

Decentralization reform in Ukraine

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The current Ukrainian political system, which is a highly centralized “winner-take-all” system, is one of the main causes of the recent mass street protests. A decentralization reform is needed to make the system more stable by providing people with more impact on policy making, and increasing accountability of the government. A decentralization reform would reduce paternalistic expectations and provide people with more opportunities to take responsibility for public policy design in their region. In addition, it would improve the quality of national politics by introducing more competition and allowing successful regional politics to spread to the national level. However, as all reforms, decentralization bears some risks. This policy brief discusses the benefits and risks of such reform, suggests some ways of mitigation of the risks, and the procedure for reform development.

“In decentralized systems, problems can be solved early and when they are small. And when there are terrible failures in economic management—a bankrupt county, a state ill-prepared for its pension obligations—these do not necessarily bring the national economy to its knees.”

Nassim Taleb

In their path-breaking [article](#) Roger Myerson and Tymofiy Mylovanov argue that the underlying reason for the Ukrainian street protests in 2004 and 2014 is a fundamental flaw in the country’s Constitution, namely, the design of its government system. Currently, it is basically a “winner-take-all” system, where a winner of the national elections gains almost a dictator’s power, and then tries to prolong his stay in office with all means.

Such a system – where almost all the power is concentrated in the hands of the central government, and where local authorities, even the elected ones, have very little room for their own decisions – resembles an inverted pyramid and is therefore unstable. A natural

way to stabilize the system is to put the pyramid on its foundation – i.e. to provide people with more impact on (and responsibility for!) both local and central government policy.

However, the Ukrainian government has announced a decentralization reform, and has already adopted a [Decentralization Concept](#), which defines the main goals and milestones of the reform. According to the Concept, the legislative base for the decentralization should be developed by the end of 2014. However, it is clear that these plans are unrealistic. This, since on top of Constitutional changes, the reform implies changes to the administrative structure of the country, a redistribution of responsibilities between different levels of local government, and changes to the Tax Code, the Budget Code, and to several other documents. Such a scope of reforms is hardly attainable within the planned timeframe.

So far, the President’s office has developed changes to the Constitution, and the Cabinet of Ministers has drafted changes to the Budget

Code. However, both documents miss the main point of the reform – empowering of people (rather than simply delegating some responsibilities from central to local governments). Instead, the drafted law on changes to the Constitution empowers the President, and the drafted changes to the Budget Code are an attempt of the central government to get rid of its “headaches” (e.g. ecological or social housing programs) while at the same time consolidating “electorally valuable” spheres, such as education and healthcare. This Draft Law proposes transferring some revenue sources from central to local levels, and at the same time to extract a part of the revenues that currently belong to local budgets to the central budget. A more detailed analysis of the proposed changes is provided [in this article](#).

To my mind, the main impediment to the decentralization reform is a lack of a systemic approach. The Decentralization Concept does not provide a clear reform path, and changes to the legislation proposed so far look like pieces of a puzzle that do not fit together.

I suggest that the decentralization reform should be developed together with the administrative reform and proceed according to the following algorithm:

1. Define functions of the state and distribute them between different levels of government according to a subsidiarity principle; i.e. a function should be transferred to the lowest government level capable of implementing it.
2. Estimate the volume of funds needed to implement these functions.
3. Assign sufficient revenue sources to local governments.
4. If a community is too small to generate a sufficient revenue flow, merge several communities and repeat steps 3-4, keeping the distance between the center of such a united community and its most remote settlement below a defined limit.

5. Establish feedback mechanisms through which people in a community could control the authorities and impact their decision-making. These mechanisms are not only elections, but also, more importantly, permanent between-elections activities, such as public hearings/discussions of drafts of local government decisions.
6. Use a few communities as pilots and thus find out potential strengths and weaknesses of the proposed reform and make necessary corrections.

The outcome of this algorithm should be a logically connected package of legislative changes rather than a bunch of separate documents.

The development of this reform should be as transparent as possible, and accompanied by wide information and education campaigns about the opportunities that decentralization will provide, and the ways to use these opportunities. These information campaigns are necessary because many Ukrainians now think that decentralization (or federalization) is pushed by the Russian president in order to split Ukraine into parts.

