

TERRITORIAL DEVELOPMENT: STRATEGIC CONTEXT

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THE STATE OF THE IMPLEMENTATION OF LOCAL BUDGETS AND SOURCES OF THEIR FILLING IN THE CONDITIONS OF CRISIS AND MARTIAL LAW IN UKRAINE

Summary

The work highlights the state of local budgets under martial law, as well as the sources and factors affecting the filling of local budgets in the conditions of crisis and martial law in Ukraine. The main approaches to receipts and balancing of local budgets in the conditions of decentralization are analyzed. It is emphasized that the fulfilment of the function of stabilization and income redistribution by the state becomes more complicated. Differences in the goals and priorities of state and local authorities reduce the effectiveness of the budget equalization policy. Economically powerful territories are interested in being independent to implement tax policy, fix taxes according to the territories of their collection, which deepens disparities in the development of regions. In today's conditions of the war, business shutdowns, growing unemployment and population poverty, the powers of social protection and social security

primarily rest with the state. The main indicators of revenues to local budgets are studied and it is noted that the overall balance of local budgets is not as critical as the situation with the state budget. This is because the state budget has more sources for «patching holes» than local budgets. Consequently, after 5 months, the consolidated budgets of all the regions are in surplus, and the average percentage of the implementation of the revenue part almost does not differ from the percentage for the similar period of previous years.

Introduction

The beginning of the 21st century became a real challenge for the Ukrainian state and society. The Orange Revolution of 2004–2005, the Revolution of Dignity of 2013–2014, Russia’s aggression and its temporary occupation of Crimea and parts of Donetsk and Luhansk regions in 2014, and, finally, Russia’s great open war aimed at destroying Ukraine in 2022. The Orange Revolution opened the way to real democracy and the rule of law, turned the vector of Ukraine’s development towards the West, contributed to the formation of a new Ukrainian identity, which became the basis of nation’s resistance to attempts to turn history and the vector of development towards Russia in 2013–2014. The Revolution of Dignity of 2014 not only confirmed the irreversibility of the European vector of Ukraine’s development, but also saved the country from being absorbed by Russia. However, Russia took advantage of Ukraine’s post-revolutionary weakness, started aggression, and occupied Crimea and parts of Donetsk and Luhansk regions.

After the Revolution of Dignity, Ukraine embarked on the path of reforms and modernization, both politically and economically. In 2019, Ukraine confirmed the irreversibility of democratic processes and the path of reforms. In a short period, the reform of local self-government and territorial organization of power was carried out, financial decentralization took place, and the budgets of Ukrainian cities significantly exceeded the budgets of Russian cities of similar size. Ukraine began to formulate and implement a new state regional policy directed towards the cohesion of the state and the entire Ukrainian space, levelling the asymmetry of development between regions, strengthening their competitiveness; regions gained access to state resources on a predictable basis, which opened up opportunities for medium-term planning. In recent years, Ukraine has started to rapidly modernize and restore its infrastructure. It is also worth noting that the plan of regional development in Ukraine was devised on the basis of European practices, which brought Ukrainian and European legislation on regional development closer together and, in the long run, gave Ukrainian regions an opportunity to adapt to European rules quite quickly during the integration of Ukraine into the EU [1].

Each of the steps Ukraine took in 2014–2021 regarding decentralization and the new state regional policy contributed to the balanced development of

Ukrainian territorial communities and regions, created thousands of horizontal connections between communities and regions. Unfortunately, at the same time, effective instruments for coordinating the sectoral policies of the ministries in the regions were not formed, and the implementation of the State Strategy for Regional Development and regional strategies of development had too limited financial resources. It is worth mentioning that only in 2014, the issue of forming the cohesion of the Ukrainian space started to look like state policy.

Russia's open aggression against Ukraine, which turned into a total war, led to the terrible destruction of Ukrainian cities and villages, the destruction of critical infrastructure in many communities and regions, millions of forced migrants, marked shifts in the demographic situation in various regions. The activities of the local self-government bodies of territorial communities in the difficult conditions of the war, the selfless assistance of communities and regions to the most affected territories showed the correctness of the previous policy in the areas of decentralization and regional development.

However, the war greatly affected all components of the state's internal policy in general, and state regional policy in particular.

