.

The amalgamated hromada is considered to be formed from the date of entry into force by the decision of all local councils (after representatives of local communities vote for creation of amalgamated hromada, they pass it in the document, where official results of the vote is written and if majority vote for creating municipality, in that document is mentioned the day when the decision must be implemented, like law) that have decided to voluntarily amalgamate territorial communities.

In case when the initiative to form amalgamated hromada does not come from the head of the village, township head or mayor, there is another process of forming amalgamated hromada, which is illustrated in figure 4.2.2.



Figure 4.2.2 Steps to create amalgamated hromada (if the proposition does not come from the head of local government)

4.3 Budgetary resources of amalgamated hromadas

Since 2014, the government has begun reforming within the framework of the current Constitution. During this time, the main package of new legislation has already been formed and is in force, priority legislative initiatives are being introduced.

- 1) Laws on Amendments to the Budget and Tax Codes of Ukraine. Results: local budgets increased by UAH 206.4 billion: from UAH 68.6 billion in 2014 to UAH 275 billion in 2019.
- 2) Law "On Voluntary Amalgamation of Territorial Communities". Results: from 2015 to 2021, 1470 hromadas were voluntarily established in Ukraine. Eleven million people live in AHs. International experts call such rates of intermunicipal consolidation very high. *“As everyone knows, in 2021, this reform received new inspiration and was eventually brought to its logical conclusion. Independent Ukraine eventually received its own administrative and territorial structure – capable 1470 territorial communities and 136 large-formed districts (rayons in Ukrainian), which mostly meet the European standard NUTS. This was also recently noted in the European Parliament and even recommended that other countries take our experience into account. I think it's a good signal”* – Central official, member of VR’s committee on AHs, deputy.

Table 4.3.1 Reforms of Financial Decentralization in Ukraine 1991-2021

<i>Stages</i>	<i>Legislative changes</i>	<i>Features</i>
Stage I from 1991 to 2001 formation of financial decentralization policy	Adoption of the Law of Ukraine "On Local Self-Government", ratification of the European Charter of Local Self-Government	- creation of prerequisites for the development of principles decentralization; – introduction of budget federalism; – determination of financial and material bases of local self-government bodies
Stage II from 2001 to 2010 strengthening the processes of centralization of public finances	Adoption of the Budget code of Ukraine	- transparent budget regulation of revenue part of local budgets; – improvement of the organization of inter-budgetary relations; – separation of expenditure powers between levels of government, taking into account the principle of subsidy
Stage III from 2010 to 2015 lack of conditions for the implementation of financial decentralization	New version of the Budget Code of Ukraine. Adoption of the Tax code of Ukraine	- no prerequisites for effective implementation of the financial decentralization policy at the local level

<p>Stage IV from 2015 to the present day the review of the powers of local self-government bodies and constitutional reform</p>	<p>The provisions of the Budget Code of Ukraine have been changed and the Tax Code of Ukraine regarding the formation of a local budgets</p>	<p>- review of the powers of local government and the constitutional reform; - functioning of local finances in the context of militarization of the economy, foreign economic shocks and falls production; - increase in revenues of local budgets as a result of expanding the revenue base of the local community</p>
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- 3) Law "On Cooperation of Territorial Communities" has created a mechanism for solving common problems of communities: garbage disposal and recycling, development of common infrastructure.
- 4) Law "On the Principles of State Regional Policy". Results: state support for regional development and infrastructure development of hromadas during the reform increased by 41.5 times: from UAH 0.5 billion in 2014 to UAH 101,4 billion in 2020.
- 5) A package of laws on expanding the powers of local self-government bodies and optimizing the provision of administrative services were implemented from 2014-2016 years. Results: it allowed to delegate to local self-government bodies of the appropriate level the authority to provide basic administrative services: registration of the place of residence, issuance of passport documents, state registration of legal entities and individuals, entrepreneurs, associations of citizens, registration of civil status acts, property rights, solving land issues, etc.

In European countries, the main components of local self-government financial resources are financial support of the social sphere, development of local economy, budget resources (local budget revenues), off-budget resources (municipal borrowings, trust funds, etc.), financial resources of communal property enterprises, revenues from the management of communal property, privatization, etc., charitable, sponsorship, donations and other resources (Oplotnik 2012).

In Ukraine, local municipalities have property resources (movable and immovable property) together with the revenues of local budgets, non-budget target and other funds, land, natural resources that are in communal ownership of territorial communities of villages, towns, cities, as well as objects of their joint ownership, which are managed by district and regional councils, in accordance with the Constitution of Ukraine and the Law of Ukraine "On Local Self-Government in Ukraine" constitute material and financial , their development contributes

to increasing the financial capacity of communities.

Head of Alfa Amalgamated Hromada: *“Before the decentralization reform, the main revenue that local community collected from land tax and lending land to other people. Local government did not have any interest in developing their own territory. They did not have any initiative. After decentralization, 60% of personal income tax goes to hromadas. This tax is the major revenue, so after local government get this 60% share from personal income tax, they started to think how to lure business to their territory. Local representatives became more initiative in planning how to create new jobs and make it simpler for business to work in their territory. Decentralization reform made local government to pay more attention in developing their local territory and this happened only because of decentralization reform. So, after decentralization reform was implemented in Ukraine, municipalities got legal basis in collecting some share from taxes, which they later use in developing their territory (see table 4.3.2)*

Table 4.3.2 Resources of amalgamated hromadas subject to a new redistribution of public finances between levels of government 2021

<i>Fees and charges:</i>	<i>Taxes:</i>	<i>Other income:</i>
1. state duty; 2. payment for the provision of administrative services; parking fee; 3. tourist tax; 4. rent for the use of property in communal property; 5. rent payments for subsoil use; 6. 50% of monetary penalties for environmental damage; 7. 75% of funds from reimbursement of losses of agricultural and forestry production.	1. 60% of personal income tax (the main tax), thanks to which own income in amalgamated hromadas increased by 2-2.5 times); 2. 25% environmental tax; 3. 5% excise tax on the sale of excisable goods; 4. 100% single tax; 5. 100% income tax for communal property enterprises (a new tax for AHs that practically does not yet arrive); 6. 100% property tax (real estate, land, transport).	1. various transfers (basic subsidies, educational and medical subventions, capital transfers) are of greatest interest to AHs; 2. targeted and voluntary contributions of institutions to local environmental funds; 3. receipt within the framework of international technical assistance programs; 4. funds of share participation in infrastructure development; funds from the alienation of communal property; 5. funds from the sale of homeless property; 6. local borrowings.

To meet the needs of territorial communities, in particular, municipalities may use the financial resources of various economic agents, in particular, local and central authorities, private business entities, financial institutions and non-governmental organizations, as well as foreign states and international financial organizations (see Table 4.3.2).

At present, the financial capacity of hromadas relies on resources of internal origin. Some resources (investments, charitable assistance) can be both internal and external at the same time. Municipalities also gained access to other external financial resources. The Amalgamated Hromada Council has the right to make local borrowings to the local budget, both internal and external, including by obtaining loans from international financial organizations. In many hromadas, where there are many unresolved problems, it is impossible to solve them only at the expense of internal financial resources, so local representatives think about entering the borrowing markets, as well as attracting investments and other resources from the outside.

Examples of budgetary resources of internal origin are revenues from taxes and fees, sale and lease of communal property. The most important external source of budget funds is the State Budget. In particular, external budget revenues may include targeted subventions from the State Budget, including within the framework of the implementation of state or regional target programs, investment projects (programs), or financing of local projects from the State Regional Development Fund

Local authorities can also attract credit resources to finance the development of their community. Credit sources of financing for local socio-economic development have many potential advantages, but are also accompanied by significant risks and certain difficulties in the preparation of documents.

V EMPIRICAL MATERIAL PART II

5.1 Results of decentralization reforms in Ukraine

In order for hromdas commit their obligations and provide services that they are responsible for, their budget revenues must have enough financial funds to make their obligations for their people. If communes do not have enough money to fulfill their obligations, they are asking them from state budget, like it is in Ukraine (Please see figure 5.1.1).

