OECD Multi-level Governance Studies

Rebuilding Ukraine by Reinforcing Regional and Municipal Governance



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This document was approved by the Programme of Work of the OECD's Regional Development Policy Committee via a written procedure on 25 November 2022.

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Foreword

This report responds to a request in 2020 from the Cabinet of Ministers and Ministry for Communities and Territories Development of Ukraine, and the European Union to support Ukraine's decentralisation and regional development reforms by following up on the OECD reports *Territorial Review of Ukraine* (2014) and *Maintaining the Momentum of Decentralisation in Ukraine* (2018). As such, the parameters of the work were defined prior to the Russian Federation's large-scale aggression against Ukraine, initiated on 24 February 2022.

In order to ensure the maximum relevance of the work in the context of the war, however, the OECD, the Government of Ukraine and the European Union agreed to expand the scope of the collaboration by including a focus on the role of effective multi-level governance for post-war reconstruction and recovery, and structuring the report around two distinct parts: Part I: "Supporting Post-war Recovery with Place-based Regional Development" and Part II: "Making the Most of Decentralisation for Post-war Recovery".

Part I includes a chapter dedicated to multi-level governance arrangements for disaster management and post-war recovery. In addition, most of its chapters include a preface that links pre-war findings to post-war reconstruction and recovery by reflecting on the specific challenges that Ukraine may face when advancing with the design and implementation of a national recovery plan at the subnational level.

Part II, drafted over the course of 2022, takes stock of developments in the decentralisation reform process since 2014, examining its effects on municipal capacity, and identifying success factors that underpin municipal performance. At the same time, it also considers the impact of the war on municipal functions, alongside needs for reconstruction and recovery.

This report was developed as part of the Programme of Work of the OECD's Regional Development Policy Committee (RDPC), a leading international forum in the fields of regional, urban, and rural development policy and multi-level governance, which is served by the Centre for Entrepreneurship, SMEs, Regions and Cities (CFE). The publication is the result of a partnership with the OECD Global Relations and Co-operation Directorate (GRC), Eurasia Division.

The RDPC emphasises the importance of multi-level governance and place-based approaches that are tailored to regional and local needs. To support the RDPC's leadership in this area, the OECD created the Multi-level Governance Studies series in 2016. This report contributes to the body of knowledge contained in this series.

This report draws on stakeholder responses to different OECD surveys and two virtual missions conducted in 2021, as well as in-depth desk research and insights from interviews with a wide variety of Ukrainian and international governmental and non-governmental experts. The report received written approval by the RDPC on 25 November 2022.

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The report was prepared by the OECD Centre for Entrepreneurship, SMEs, Regions and Cities (CFE), led by Lamia Kamal-Chaoui, in partnership with the Global Relations and Co-operation Directorate (GRC) of the OECD, led by Andreas Schaal. It was produced as part of the programme of work of the Regional Development Policy Committee. The project was implemented in the context of the OECD-Ukraine Memorandum of Understanding signed in 2014. It was made possible thanks to the financial contributions of the European Union, Latvia, Lithuania and the Slovak Republic.

The report was co-ordinated by Stephan Visser, under the supervision of Maria Varinia Michalun, Head of the Governance and Strategic Planning Unit in the Regional Development and Multi-level Governance Division in CFE, led by Dorothée Allain-Dupré. Its chapters were drafted by Stephan Visser and Geoff Upton, with significant contributions from Antti Moisio, Fernando Riaza and Andrés Sanabria in the Regional Development and Multi-level Governance Division, as well as from external experts, including Pedro Camões (Portugal), Tamara Krawchenko (Canada), Sergey Maksymenko (Ukraine) and Antonio Tavares (Portugal).