Scientists such as T.M. Bezverhniuk, P.M. Borovyk, R.L. Brusak, R.Ye. Demchak, M.I. Zhadan, I.R. Zalutskyi, Ya.M. Kaziuk, N.B. Kosarevych, A.V. Kulai, M.D. Lamskyi, I.V. Lintur, N.Yu. Melnychuk, O.O. Nepochatenko, S.V. Pavlov, L.V. Panasiuk, T.O. Pautova, V.B. Sapozhnikov, R.S. Soroka, M.M. Treshchov, P.I. Shevchuk and others devoted their work to the study of budget support problems, as well as to strengthening the financial base of local self-government bodies. At the same time, the analysis of the works of Ukrainian and foreign researchers in the light of modern challenges of the socio-economic development of territorial communities allows us to stress the need for an in-depth study of the theoretical and practical aspects of their budgetary support in relation to the current state of Ukraine's development and recovery.

Part 1. Peculiarities of forming local budgets

The socio-economic development of Ukraine largely depends not only on the effective activity of the central authorities, but also on the activity of local self-government bodies.

“Local self-government in Ukraine is a state-guaranteed right and real ability of a territorial community i.e. residents of a village or a voluntary association of several villages, residents of towns, cities to resolve issues of local importance independently or under the responsibility of local self-government bodies and officials within the Constitution and laws of Ukraine. Local self-government is carried out by territorial communities of villages, towns, and cities both directly and through village, town, city councils and their

executive bodies, as well as through district and regional councils, which represent the common interests of territorial communities of villages, towns, and cities» [2, p. 85]

In order to balance local budgets it is necessary to ensure the compliance of expenditure with revenues of the budgets, i.e., the authority to carry out budget expenditure must correspond to revenues for a certain budget period. In view of the decentralization reform and an increase in the powers of local self-government bodies, there is a growing need for additional financial resources of local authorities to ensure the performance of delegated functions. At the same time, budget imbalances are deepening even more. The war, an economic recession (according to various forecasts, the reduction of GDP will reach 30–50% in 2022) and a decrease in revenues to local budgets, on the one hand, and an increase in the powers and needs for financial resources (for the provision of public services, the restoration of infrastructure, residential buildings, hospitals, etc.) on the other hand are the causes of such imbalances. For example, the local budgets of Odesa Region did not receive 374.8 million hryvnias in March [3]. Similar situations are observed in most regions of Ukraine, and this problem will become even more serious in war conditions. There is a need to find sources of financial support for local self-government and the restoration process of the socio-economic development of territories in war conditions.

As the world practice and Ukrainian experience demonstrate, when implementing the budget decentralization reform, regardless of the positive aspects of the changes, it is worth taking into account certain risks. They are connected with the insufficient level of financial support for the performance of functions by local authorities, the prevalence of local interests over national interests, «eating away» and irrational use of funds from local budgets, uncontrolled and ineffective loans, irresponsibility and impunity of civil servants, the insufficient level of professional qualification of personnel and management experience in solving modern local problems of the public sphere [4, p. 174].

In the conditions of budget decentralization, it becomes difficult for the state to fulfil the function of stabilization and income redistribution. Differences in the goals and priorities of the state and local authorities reduce the effectiveness of the budget equalization policy. Economically powerful territories are interested in being independent when implementing tax policy, fixing taxes according to the territories of their collection, which deepens disparities in the development of regions. In today's conditions of the war, business shutdowns, growing unemployment and population poverty, the powers of social protection and social security primarily rest with the state. Moreover, the local authorities of the territories, where heavy fighting is taking place, are unable to provide even the most basic social services to the residents

of the communities, which forces the population to evacuate in search of safety and survival opportunities. This, in turn, determines the need for additional financial resources in those regions of the country that are relatively safe and host forced migrants [4, p. 175].

The deepening of imbalances in local budgets stimulates the authorities to search for effective tools to activate entrepreneurial activity in relatively safe territories, attract international grants, EU structural funds, draw the attention of international public organizations and international business to solving local issues, and find cheap and profitable internal and external loans. In this regard, it is worth stressing the role of domestic banks and non-banking financial institutions, which should become a locomotive for restoring the economic and social infrastructure, directing their activities towards the real sector of the economy, performing accumulative, credit, investment, informational, social and stabilization functions [3].