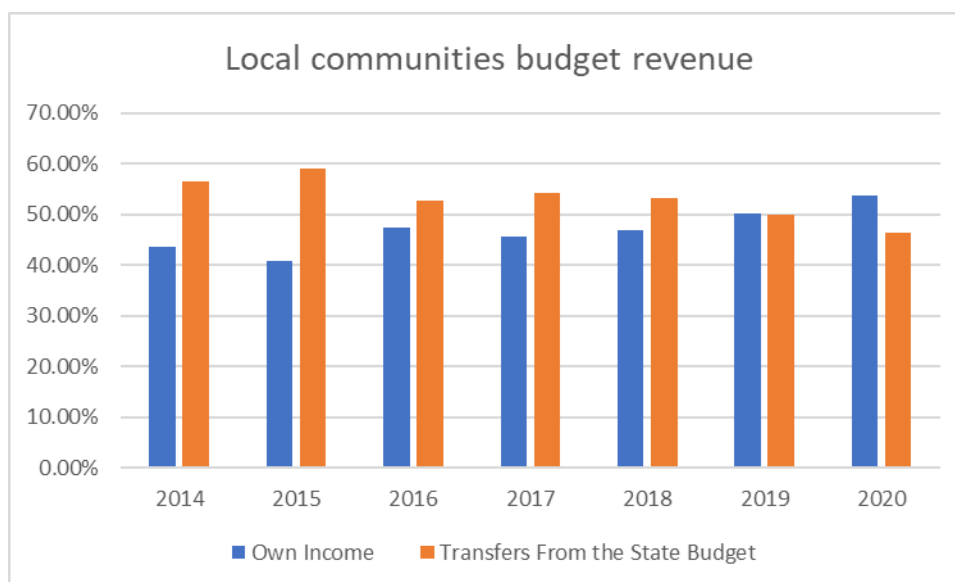


Figure 5.1.1 Average local budget revenue proportion (based on statistics from website mate Decentralization)

From the figure 5.1.1, it is illustrated that in most years that the reform of decentralization was implemented, from 2014-2018, more than half of municipality's budget is financed by the state budget and only from 2019, their budget revenues were not higher than 50%, in 2019 hromada's own income was 50, 2% and in 2020, it was 53,6%, which is still not enough. Imagine the situation where the state budget has a deficit and it cannot any longer give transfer, because there are not enough resources. What would happen? Local government would only have half of current financial resources without state's budget support and as the result they will be in a deficit in financing in different fields, such as: education, healthcare, administrative services, roads, lighting, water, waste, landscaping, construction, and safety. Unprepared roads, no fixing of electricity and water infrastructure, and increase of crimes. These are just a tip of an iceberg of what would happen in local communities if the state would suddenly stop financing local communities, which is unacceptable.

From the very beginning of decentralization reform, starting in 2014 year, almost all local communities were not financially sustainable, so the central government passed Law "On the Principles of State Regional Policy", which allowed communes get financial help from

central budget’s transfers. In 2014, the overall financial dependence on state’s budget transfers was 57% of their total revenue. And this trend has continued until present days.

These results (2014-2020 Financial dependence) picked my suspicion. After I have found that it was because of the Law "On the Principles of State Regional Policy", which became effective in 2014, I had formed a hypothesis that this was done intentionally by the central government institutions in order to have power over local community and its governance.

Figure 5.1.2 bellow illustrates that the state support in Ukraine has been increasing since the implementation of decentralization reform, which started in 2014. In 2014 the state support for local communities was only 0.5 billion hryvna, and the state support has increased to 20.75 billion. So, state budget support has increased by 41,5 times.

Local government gets more financial support for its development, so it is positive. The negative effect is that its dependence has increased from the state government, which is counterproductive to decentralization reform. You cannot expect local communities to

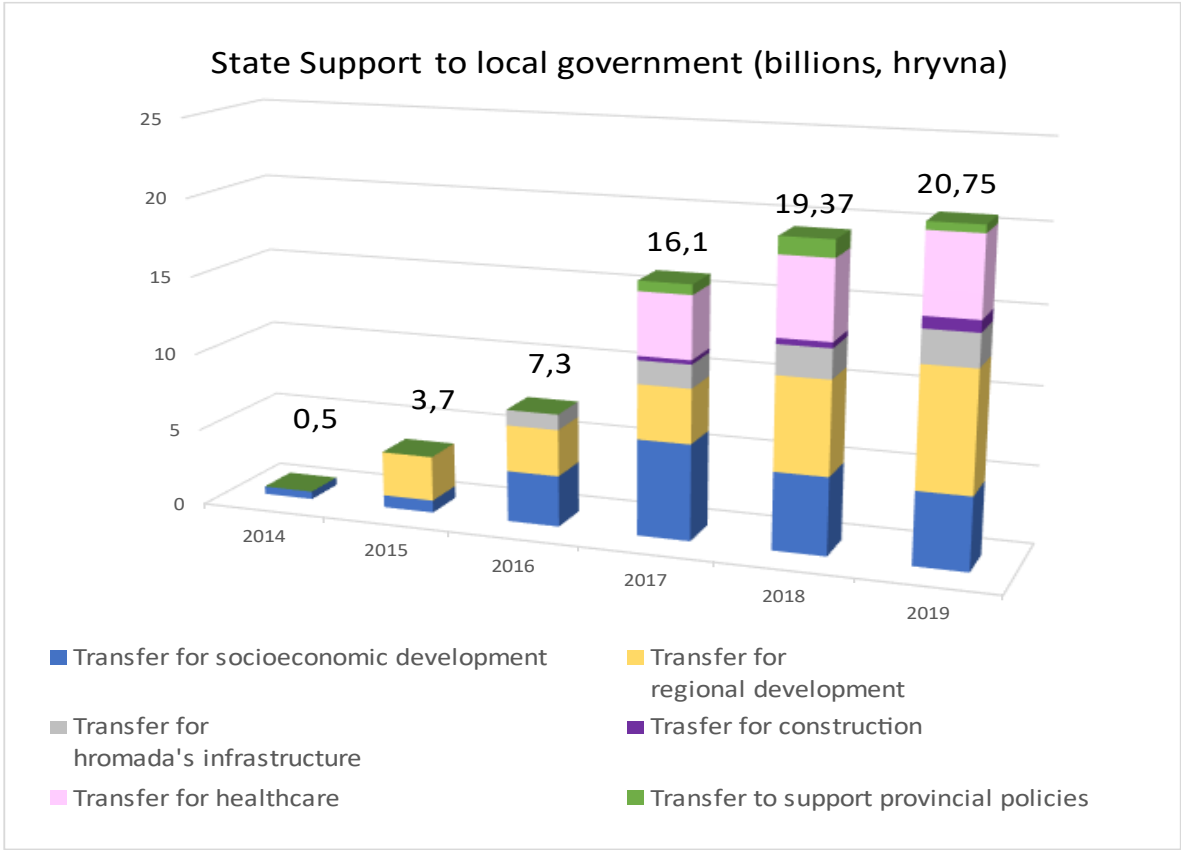


Figure 5.1.2 Fields in which central government finance local government

develop independently, have their own opinion and be independent from the state decisions if their own budgets have strong financial support from the state government.

Looking at figure 5.1.2 above, it picked my interest because I saw from it the increase of fields where state’s budget support had increased and this help was increased in stages each

year. In 2014, the central government helped local government only by transferring 0,5 billion hryvnas to help them develop socioeconomic development. In 2015 year, there were two fields that central government “helped” local government and the trend is only increasing and within each year more kind of “help” of financing by state budget was offered, which was highly suspicious to me. I looked further and found that from 2015, the central government clamored that if hromadas want to develop independently and have the rights to use taxes and charges, they had to take some responsibility from the central government (costs), so that not only local government got money, but also fulfilled its obligations to its people (providing security (finance police department), health care (build hospitals), education (build kindergartens and schools and so on...)). It sounded reasonable at the beginning, but later after I saw added *obligations*, my suspicious had increased.