As with all reforms, the decentralization has its potential benefits and risks, which should be accounted for. Fortunately, there exists both a wide academic literature and international experience on this issue.

The economic literature, both theoretical and empirical, does not unambiguously show that “decentralization is good”. Rather, a success of decentralization depends on a number of other factors, such as the presence of democracy (Inman, 2008) and a sufficient accountability of the government (both local and central).

In itself, decentralization does not lead to higher economic growth (e.g. the review of Feld et al, 2013). However, when accompanied by other growth-enhancing reforms, decentralization can positively impact

a country's economic development (Bardhan 2002).

Both the literature and experience of other countries suggest the following major risks of decentralization:

1. Decentralization may increase corruption at the local level. If a local official is not accountable to a higher-level government, she may try to extract some rent from her position. This risk can be reduced by a high transparency of the government and working mechanisms of control of citizens over officials.

Indeed, Lessmann and Markwardt (2009) show that decentralization lowers corruption in countries with high levels of freedom of the press, and is harmful for countries where monitoring of the government is not efficient. Besides, Fan, Lin and Treisman (2009) find that "giving local governments a larger stake in locally generated income can reduce their bribe extraction", i.e. for decentralization to lower corruption, the institutional setup should encourage local officials to create a favorable business environment in their regions.

2. Decentralization may intensify secessionist movements. To lower this risk, the largest volume of responsibilities should be transferred to the lowest (community) level. It is rather easy for separatists to buy support of oblast-level officials and get control over an entire oblast. It would be much harder for them to buy every community head in an oblast. Moreover, getting control over an oblast, even rayon by rayon, let alone by community, is practically infeasible.
3. Decentralization enhances initial inequality between regions – so the central government has to step in by providing subsidies/subventions to less developed regions (Cai and Treisman, 2005).

At the same time, the "bonuses" of decentralization are worth taking the risks:

1. Reduction of tensions between the regions. In the Ukrainian situation, this implies removing grounds for mutual accusations that "one region feeds other regions" or "one region rules the entire country". If a party that wins a majority in the national elections does not have extensive power over the daily life of people, they can more easily accept the fact this is not the party they voted for.
2. Improvement of the national politics by increasing competition between local officials, and between local and central officials. As we know, competition typically increases the quality of a product. Political competition is no exception. As Myerson (2006) notes, "by creating more opportunities for politicians to build reputation as responsible democratic leaders, a federal [decentralized] system can effectively offer an insurance policy against general failure of democracy". Thus, democracy and decentralization strengthen each other.
3. More efficient government. On average, policy decisions will be made closer to their final beneficiaries and hence, will be more fitted to the needs of a certain community. At the same time, all levels of government will work more efficiently.

Decentralization does not imply a weakening of the central government. Rather, it frees its institutions from an unnecessary workload allowing them to concentrate on more strategic tasks, such as:

- protecting people's rights by establishing a working judicial and security (police and army) systems;
- forming a strategic vision and general directions of the country's development;

- protecting the country's interests on the international level.

To make sure that decentralization does not result in feudalization, local officials should be controlled not only by local citizens but also by the central government (law enforcement); strong country-wide political parties would also help to hold the country together.

Conclusions

A decentralization of the Ukrainian political system is currently in the very focus of political, public and research debate.

However, this reform is not likely to be an easy one. The prerequisites for successful decentralization include functioning democratic mechanisms - fair elections, a free press and a strong civil society - resulting in government accountability. Also, for the decentralization reform to succeed, it needs to be coherently bundled with a range of political and administrative reforms (such as the development of a functioning judicial system, deregulation, reduction of rent-seeking opportunities etc.), and development and implementation of such a package is challenging and time-consuming.

At the same time, a wisely designed decentralization process will be highly beneficial for Ukraine, both politically and economically. It will strengthen democracy (by increasing people's participation) and improve the quality of national politics by introducing more competition into the political system. It is also likely to significantly contribute to economic growth and prosperity, and these benefits make the decentralization reform in Ukraine a challenge worth undertaking despite of all the costs and risks.

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