The first half of the most difficult year in the history of independent Ukraine is behind us, but it is extremely hard to assess the real current state of the economy (in particular, regionally). If one decides to focus on such an aspect of the issue as the state of the implementation of local budgets, then the task for analysis will still remain problematic – first of all, due to the lack of information.

The Analytical Centre «Observatory of Democracy» systematized the available official data on local budgeting during the war and compared the situation with the implementation of budgets in different regions of Ukraine.

Before the start of the full-scale war, some information on the state of the implementation of local budgets, amendments to them, the financing for local programs could be found on the official websites of territorial communities and state administrations. However, the Resolution of the Cabinet of Ministers allowed the authorities not to publish the documentation related to the budget process during the martial law period.

In reality, this permission only legalized the fact that heads of communities and administrations decided for themselves not to update budget information on official websites (in the situation of occupied or front-line communities for obvious objective reasons). The justification is that during the war, the enemy should be prevented from using open sources to learn information that may be useful to them in some way.

At the same time, for example, when the deputy chairman of the Kharkiv Regional Council has a Russian passport and continues to fulfil his duties, having access to any budget documentation, then these precautions with websites look absurd.

The Kharkiv Regional Department of Statistics took a similar position regarding the closure of data. On its Facebook page there is a template message, which regularly appears and explains the lack of planned calendar publication of certain data by referring to the Law «On protection of the

interests of subjects of reporting and other documents in the period of martial law or the state of war» [3].

Part 2. Analysis of factors in the formation of consolidated budgets of territorial communities

In fact, the only source of comprehensive open information on the implementation of local budgets is the web-portal «Open budget», created back in 2018 at the instigation of the Ministry of Finance of Ukraine. Currently, it displays information on regional budgets, as well as consolidated regional budgets (i.e., the totality of all local budgets in the region). The main menu also states that it is possible to review the status of the implementation of the budgets of individual communities, but the data on them are not displayed.

As of the first half of July, the last update of the website information concerned the implementation of budgets in May 2022 – accordingly, there are complete data for the first 5 months of the year, in particular, for the «war quarter» (March-May), which may be used to carry out a preliminary analysis of how the first three months of the war affected the implementation of local budgets in different regions of Ukraine.

The diagram (Fig. 1) presents information on the percentage of the implementation of annual plans for 2022 in terms of revenues and expenditure of the consolidated budgets of regions.

It is difficult to assess how the Ministry of Finance received information about the implementation of budgets from the occupied territories (as well as the relevance of such information), but the data on the spring months, even for partially occupied regions, were updated [3].

Strictly speaking, the differences in these percentages of the implementation of regional consolidated budgets correlate with the fact whether hostilities took place in the territory of a region. The top five include 4 regions of Western Ukraine and Poltava region (the maximum percentage of the implementation of the revenue part for 5 months is 43% in Zakarpattia). At the opposite «pole» are front-line and partially occupied regions (the lowest percentage of the implementation is 31.6% in Kherson region) [3].

At the same time, one should bear in mind that the position of the regions in the diagram would be different in absolute terms, because the volume of the annual plans of consolidated budgets in various regions differs radically.

The first thing that attracts attention is the surplus of consolidated budgets of absolutely all regions. While the state budget is facing a deficit – the implementation of the revenue part for 5 months was 37.8%, and the expenditure part was 43% (besides, in the annual plan itself, expenditure is significantly higher than revenues). It is hard to unequivocally evaluate this surplus of local budgets: intuitively, it is understood to be a kind of a positive phenomenon, but de facto it can have different explanations (in particular, due

to the «freezing» of special fund expenditure, the curtailment of infrastructure projects, being in arrears with a number of payments due to the cancellation of «protected» articles of the budget during martial law, etc.) [3].