The figure 5.1.3 bellow shows that the total state support to local communities in 2020 was 101.9 billion hryvna. Compared to 2019, which was only 20.75 billion hryvna, it is basically a fact that state’s support increased by almost 5 times. It is undeniable that the central governmental help has been increasing since 2014 and it is hardly a great news. Municipalities’

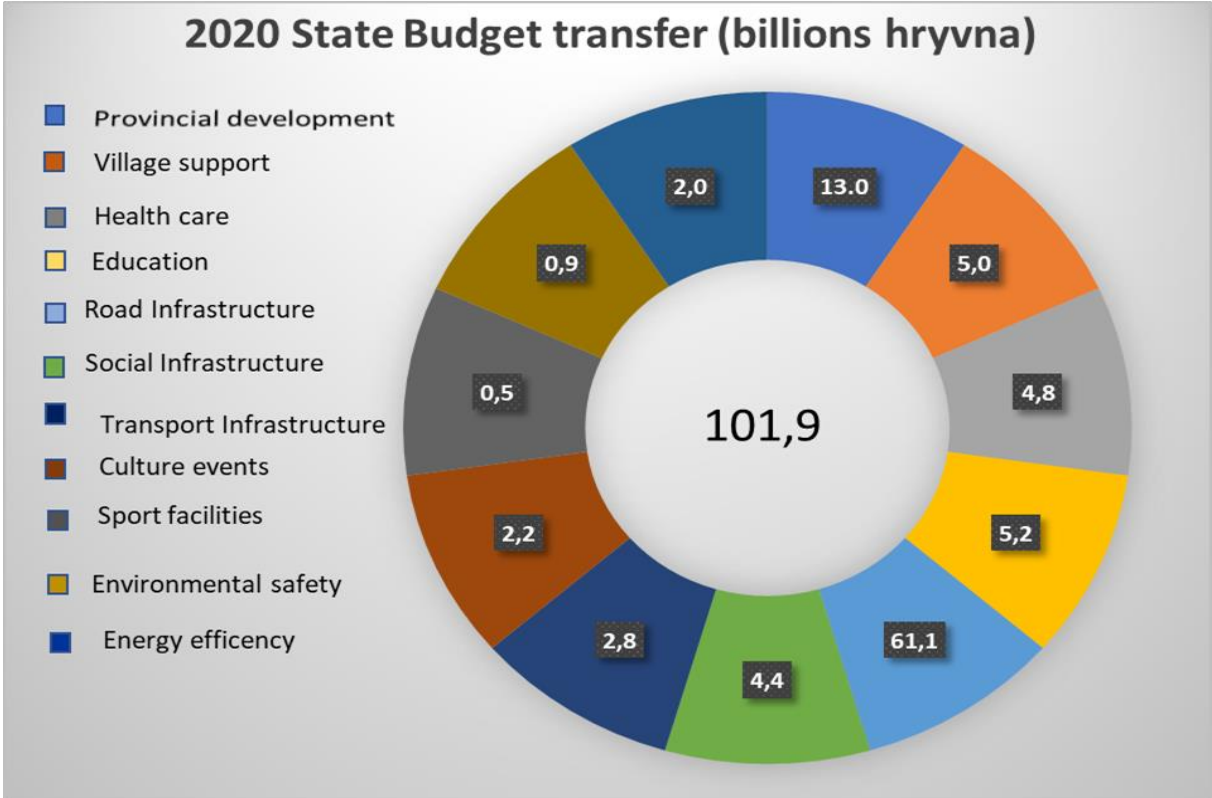


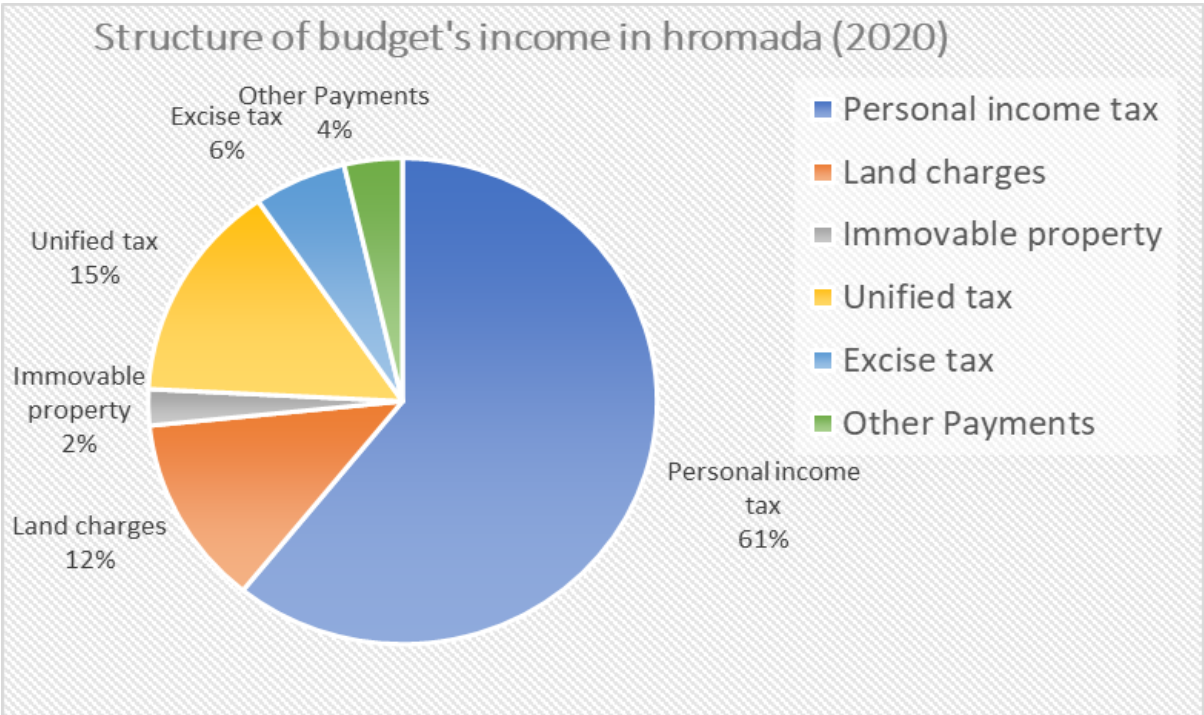
Figure 5.1.3 2020 Fields of state budget transfers

budgets help is increasing, which means that the local government cannot fulfil its own obligations independently, which is not healthy for local economy.

Looking at figure 5.1.3, it is seen that the main component of the transfers is Road infrastructure, which accounts to almost 60%. 61.1 billion hryvna is in itself is almost 3 sums of all 2919 state’s budget transfers to local government. This responsibility convinced me 90% that additional tasks that are transferred by the central government to municipalities is done intentionally.

The figure 5.1.4 bellow shows sources of municipality’s own income and its proportions to total revenue. Personal income tax pays the major role in hromada’s budget revenue and according to this graph, 61% of all income come from this tax. In western countries all personal income tax goes to local government. In Ukraine, according to the budget Codex, 25% of this income come to state budget, 15% to provincial government and 60% amalgamated hromadas.

Figure 5.1.4 Resource of local income in 2020



According to the Ukrainian Ministry of Finance, in 2020 central budget received 295.1 billion hryvna from personal income tax. This sum is only 25% of proportion of the total income tax. Looking at graph 3, it is shown that the total central budget transfers to local government was equal to 101,9 billion hryvna. So, the deficit of hromadas which covered by the central budget transfers can be solved by giving those 25% from personal income tax to communities, instead of transferring them to central budget and then using them in budget transfers. This behavior of central government can serve as evidence that the central institutions do not want to have prosperous independent municipalities with financial sustainability, otherwise central government would give that 25% of proportion to local government and their deficit would be

solved instantly and they would have surplus, which could be used to develop local communities.

Ukrainian municipalities cannot simply continue in this way, because it is the road of nowhere. Decentralization reform was firstly implemented on the ideas that local people know better what is needed for development in their community. People who live on territory know better than the state government and by implementing decentralization reform local communities got legal tools to decide their own destiny, but they cannot do this, until their budget revenue does not have any transfer from state and by having almost 50% budget from the state, local government can forget about deciding on their own how and on what to spend money. What is more unforgivable, is that when financial situation of local communities is improving, new responsibilities “suddenly” occur that keeps hromadas dependable from state’s budget transfers. The only reason of why commune dependence in overall is not increasing is due to uniting with other communes, forming stronger and more efficient municipality and due to villages and towns transferring their status and forming hromadas. Hromadas are not financially independent and until this problem is solved, forget about deciding its own political power and rights to develop their own local territory.

5.2 Problems with grants for amalgamated hromadas

Amalgamated hromadas that wish to receive grants from central government for special project, have to follow five steps. Figure 5.2 shows those steps, and it was constructed based on the central government official who works in one of the commissions that decide, which projects should be approved.

For the step 1, representatives from amalgamated hromadas must provide detailed information about the problem and detailed plan of solving it. Member of committee on grants: *“The more details the problems of AHs and directions of its solution will be revealed, the more arguments in the project application will be, and, accordingly, the chances of winning the competition”*.

For the step 2, representatives of amalgamated hromadas should search for grants problems and consider that there are competitions. Member of committee on grants: *“Grant activities should be started with participation in competitions with a small amount of funding (small grants). In particular, regional or local grant programs”*.

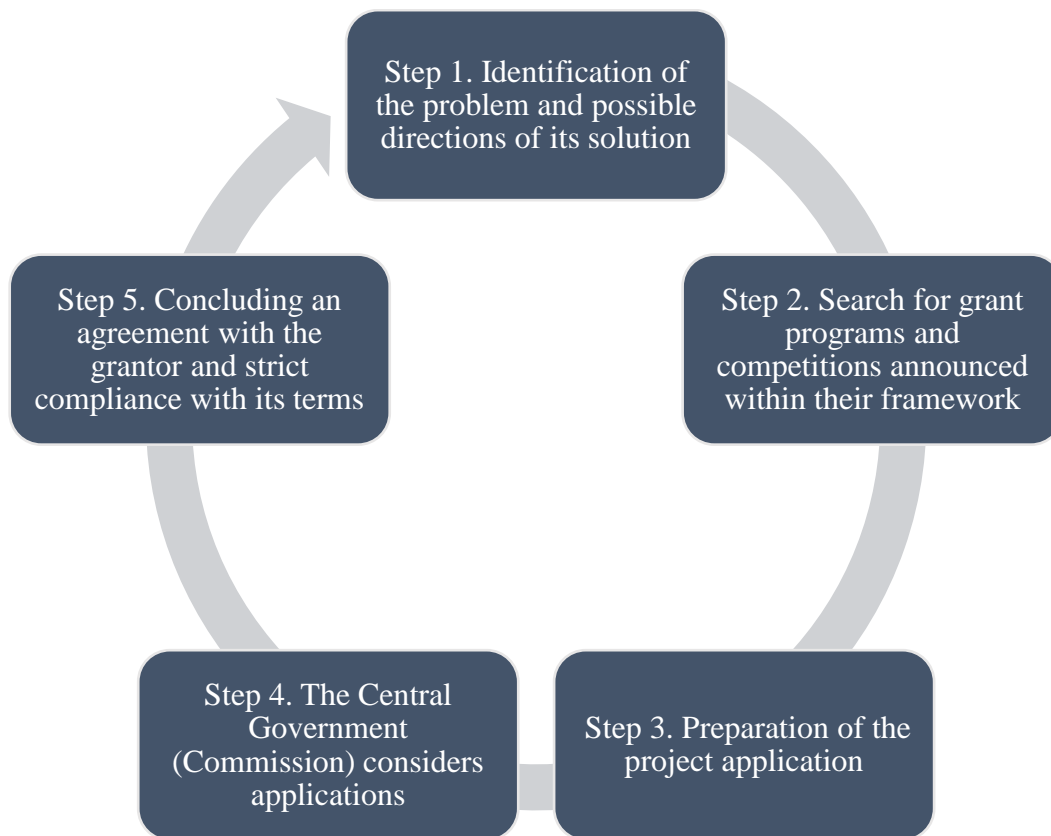


Figure 5.2 Steps for amalgamated hromada to receive grants from central government (based on interview from the member of committee on grants)

For the step 3, *“In the project application, it is important to reflect rational ways to solve the community problem and an adequate amount of resources requested in accordance with the grantee’s application form. In order to attract the attention of the grantor, it is desirable to formulate a unique name of the project”*.

According to the member of committee on grants, step 4 is the most problematic step for everyone, both amalgamated hromadas and the central government. Central official: *“We, in our commission faced lots of situations, where representatives from certain hromadas found us and tried to bribe us. There were also cases when some workers from this commission also demanded bribes (share from grants) from certain representatives of hromada”*.

What is more, this official also told me that this step may be influenced from the decisions from above. He did not want to name this people, but he told me that *“... the above demands political loyalty. If they, local officials’ parade against the current government, somehow agitate people to vote against president’s party or held protest with other hromadas in Kyiv against central government, those hromadas can forget about grants. They will be in blacklist”*. Member of committee on grants described me situations when in amalgamated

hromada (did not want to name it) won opposition party) and when those oppositions started to criticize central government locally, the commission got instructions from “above” to never approve applications for getting grants from this hromada. Member of committee on grants: *“You (Amalgamated Hromada) be quiet there – and we (central government) do not touch you. Or you (representatives of amalgamated hromadas) harshly troll us (central government) and we (central government) will not let you work (block grants to those hromadas).*

Step 5, the member of committee on grants: *“...if the grant is approved, the agreement is signed with amalgamated hromada and it is required from them to follow it”.*

So, after interviewing the member of committee on grants, who is working in commission on grants approval, what I understood is that he does not believe that the central government had planned before the decentralization reform implementation, how to control the local government financially. On the other hand, he agreed that the central government has no problems in using available tools to have some control in local communities. In this case, those amalgamated hromadas, who are not politically loyal or their representative who held protest against central government, will be blacklisted and will not have opportunity to receive needed financial resources for their projects. Overall, the central government does not try to control the management inside hromdas, but it tries to control the political voice of those hromadas, using the tool of grants approval.

5.3 Results of decentralization reforms and amalgamations for local governments

5.3.1. Using Provincial government to control amalgamated hromadas, case of Beta AH

In 2019, city’s amalgamated hromada was formed. Basically, a city Beta with twelve village formed amalgamated hromada. Number of residents is 272.972 people.

I got an opportunity to interview one of the deputies of Beta AH, who describe to me how central government in their case, can control their amalgamated hromada, using political and economic power.

Deputy of Beta AH: *“Everything started with L in 2018. L is a city of regional subordination and around the city – L-ke district. The authorities of the city and district belong to different political forces and, to put it mildly, are not friendly with each other. But in the subordination of the district there is the Central District Hospital, which served patients both from the city and from the district. But as a legal entity, the hospital was located in the city. Understand? So, 60% of the personal income tax from the salaries of doctors fell into the city budget (L) and the district didn't get anything. After opposition won in L city and started to lead*

and promote protests against central government, surprise, district leadership, screwed up by their party bosses, transferred the hospital actually to the paramedic station of the neighboring village.

60% share from personal income tax began to go to the budget of the village council. And from there – a reverse subvention to the central budget. So, the city budget immediately lost several million hryvnias”.

In Ukraine, if the local budget income (includes cities, towns, villages and amalgamated hromadas) index is higher than 3.000 hryvna on one person. If the index is higher than 3.000 hryvna on one living resident, than the sum of the current local income minus 3.000 hryvnva multiply by the number of residents = Difference and this difference is transferred to central budget. In L case, central government transferred legal residence of the city’s hospital to the village, then the money that are used to financed hospital were transferred to the village and later those money was transferred to central government’s budget. So, as the result, L. city lost millions of hryvna and they (City L) still had to pay for the hospitals electricity, water, and its repairs cost, because village council did not use trafered money for those purposes because de facto hospital is located in L city.