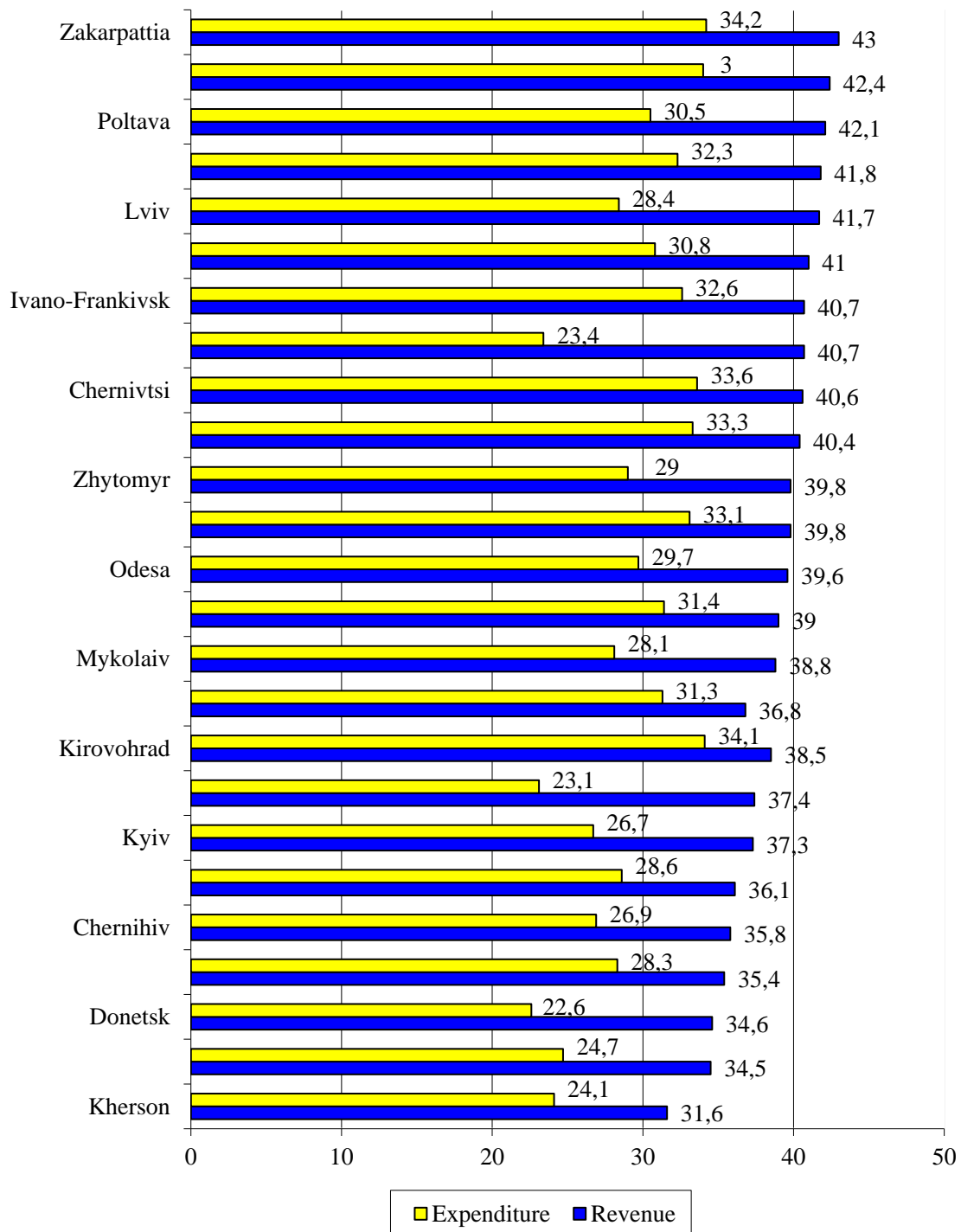


Figure 1. Implementation of consolidated budgets of regions (January-May 2022)

Source: the diagram was compiled based on the data of the «Open budget» web portal of the Ministry of Finance of Ukraine

Second, the difference in the percentages of the implementation across regions is not as big as one might expect (a “spread” of percentages from 32% to 43% in the revenue part and from 24% to 34% in expenditure). It can be assumed that with each new month of the war, this range of fluctuations will only grow and expose the difference in the situation in the partially occupied front-line and rear regions.

And the third point is an assessment of how «normal» this percentage of the budget implementation is. In general, for all local budgets, the percentage of the implementation of the revenue part of the annual plan was 38.5%, and the expenditure part was 28.4%. It is incorrect to purely arithmetically extrapolate these indicators after 5 months to 12 due to two circumstances. Firstly, only 3 out of 5 months were affected by the full-scale war, which will determine the further pace of the budget execution, and secondly, there is traditionally certain unevenness of the execution by month (for example, almost every year peak expenditure is observed in December) [24].

At the same time, we can compare the percentage of the implementation of local budgets for 5 months with similar periods of recent years, as well as make a corresponding comparison for the state budget.

Based on the following diagram (Fig. 2), we can draw a preliminary conclusion that because of the war the state budget received a major blow. And this blow is becoming more and more severe every month: in March, the deficit of the state budget amounted to 79 billion hryvnias, in April – 92 billion, and in May – already 118 billion. The short-term effect of a number of advance payments to the state budget is wearing off and the dependence on non-tax revenues (primarily international aid) is growing [5, p. 40].

While the general situation with the implementation of the revenue part of local budgets does not look so critical. For the first 5 months of 2022, the percentage of local budget revenues compared to those planned in the annual plan almost does not differ from the same period in 2020 and 2021 (38–39%), and, in absolute terms, it is even higher (although, taking into account inflation, this growth is purely nominal). In order to understand how this became possible in the conditions of the full-scale war, it is worth taking a closer look at the general structure of local budget revenues.

In the first 5 months of 2022, local budgets received 213 billion hryvnias in total, and expenditure amounted to 163 billion hryvnias. The details of the structure of revenues and expenditure are given in the diagram below (Fig. 3.) [3].

Approximately two-thirds of the revenues of local budgets are tax revenues, among which personal income tax (PIT) stands out. This is a key element in the revenue structure of the budgets of territorial communities – 60% of personal income tax is received by those budgets, and another 15% goes to regional budgets. For the period January-May 2022, personal income tax

accounted for 93 billion hryvnias out of 213 billion hryvnias of local budget revenues (for comparison, in 2021, it was 78 billion hryvnias for the same period) [3].

Accordingly, in many respects, local budgets stay afloat due to the fact that the total «white» income of citizens remained at the same level (taking into account inflation) as it was in 2021. This is possible because of high official pay to all defenders of Ukraine and the «power bloc» in general. In the revenues of local budgets, the taxes from these salaries of a certain category of citizens statistically «close» the factor of other citizens' job loss. Of course, this by no means solves the problem of unemployment for the economy, but in the short term it maintains approximately the same level (nominally it is even slightly higher) of filling local budgets at the expense of personal income tax [7, p. 278].

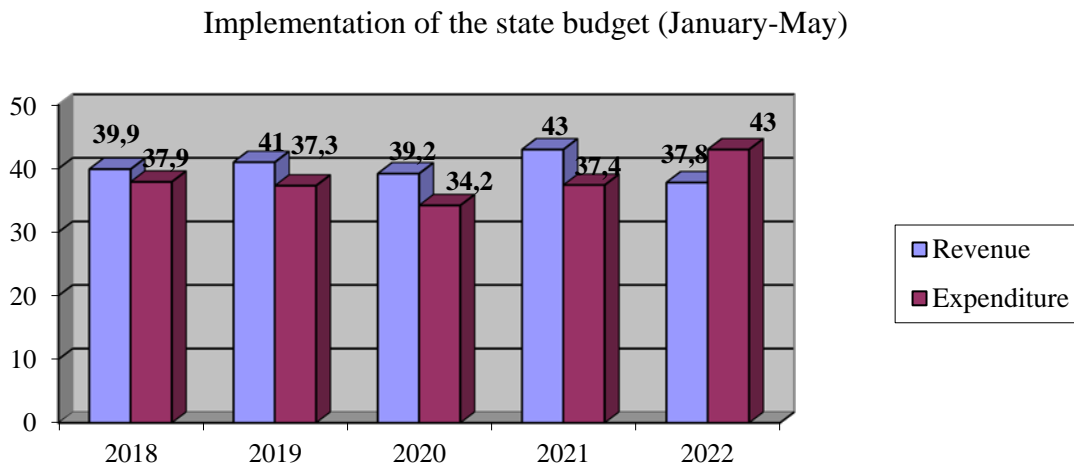
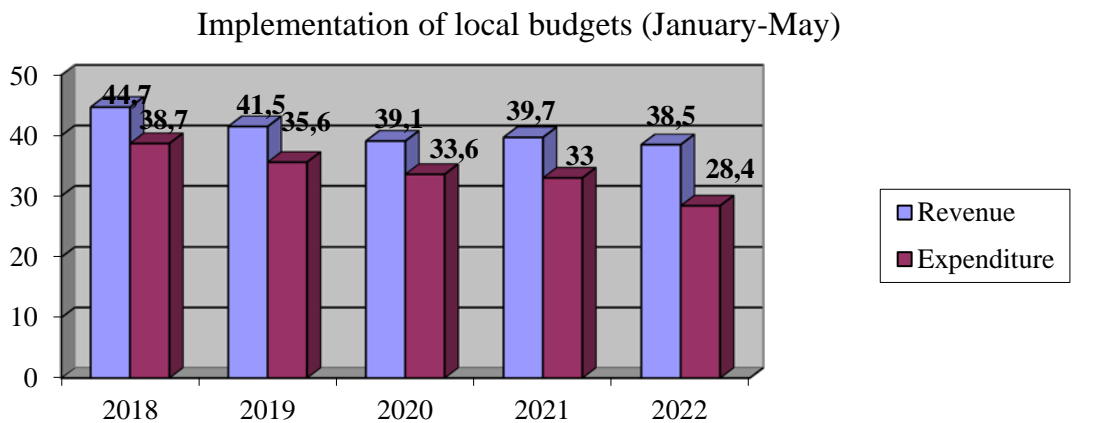