The same thing happened with Beta’s amalgamated hromada. According to the deputy of Beta AH, after 2019 local elections where the opposition party won in city Beta, central government have decided to punish them. Local official 2: *“The president’s party got majority in provincial government, so they (central government) started legal transfers of all Beta’s AH hospitals, schools and even theaters to other villages...Can you imagine? I was greatly surprised when I found that even our main theater was transferred to some Hatsapethivka village? Legally, of course... Pandora's box was opened in Beta’s amalgamated hromada. In such a simple way, our hromada lost about 70 million in 2019 year and 83 million hryvnia in 2020”.*

According to deputy of Beta’s amalgamated hromada, they (local governemnt in Beta’s AH) enormous pressure, because central government use provincial government as a tool to punish those amalgamated hromadas who “do not behave” or when the opposition party is a majority and to harm their reputation, president’s party may use legal transfers of local property to other villages, towns or cities, so that those amalgamated hromadas will have less financial resources and later president’s party will tell residents that it is the fault of local government.

So, from the Beta amalgamated hromada I confirmed that the central wants to keep political power in local communities. Beta AH case shows that if opposition party dominates local community, Ukrainian central government (represented by presidential party) will use provincial government as a mean to decrease states budget transfers, so that local leaders would not have enough money to function normally and provide necessary public services. Later, central government (presidential party) will promote that it is the fault of local leaders and local resident should choose central government (presidential) party in next elections, to fix their problems. The case of Beta amalgamated hromada shows that the central government is ready to use its power in provincial government to keep their political power in local areas by making amalgamated hromada incapable, so that local people would blame local leaders and change them.

5.3.2. Delegated Responsibilities - Alfa amalgamated hromada

Alfa AH (capable) was formed in 2020. Alfa AH is a village type amalgamated hromada because it only consists of villages. In total, there are 14 villages in Alfa AH and it has 16.746 residents living there.

I got an opportunity to interview the head of Alfa amalgamated hromada. In 2020 he ran in election for the head position in hromada from the party “Servants of the People”. This party belongs to the president and helped the majority position in the parliament and ministries, basically rule the central government and because of this, local official 1 (head of Alfa AH) was not so direct, but I still got useful information.

Head of Alfa AH: *“Different hromadas have different possibilities. For example, Alfa Hromadas is located near Kyiv (figure 5.4 right side map) and because of its location, our hromada has more human resources (well experienced workers) and due to this reasons, our hromadas from the very beginning had better chances to attract businesses, build factories, plants, warehouses and other offices, because it is located near major city (city with the population of more than 1 million). Some companies prefer to open offices near main cities because the lanland is cheaper compared to main cities, water and electricity tariffs are comparably cheap too and smaller property tax may also pay significant role in introducing business in hromadas”*. As I understood, Head of Alfa AH does not believe that central government made it intentionally from the beginning of decentralization reform to keep amalgamated hromadas financially dependent from the central budget transfers. The main problem for current hromadas is geographical position (location). *“On the other hand, those hromadas who are located 50 kilometers away from main cities, have problem with human*

resources and business do not want to ho there, because it is too far for them and the infrastructure (roads, water facilities and electricity) is old or unrepaired, so more problems for them”. So, according to Head of Alfa AH, it is natural for some hromadas do be financially dependant, because not every amalgamated hromada has the same opportunities.

It should be mentioned that the head of Alfa AH acknowledged that due to delegated responsibilities, Alfa and other hromadas cannot be total financially independent. *“First of all, it should be mentioned that hromadas have two types of responsibilities. First one is their own responsibility. For example, collect complains from people, check hromada’s property and manage it, have communication with their people and manage their own land. With fulfilling their own responsibilities, hromadas can be self-sufficient.*

The main problem lies with delegated responsibilities that the central government passed to us. For example, central government only pay teachers and doctors their own salary, but the cost of building schools, kindergartens, hospitals, repairing them and paying for used electricity and water, after decentralization, this delegated responsibilities the central government transferred to us and because of them, our hromadas cannot be self-financed”. So, Head of Alfa AH claims that the reason for financial dependence of amalgamated hromadas, lie in delegated responsibilities. In his opinion, amalgamated hromadas should not do it, because those delegated responsibilities should be fulfilled by the central government, not local communities and until those delegated responsibilities are financed by AHs, local communities will not be able to be self-sufficient.

Even share from taxes will not be sufficient to finance delegated responsibilities.” *“You cannot kill a hen that lays golden eggs”*. *Entrepreneurs became smarter and they started to do indexes like doing business in different provinces. They compare these indexes and chose to invest in those hromadas who have better rated in doing business”*. According to him, if amalgamated hromadas increase local taxes, local business will simply move to the other AH with lower local taxes.

The final thing that I got from the interview is that Head of Alfa AH acknowledged that the central government use reverse grants as a mean that slows down the development of successful amalgamated hromadas. *“Right now, if hromadas have the income of more than 3000 hryvna on 1 person who lives in those hromada, central government use reverse grants. Tio be more precise, after calculating how many people live in hromada and multiply by 3000 hryvna, getting the sum and if the income of hromada is bigger than that sum, that the difference between them is transferred to central budget. After money are transferred the central*

government transfer those money to those hromadas whose income is less than 3000 hryvna on one person". Even if amalgamated hromadas cannot fulfill own responsibilities (not including delegated responsibilities), those local communities are still supported by central government using central budget transfers. Those money come from successful, self-financed AHs and due to this reverse grants, successful hromadas are developing slower than they could.

So, I did not get a definite answer from the head of Alfa AH, weather the central government made it intentionally to make local communities financially dependent from the central government. Considering his position (representative of president's party) it is understandable, but what I get, is his acknowledgement that the central government transfer of delegated duties made most of AHs financially dependent and even if AHs are financially sufficient, their extra income is taken by the central government (reverse grants), which slows down their development.

Alfa AH is a capable hromada and one of the reasons why it does not have any unpredicted situations like it is in Beta hromada. It is because its head belongs to presidential political party. I was told that the main task of the council of Alfa hromada it to develop its own local community and because Alfa hromada does not make or promote any political slogans, does not criticize central government, there is no problems with grants application and overall situation.

VI Analysis

6.1 How institutional theory explains the development of decentralization reforms in Ukraine

This paragraph gives reasons central governmental resistance to decentralization reform why central institutions do not want to lose their influence over local communities using institutional theory.

Part 1: The clash of old institutionalism and new institutionalism in Ukraine (2005-2014)

In this paragraph I would like to explain of why the reform of decentralization happened in the first place (starting from 2014) using institutional theory.

Support

Old institutionalism has *support of ordinary people in Ukraine and local government*

The main idea of the old institutionalism is to bring new ideas and new people to the institution (in our case Ukrainian government as an institution), who can reform and bring changes, so their functionality and purpose is up to date with current demand. In works of Weber, it is shown that he believed that the only way for the institution survived and be stable, the new people and ideas are essential. This way of thinking is highly supported in the current Ukrainian society and because of it, people demanded from the government reforms to the old way of governance of Ukraine.

New institutionalism is *supported by central government*

DiMaggio & Powell (1991) in their work mentioned that “homogeneity of organizations” is the key factor to the stability of the whole institution. Instead of having ideological fight for the power in institutions, thus causing sabotage to its internal operation, it is better to keep the unity inside institution as whole, which brings stability and efficiency in organizations. New institutionalism implies that Organization has classifications, scripts, procedures and plans for different scenarios and by having following them, it brings stability and efficiency to the whole organization. This way of thinking was highly popular in Ukraine (President Viktor Yanukovich 2010-2014) and even the whole society. The main reason for this is that the previous government (President Viktor Yushchenko 2005-2010) was brought by Orange revolution, which tried to implement new reforms to Economy and constitution. Their attempt failed and economy collapsed during the global mortgage crisis and their way of solving it was disastrous. When President Viktor Yushchenko came to power, he promised changes to

people reform the government and their team was called reformist. Old institutionalism was their ideology, bring new people to old governmental institutions and make changes and by the end of his presidency according to FORM-Ukraine, more than 88,5% of Ukrainians did not support his actions and reforms included. During his presidency, Viktor Yushchenko gave up part of his power and gave it to the parliament and formed some new governmental agencies. The result was that during the mortgage crisis, different parties have different solutions to the crisis and because the ministries were divided by different political factions, there was no consensus and because of their long inactions, the crises was even prolonged.