Figure 2. Implementation of consolidated local budgets and the state budget (January-May 2018-2022)

Source: the diagram was compiled using the data of the «Open budget» web-portal of the Ministry of Finance of Ukraine [5; 6]

Other statistically significant taxes for local budgets are the single tax (21 billion hryvnias collected in 5 months) and property tax (13 billion hryvnias). When income from the property tax decreased as expected compared to last year (in the first 5 months of 2021, it was 16 billion hryvnias), it was possible to collect the single tax in a nominally bigger amount (21 against 19). The main role was played by the adoption of changes to the Tax Code in March, which allowed large enterprises (with annual revenues of up to 10 billion hryvnias) to pay the single tax instead of VAT and income tax during martial law. In addition to easing the tax burden for businesses, this also shifted the transfer of their taxes from the state budget to local budgets. That is, due to the lack of revenues to the state budget, the central government uniformly helped local budgets to increase revenues from the single tax [3].

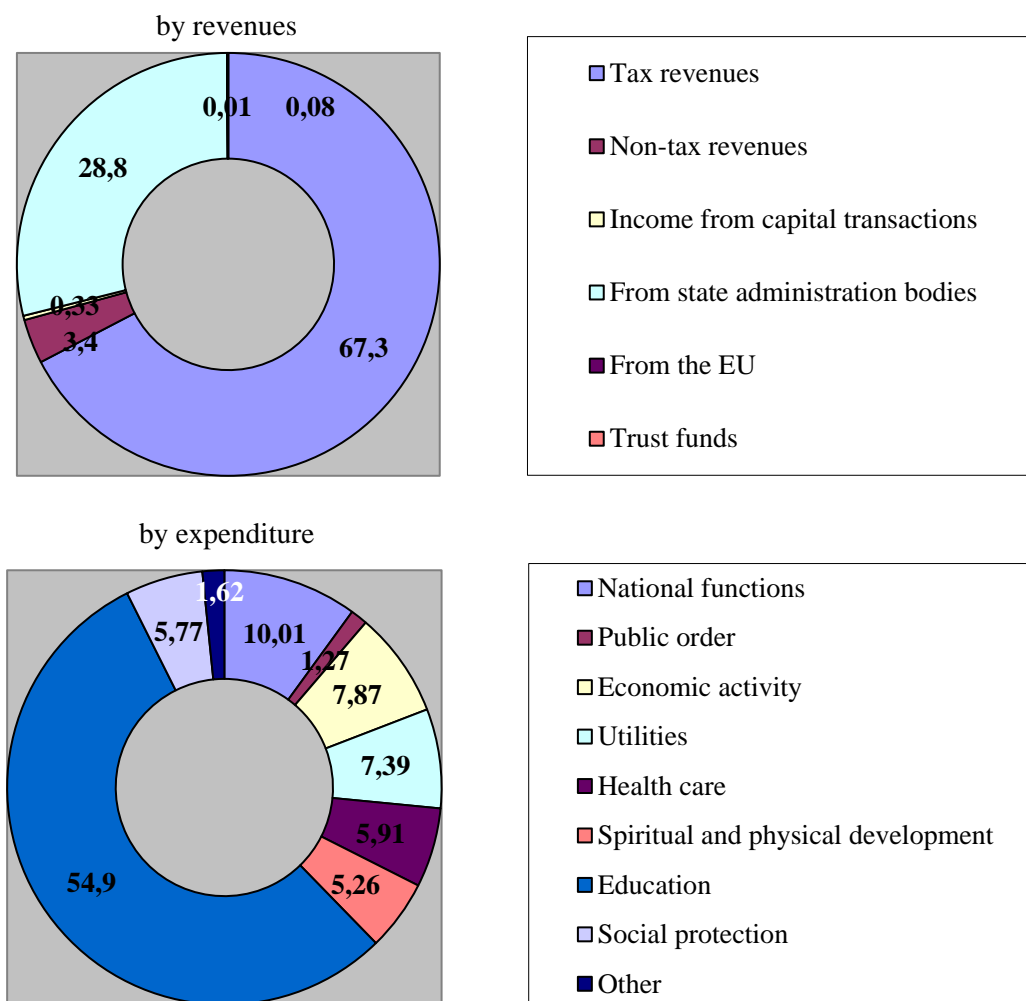


Figure 3. The structure of revenues and expenditure of local budgets (January-May 2022)

Source: the diagram was compiled based on the data of the «Open budget» web portal of the Ministry of Finance of Ukraine

Subventions and subsidies remained another instrument of direct state aid to local budgets. In 5 months, local budgets received 61 billion hryvnias from the state budget, and the main part here is an educational subvention (43 billion hryvnias out of 61 billion). And here it is necessary to pay attention to the structure of local budget expenditure, 55% of which is on education. It would be incorrect to interpret this percentage as some kind of a high priority of education for the country or the system of local self-government – the question is limited to which areas are financed from the state budget, and which ones from local budgets.

At the same time, a comparison of local budget expenditure on education (almost 90 billion hryvnias in 5 months) and the amount of an educational subvention (43 billion hryvnias) shows the constant contradiction between local and central authorities. In general, from year to year the centre takes the position that communities need to assume financial responsibility for their own education system, in particular, by making unpopular decisions regarding reductions and optimization of the network of educational institutions [3].

On the other hand, communities express dissatisfaction with the fact that the educational subvention from the state budget does not cover all expenses for the maintenance of this sphere, and community leaders understand the negative political consequences they might face because of the decision to close schools. The problems of the functioning and, in particular, the financing of the education system in war conditions certainly deserve separate studies, but in the first approximation, in this resource-consuming area the situation may worsen in the autumn-winter period while the central and local authorities will transfer responsibility to each other.

During the period of martial law, a number of regulations on the transparency of the work of local authorities were relaxed. For example, there is no need to convene a session of the local council to make changes to the budgets, anti-corruption inspections are not conducted and declarations are not submitted when appointing officials to local self-government bodies or communal enterprises. Similarly, local authorities are allowed not to make public documents related to the budget process, and there has been a moratorium on auditing local budgets by the State Audit Service. And, probably, such relaxation was logical for the first period after the full-scale invasion. However, such simplifications are expedient only as a temporary measure for the short-term adaptation of the local self-government system to new circumstances. From the point of view of the future prospects of accountability of local authorities, it is unreasonable and risky to keep these simplifications for the entire duration of the legal regime of martial law throughout the country.

It is important that on June 24, the government returned mandatory procurement in the Prozorro system for state and local authorities after a 4-month simplified period. Probably, it is necessary to move in the same

direction when it comes to the issues of publicizing budget documents (at least to start with those regions where there are no hostilities), so that the «habit of the lack of accountability» does not lead to chronic aggravation of abuses and corruption risks. A positive point is that the «Open budget» website of the Ministry of Finance continues to publish generalized statistical information on the status of the implementation of state, regional and consolidated regional budgets. This provides interested entities with limited (in terms of individual communities or the implementation of individual programs), but official information for analysis. The available data for the first 5 months of 2022 make it possible to carry out a preliminary assessment of the impact of the war on the implementation of budgets [3].