Due to the above reasons, Weber (1968) concept of bringing new people into power and having more voices in institutions collapsed in Ukraine (2010 year). So, it is no surprise that when President Viktor Yanukovich (2010-2014) promised stability, unity of decision making in the government and more focuses on economy, people chose him and even his party in parliament with alliance of communist party got majority, so that decision making was fast and efficient and thus in 2010 new institutionalism won. Thus, it should be no surprise that when some people started to demand changes to the government and again the idea of old institutionalism came to power, the government in 2014 was highly resisted and did not want to reform, because they came to power on ideas of stability, but those demands from protesters were too radical and even if half was realized, no one could predict what tomorrow would be.

Part 2: The clash of old institutionalism and new institutionalism in Ukraine (2014-2015)

After the Revolution of Dignity (2014), society again wanted changes and using features of institutionalism in this paragraph, I would try to explain why the reform of decentralization was started.

The first reason of implementing decentralization reform was the high demand, so *external forces* or in other word *external environment* played the major role in forcing central government to give power to local people. This feature of institutionalism is important in this case, because when voters demand reform, they will support those candidates who vote for it, so external force played the major role in decentralization reform.

The second feature of institutionalism is *limited rationality*. The idea that local people in their local community knew better how to develop their territory and what that territory needed (new school, new hospital or repaired infrastructure, etc. ...) is logical and rational. Instead of writing to provincial government or central government to change budget spending,

it is more efficient to give local representatives power and financial means to manage their local communities.

The third feature of institutionalism attenuated *consciousness* and it played part in forming voters' demands for decentralization reform. Due to Revolution of Dignity (2014), the whole society wanted prosperity like in European Union and thus people start to see successful examples of how local communities with political and financial power can better develop, so decentralization reform was taken for granted as the means of better and efficient governance and thus it gained popularity.

The last feature is *symbolism* and before the reform of decentralization, municipalities did not have legal rights to chosen how to spend money. They were given financial from the central budget and were told by central government on what should they spend and if representatives of commune spend those money on infrastructure (which was unrepaired in our case) instead of building new kindergartens (community has enough kindergartens, but the central government does not know), those representatives of local communities would face criminal charges. As a result, in 2014, local leaders got the legitimacy, that allowed them to manage their commune inside their community.

Part 3: The clash of old institutionalism and new institutionalism in Ukraine (2015-2021)

Even after 2014 revolution the central government believed in in new institutionalism and the major reason why it was implemented is due to external pressure and the question of legitimacy. The pressure brought by society was enormous and many people asked the central government "how can you be considered legitimate, if you do not represent the majority", so to save itself new government had to bring reform, but the question is how.

The government understood that it cannot do nothing, but loosing central power was not ideal, so they gave political power to local communities and financial means of sustainability, but at the same time they told society that if municipality want to have financial means (rights to collect some taxes, collect charges and fees and have other income) local municipalities must fulfill their responsibilities (repair infrastructure, provide security to its members, finance program on energy efficiency and so on). As it is expected, local representatives told the government that it is a wishful thinking and dreams to think that they can be self-sufficient right from the start without any experience and knowledge, so Law "On the Principles of State Regional Policy" was passed, which basically meant that amalgamated hromadas who have not enough financial resources to fulfill their responsibilities do not need

to worry, because they will get budget transfers from the central government and here lay the crux problem. From the very beginning, hromadas were made to be financially dependent from the central budget's transfers. So, nominally municipalities in Ukraine are politically independent and have the rights to choose how to spend money and develop their territory, but de facto hromadas are financially dependent and almost half of their budget's income come from central budgets transfers, so the central government is still keeping power locally. In other word people who demanded reform (old institutionalism) were satisfied and the central government (new institutionalism) who gave up put of their political power but has economic means to control local community. Central government legitimacy was saved, and people go satisfied with decentralization reform, win for the central government (new institutionalism).

6.2 Clash of Central and Local governments in Ukraine

The main idea of the old institutionalism is to bring new ideas and new people to the institution, who can reform and bring changes, so their functionality and purpose is up to date with current demand. In works of Weber, it is shown that he believed that the only way for the institution survived and be stable, the new people and ideas are essential. On the other hand, starting from DiMaggio & Powell (1991), whose work brought foundation for new institutionalism, mention that "homogeneity of organizations" is the key factor to the stability of the whole institution. Instead of having different voices inside organization, that cause sabotage inside institution, it is better to keep the unity inside institution.

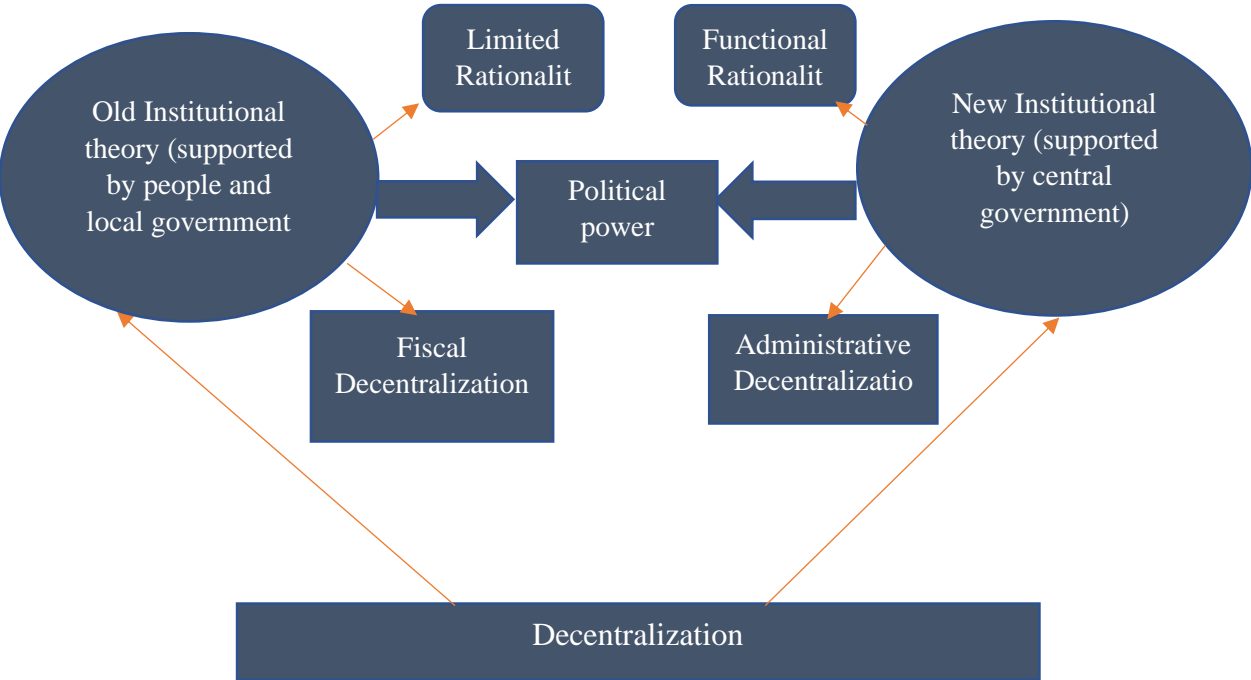


Figure 6.2 Clash of Central and Local governments

Figure 6.2 illustrates my analytical model and how my assumptions influenced the way of choosing the theory. In my research I am using the abductive approach and as a result after analyzing lots of official governmental statistics and reports, I made an assumption that the central government from the very beginning was not planning on giving real power to local municipalities.

The main crux of figure 6.2, is the way different parties understand and wish to have decentralization. The majority of Ukrainian people and local government view decentralization as the main tool to bring changes to the whole governmental system (limited rationality - change everything) and become equal or partners with the central government. To do so, Ukrainian municipalities need to be self-financed and thus the idea of fiscal decentralization is promoted by local government and residents.

On the other hand, as the empirical findings show, central government does not want to lose its power, but due to external environment, it had to implement decentralization reform. To keep political power and have less changes inside the system, central government wants to implement administrative decentralization, so people would be satisfied, and local government will have de jure political power (symbolism of decentralization). At the same time, by giving political power and less financial means and central government wants to have financial power over amalgamated hromadas, so that central government can have power over local community and be in a relationship as the boss and local government is its subordinate.