First of all, it should be noted that the overall balance of local budgets is not as critical as the situation with the state budget. Ukraine is used to a constant confrontation between the central government and local self-government, but the initial decisions of the government (the parliament, the president's office) were made with the interests of local budgets in mind – in particular, the fact that large enterprises pay the single tax (which is included in the budgets of communities), the cancellation of reverse subsidies, etc. This was because the state budget has more sources for «patching holes» than local budgets. Consequently, after 5 months, the consolidated budgets of all the regions are in surplus, and the average percentage of the implementation of the revenue part is almost the same as the percentage for the similar period of previous years.

There is a relationship between the state of the implementation of local budgets and the absence/presence of hostilities in the territory of a region. With each subsequent month, the gap between the implementation of budgets in the rear and frontline regions is likely to widen. This means that the state should move away from a unified approach in its next steps. The initial decisions of the government were unified – benefits were provided for any branch of business (except for excise) in any territory. The fact that on July 9, the parliament adopted the draft law No. 5323, which amends the Law «About the fundamentals of state regional policy» can be considered the first step in moving away from impractical unification (on the same day the draft law No. 7426 was adopted; it ensures greater flexibility in using money from special funds of local budgets). Currently, the central government is facing an extremely urgent task of balancing regional policy and involving horizontal equalizing mechanisms relevant to the new conditions [8].

An optimistic picture of the general state of local budgets (at least against a background of the balance in the state budget) is being formed after 5 months of martial law – the key common problem for communities and regions is the future heating season. The resolution adopted by the central government regarding the unchanged tariffs for the population raises an issue of compensation for the difference in these tariffs, which should be covered either

by local budgets or the state budget. As the state budget deficit is progressing daily, there are reasons to doubt that one hundred percent of the difference will be covered from this source. Accordingly, community leaders need to prepare for various possible scenarios, and, furthermore, immediately (where it is possible) try to use the surplus of their budgets for thermal modernization and the transition to alternative sources of heating.

Conclusions

One of the significant events on the path of decentralization of local government bodies was the date of signing the European Charter of Local Self-Government on behalf of Ukraine on 06.11.1996. Since 2014, the decentralization reform has been introduced in Ukraine. With the adoption of the Concept of reform of local self-government and territorial organization of power in Ukraine, 4,882 communities voluntarily united to form 1,070 united territorial communities [9].

In 2015–2022, Ukraine made substantial progress in reforming regional policy with the support of the EU and other partners. In 2018, Ukraine joined the Recommendation of the Organization for Economic Cooperation and Development (OECD) regarding effective public investment at all levels of government. This proved the readiness of our state to take measures to reform the system of public investment management. In particular, to ensure its stability, transparency, efficiency, reduction of corruption risks at all stages of the implementation of investment projects.

On April 21, 2022, the President of Ukraine issued the Decree No. 266/2022, which established the «National council for the recovery of Ukraine from the consequences of the war». According to the approved Provision about this council, its main objective is: «to develop a plan of measures for the post-war recovery and development of Ukraine, which, in particular, will provide for the restoration and development of transport, medical, social, communal, production infrastructures and housing, an energy infrastructure, communication, a military infrastructure and the military and industrial complex, structural modernization and the restart of the economy, measures to overcome unemployment, support families with children, vulnerable sections of the population, people who found themselves in difficult life circumstances as a result of the war, restoration and preservation of objects of cultural heritage» [10].

In our opinion, for the successful post-war development of Ukraine within the framework of the implementation of economic policy by local authorities, it is important to:

- 1) differentiate economic policy measures for different types of communities and regions using the criterion of the level of damage caused to

them by the war, as well as taking into account the specifics of post-war security challenges for each of them;

2) clearly divide regions and show this division in the new State Strategy for Regional Development of Ukraine, which, among other things, should also outline the main development priorities for each of them. On its basis, regional strategies and strategies for developing individual territorial communities should be updated, taking into account the priorities of local policy regarding internally displaced persons and relocated businesses;

3) form effective mechanisms for management interaction between authorities of different levels, in particular, between state authorities and local self-government bodies. First of all, this concerns inter-budgetary relations such as the optimization of the current system of inter-budgetary transfers, the delegation of powers and ensuring sufficient administrative capacity of local self-government bodies of territorial communities;

4) establish mutually beneficial cooperation between government institutions and representatives of civil society and the business environment of communities and regions of Ukraine at the post-war stage of their development. This will help to improve the investment climate in our country and attract additional financial resources from private investors and grant-makers, including foreign ones, for the restoration of the most war-affected objects of its infrastructure and economic spheres.

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