Both sides, central and local governments want to have real power and thus political fights are happening over decentralization reform in both parliament and local communities about ways of its implementation.

6.3 Role of Political Power on Ukrainian municipalities

When I interviewed officials, who work in central government and officials that hold positions in local government, all parties have agreed that the financial dependence of municipalities was not prearranged by the central government and before the implementation of decentralization reform, no one planned ahead to make Ukrainian municipalities financially dependent from the central budget transfers. All five respondents made it clear, that this dependence was a natural thing and the main culprit of municipalities hardship is the geographical position of amalgamated hromadas. *“The closer amalgamate hromada is located to any city with one million residents, the easier it is for it to attract entrepreneurs and promote the idea of moving manufacturing industry out of the city to their hromadas. The prices on water and electricity are much cheaper in hromadas compared to city and in some cases*

hromada can give a symbolic price to land in which factory is build. So, for those hromadas that are near big cities (50 kilometers distance), they have larger chances to be self-financed than other hromadas on a periphery” – Head of Alfa AH.

Although, there are no direct evidences that the central government made the situation intentional, in which most Ukrainian municipalities are dependent on central government transfers, I have got confirmation from two local official and two central officials that the central government use its economic power (giving grants, transferring local property to other local entities using provincial government and transferring central budget transfers share from “Hromadas that do not behave” (Beta AH’s deputy) to villages and towns that do not need, in order to punish them financially and political power (central government party agitate local people, that their current problems and low quality public services is because of incompetent local government, while at the same time decreasing transfers to those amalgamated hromadas) to control the political voice in local communities.

“Every inhabitant of a village or city has the right to modern medicine and education, accessible and high-quality administrative, communal, social services, good roads, clean and lighted streets. But people can only influence the quality of these services when local governments are responsible for providing them” – Member of Verchovna’s Rada (VR) committee on Decentralization Reform.

It should be agreeable, that when central government use different rhetoric in local communities, such as: right of having modern medicine and education, high quality public services (providing water, electricity and gas); at the same time central government decrease central budget transfers to those municipalities, municipalities will not have any financial resources to provide high quality public services and thus people will vote for central government party (president’s party) and as the result, even if the opposition party win in municipality, this opposition will not be able to criticize central government otherwise they will face financial deficit and will lose political power in the local community.

VII Conclusion

Decentralization reforms are implemented globally in order to make municipalities less dependent from state budget transfers, increase efficiency of local government and make it more transparent. However, there is a paradox in Ukraine. Despite implementation of decentralization reform, almost half of municipalities' revenue come from state budget transfers, which makes local government more cautious in their objections to central government and for those who criticize it, central government decrease state budget transfers, making amalgamated hromada financially incapable and decrease chances of local leaders to be reelected. So, even though decentralization reform is implemented, it did not bring self-sufficiency and made local government more obedient to central government.

7.1 Why and how is the decentralization reform held in Ukraine?

The decentralization reform was started in Ukraine in April 1st 2014 with the implementation of Concept of Local Governance Reform and Territorial Organization of Power in Ukraine. Due to the centralized government (before implementation of decentralization reform), the development of local territory was slow or in some cases abandoned. Most people moved to big cities, which had brought financial losses to local government and due to these reasons, the quality of public services was poor, which harmed the local government's prestige among local people. The implementation of decentralization reform gave legal base for local communities to form municipalities and to collect local taxes and some of those taxes that were given to central government were transferred to local municipalities (Table 4.3.2), so that local government could develop their own territory more efficiently and provide better quality of public services.

The main reason of implementation of decentralization reform is the external pressure. This component of institutional theory was mentioned by Tolbert & Zucker (1996) and according to their research, the external environment can force institutions (government entities) to bring changes inside organization. This external pressure was greatly increased in 2014 by Ukrainian society and the central government was forced to bring changes otherwise they (central government) would face the crisis of legitimacy.

As it was mentioned by the head of Alfa amalgamated hromada, before decentralization reform, the main revenue to local communities came from land rent and its charges and other collected taxes were transferred to central government. So, local government did not have any incentives to develop local territory and provide its residents with job.

The main part of decentralization reform is that central government passed a group of laws, which allowed villages, small town and cities form municipalities and after they are formed, this municipalities are allowed to collect parts of taxes, which go to local government's management and representatives of amalgamated hromada decide on their own how to spend those financial resources. So, if local residents are not happy how local government spend money, they can pressure local politicians to change the field of expenses. This is great, because before decentralization reform, only central government decided how money were spent locally and if people wanted to change those expenditures, they had to petition to central government, because local government did not have power to influence the decision of central government's expenditures.

7.2 Why are Ukrainian municipalities financially dependent on the state's budgets transfers despite the decentralization reforms?

Using official governmental statistics from the website Decentralization, it was found that after the implementation of decentralization reform, the central government added delegated responsibilities to local communities. After interviewing the Head of Alfa AH and the deputy of Beta AH, it was confirmed that those added delegated responsibilities are the main reason of Ukrainian municipalities financial dependance.

Both local officials confirmed that if they were responsible for their own responsibilities that they had before decentralization reform, their amalgamated hromadas could fulfill them and be self-financed. Due to delegated responsibilities, which include the repair of public facilities, paying for their water, gas and electricity use and repairing infrastructure, most Ukrainian municipalities are unable to fulfill their responsibilities without state budget transfers and grants despite decentralization reform. It is especially hard to municipalities who are located on a periphery (more than 50 kilometers from cities with one million population), because entrepreneur, businesses and manufactures invest in those municipalities that are located near big cities (Head of Alfa AH).

I cannot claim that this dependance of municipalities was prearranged by the central government, but there is evidence that the central government uses its financial power to keep local municipalities 'in check' – keeping down local political opposition to central government's decisions and actions (no criticism of central government, otherwise central budget transfers will be decreased) and increase political power of central government in municipalities by decreasing central budget transfers, so they would not be able to fulfill their

responsibilities and in next local elections central government political party (presidential party) will be elected.

7.3 How can Ukrainian local communities become more financially independent?

Ukrainian municipalities are financially dependent from the state budget transfers and in average Ukrainian municipalities have almost 50% of their revenue from central budget transfers. This is not a sufficient way of further development. There are different ways to ease financial dependence of Ukrainian municipalities.

One possible solution for local communities is to demand from central government to transfer the whole personal income tax to local communities. Right now, only 60 % of share of this tax is transferred to amalgamated hromadas and the other 40% is shared by central government, 25% of share of personal income tax and provincial government, 15% share of personal income tax. According to the Ukrainian Ministry of Finance, in 2020 central government got 295.1 billion hryvna from personal income tax. This is only 25% of proportion of the total income tax. The total deficit of Ukrainian municipalities was equal to 101,9 billion hryvna (2020). So, by giving those 25% share of personal income tax from central government to local communities, can ensure that municipalities will be able to fulfill their obligation (including delegated obligations) and at the same time be financially independent from the central government.

The second possible solution is to cancel the mechanism of reverse subvention, so that capable municipalities will have a chance to develop naturally, instead of slowing their development and financing artificial municipalities, who are simply incapable to be self-financed. Currently the central government transfers some financial resources from capable municipalities to those who do not have enough revenue to support their operation. This slows down the development of successful municipalities and give support to those who may work less or located too far from big cities. The development of periphery municipalities is unnatural and without governmental support, they cannot exist, so maybe they should simply disappear and natural developed municipalities can bring success to local community.

The third solution is that Ukrainian municipalities can implement is Public Private Partnership. Approximately 15% of all central government transfers is financed to keep workable water, gas and electricity infrastructures. Inviting private sector, the financial dependence of Ukrainian municipalities can decrease by 15%, so the dependence will decrease and even new jobs in local areas will appear for local people due to Public Private Partnership.

Finally, the formation of strategic planning department in local municipalities can be used to improve the development and performance of Ukrainian municipalities. Johnsen (2016) research used Norwegian municipalities as a basis for his research. His research proved that municipalities that have strategic planning department have better quality provision of public services with the less cost. So, Ukrainian municipalities can also form strategic planning department. If it this department is taken seriously, the efficiency of municipalities should greatly improve and the cost of provision of public services will decrease for municipalities.

7.4 Contributions of the study to the literature on decentralization reforms

This master thesis has several theoretical and practical contributions. First, it contributes to the growing body of knowledge on development of the public sector, decentralization reforms, in the context of transitional economies, specifically the Ukrainian context (Vakulenko, 2020; Dorosh, 2019; Volodina, 2020). It can change perspectives of researchers about decentralization reform as a panacea and how political power (Leland & Thurmaier, 2014) may stimulate central government to act to keep it, especially for countries who had long centralized power and want to transition from centralized structure to decentralized structure.

The practical contribution of this research is for those people that are involved in public sector finance, reforms and politics. My research shows how central government fights for the local influence using its financial tools (transfers, grants and reverse subvention). The lessons learned from Ukrainian municipalities are useful to study for future policy makers that would want to implement decentralization reform in their countries, especially in the countries with the transitional economies.

The research reported here, thus, contributes to the existing literature in the following ways. Firstly, it discusses how the belief of old and new institutional theory (DiMaggio & Powell, 1991; Scott, 2008; Farah & Dieter, 2020) may influence society, local and central government to act and explains reasons for their actions and choices. It provides evidence that central and local government may interpret decentralization reform differently and for political power, they can have a confrontation of its implementation. So, studying reforms should always include analysis of actions, motivations, etc. of both – central and local government, as it is done in my research.

7.5. Limitations of the study

I should acknowledge that I have certain limitations in my research. The first limitation of my research is the amount of amalgamated hromadas, included for deeper analysis. The amount of municipalities in Ukraine is changing fast and the last time I checked (May 11, 2021)

there were in total 1439 municipalities. To get more detailed information, all municipalities should be researched (interviewed or surveyed), but it is simply impossible for me alone to do it (not enough time, etc.).

The second limitation of my research is the number of interviews collected. Due to COVID-19, many people who agreed to participate in the interview, simply canceled it because their department registered many COVID-19 cases and did not want to spread it. Most local and central officials wanted to have face to face interview and did not want to have other ways and when lockdown was implemented in the whole country, most respondents cancelled interview meetings. However, I was lucky enough to talk to five people under these circumstances and draw conclusions.

Finally, I could not contact authors and active promoters of decentralization reform in Ukraine (those people who wrote laws for this reform) to understand their perspective. This may become a fruitful area for further research.

7.6. Proposed avenues for further research

Very little research has been made on a topic decentralization in the context of transitional economies, especially Ukraine (Volodina, 2020) and how central government may sabotage reform for the sake of keeping power in local areas. In order to improve our knowledge and understanding of decentralization reform and its influence on municipalities, it is necessary to conduct further research on formations of fiscal system and development in other countries and pay attention how the power is redistributed between local and central government, especially for those countries who are in transition (Sekula &, Smiechowicz, 2016).

The study of Ukrainian decentralization reform showed how central government use its financial influence over local communities, so that local politicians are under huge pressure and thus they are unable to criticize the central government. For those municipalities where local representatives voice their objections, central government decrease state budget transfers and prevent them from getting governmental grants. The question arises of what can be done to ensure municipalities autonomy from the central government and this requires further research. Comparative analysis on the cases of other post-soviet countries and countries in transition (from centralization to decentralization) on the roles and responsibilities of local government and central government and the division of financial resources is also a good avenue for further research.

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Appendix 1

Contact respondents process

The search of respondents was organized through email. Email addresses were found at the central government official websites and official websites of amalgamated hromadas. The following message was sent to the SAI auditors:

My name is Volodymyr Kovalenko, I am a 2nd year master's student of the double degree program of Taras Shevchenko National University of Kyiv in Ukraine and Nord University in Norway. I am conducting a master's thesis research on the topic: "THE PARADOX OF THE FORMATION OF MUNICIPALITIES'(HROMADAS') BUDGET REVENUES IN UKRAINE". To get a high-quality master's research, I need to conduct an interview with representatives from committee on Hromadas budget and representatives from grants approval committee.

Kindly asking you to help with search of respondents who are willing to answer my questions (bellow attached). The interview will last approximately 20-30 minutes. If you wish, your contact information will not be listed in the study, and anonymity of respondents' personal data is guaranteed.

Thank you in advance!

Appendix 2

Interview questions for officials from the central government

- 1) How do you assess the implementation of the decentralization reform?
- 2) What is the main role of the decentralization reform and has this reform fulfilled the problem of self-financing of local budgets?
- 3) What do you think is the main role of amalgamated hromadas?
- 4) Are territorial communities capable (in your opinion) to develop today without the support of the state? (If not, then please tell me why?)
- 5) Please tell me what was the main purpose of the implementation of the Law of Ukraine "On the Principles of State Regional Policy" (Information of the Verkhovna Rada (VVR), 2015, No. 13, p.90)?
- 6) Section IV "FINANCIAL SUPPORT OF THE STATE REGIONAL POLICY" of the Law "On the Principles of State Regional Policy" says about the mechanisms for financing state regional policy. (Detailed Opinion). Where are the methods that the government usually use to support hromadas?
- 7) According to the decentralization website (Monitoring section) in 2014, state transfers to local authorities amounted to only half a billion hryvnias, in 2019 = UAH 20.75 billion and in 2020 almost UAH 102 billion (road infrastructure development, energy efficiency, development in the field of education...). Do you think this is a burden for the central budget? What can local authorities do to reduce these costs? Are local authorities able to cover these costs on their own?
- 8) Do you think that local authorities are able to implement an independent policy to develop their territory having such dependence on state budget transfers? (detailed opinion)?
- 9) Looking at state transfers from 2014 to 2020: Subvention for social and economic development, The State Regional Development Fund, Subvention for AH infrastructure, Funds for the construction of sports facilities, Subvention for the development of medicine in rural areas (*including UAH 4 billion – transitional balance from 2018), Funds to support sectoral regional policy, Funds for the development of road infrastructure and others, I saw a trend that the areas where this assistance is provided is increasing yearly.(In your opinion) Is this not proof that the decentralization reform is failing? Every year the areas where state transfers are

financed increase and local authorities simply cannot finance it. Does it make sense to implement decentralization reform if the central budget finances local authorities?

10) Can this dependence of local authorities on state transfers somehow affect the decisions of local authorities regarding local policy and development of their area?

11) The Law of Ukraine "On the Principles of State Regional Policy" (Information of the Verkhovna Rada (VVR), 2015, No. 13, p.90) provided an opportunity for the central government to make state transfers to local authorities. Was it adopted in order to increase the influence of the central government on local authorities? (your opinion)

Appendix 3

Interview questions for officials (representatives) of Amalgamated Hromadas (municipalities)

- 1) How do you assess the implementation of the decentralization reform?
- 2) What is the main role of the decentralization reform and has this reform fulfilled the problem of self-financing of local budgets?
- 3) What do you think is the main role of amalgamated hromadas?
- 4) Are territorial communities capable (in your opinion) to develop today without the support of the state? (If not, then please tell me why?)
- 5) What are the main challenges that current hromadas are facing with self-financing?
- 6) Can you explain more of how hromadas get budget transfers from central government? Is it automatic process or do you have to agree with some demands from central government?
- 7) In your opinion, do you think that the central government made the situation where most of hromadas are financially dependent on those transfers?
- 8) If after decentralization reform most hromadas became incapable to be self-sufficient, then what is good in implementation of decentralization reform?
- 9) Can local government control the rate of local taxes and charges after decentralization reform? Can it solve financial dependence?
- 10) Does reverse grant mechanism slow the development of your hromada? Those hromadas who may work more, risk more and be more creative have to give their own money to the central government who finance unsuccessful hromadas. Is it fair to them?

Appendix 4
Respondents' information

№	Institution	Position	Form
1	VR committee on Amalgamated Hromadas' Budget	Member of VR's committee on AHs, deputy	Meeting
2	Ministry of finance, committee on grants	Member of committee on grants	Phone call
3	Alfa Amalgamated Hromada	Head of the hromada	Phone call
4	Beta Amalgamated Hromada	Deputy of hromada	Phone call
5	VR committee on Decentralization Reform	Member of the committee	Phone call