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Abbreviations and acronyms

ASC	Administrative Service Centre
AUC	Association of Ukrainian Cities
CabMin	Cabinet of Ministers of Ukraine
CFE	Centre for Entrepreneurship, SMEs, Regions and Cities
CIT	Corporate Income Tax
COVID-19	Coronavirus disease of 2019
CSO	Civil Society Organisation
DEA	Data Envelopment Analysis
DOBRE	Decentralization Offering Better Results and Efficiency project
EMAC	United States Emergency Management Assistance Compact
EU	European Union
EUR	Eurozone currency
FONDEN	Trust Fund for Natural Disasters *Fideicomiso Fondo de Desastres Naturales*
FUA	Functional Urban Area
GDP	Gross Domestic Product
GRC	Global Relations and Co-operation Directorate
GRP	Gross Regional Product
GVA	Gross Value Added
IATI	International Aid Transparency Initiative
ICC	Inter-Departmental Co-ordination Commission for Regional Development
IMF	International Monetary Fund
INEGI	National Institute of Statistics, Geography and Informatics *Instituto Nacional de Estadística y Geografía*
MIM	Mutual Investment Model
MinFin	Ministry of Finance of Ukraine

MinRegion	Ministry for Communities and Territories Development of Ukraine
NEET	Not in Education, Employment or Training
NES	National Economic Strategy 2030
NSDRM	National System for Disaster Risk Management
OECD	Organisation for Economic Co-operation and Development
OHCHR	Office of the United Nations High Commissioner for Human Rights
PIT	Personal Income Tax
PPP	Public-Private Partnership
RDA	Regional Development Agency
RDPC	Regional Development Policy Committee
SFRD	State Strategy for Regional Development
SFRD	State Fund for Regional Development
SFT	Scottish Futures Trust
SIGMA	Support for Improvement in Governance and Management initiative
SME	Small and Medium-sized Enterprise
SNIEG	National System of Statistical and Geographical Information *Sistema Nacional de Información Estadística y Geográfica*
SRC	Sector Reform Contract
SSRD	State Strategy for Regional Development
SSSU	State Statistics Service of Ukraine
TRNC	Turkish Republic of Northern Cyprus
UAH	Ukrainian hryvnia (currency)
UK	United Kingdom
U-LEAD	Ukraine – Local Empowerment, Accountability and Development programme
UN	United Nations
UNDP	United Nations Development Programme
US	United States
USD	US dollar (currency)
UTC	Unified Territorial
VAT	Value Added Tax

Executive Summary

Part I: Supporting post-war recovery with place-based regional development

In 2014, the Government of Ukraine embarked on an ambitious overhaul of its multi-level governance structures to boost territorial development. It established a legislative framework for its State Regional Policy and adopted successive State Strategies for Regional Development. It also significantly increased public funding for regional development—a testament to the importance that the government assigned to it. Prior to Russia's large-scale invasion of Ukraine in February 2022, the government was poised to further consolidate this framework to better meet its growth and well-being objectives.

The war has severely undermined progress and exacerbated existing territorial disparities and governance challenges. At the same time, it has demonstrated the critical importance of local human resource, administrative and service delivery capacities in dealing with the immediate consequences of the war. These capacities will be just as important in the recovery process and additional skills, for instance engagement with donors, will need to be developed in order for subnational governments to meet short-term reconstruction objectives, and create the conditions for increased resilience and improved citizen well-being. In this sense, while many of the findings outlined in this report reflect the situation on the ground prior to the war, their focus on institutional and structural challenges, such as limited public participation in subnational decision making and the dearth of territorially-disaggregated data on a wide range of indicators, will remain as relevant, and perhaps even more so, in the post-war period.

Key findings

- **In the decade prior to Russia's large-scale invasion in February 2022, Ukraine's performance in several strands of development improved significantly**. For example, between 2015 and 2019, the share of the population living below the nationally defined subsistence income level fell by over half, from 52% to 23%. Internet access increased significantly between 2010 and 2020 (from 23% to 63%), although this progress was more pronounced in urban *oblasts* than in rural ones. The share of the population that uses internet also remains lower than in comparator countries such as Poland (78%) and well below the average for OECD member countries (86%). Between 2015 and 2020, Ukraine's performance on the Worldwide Governance Indicators also improved, particularly in terms of political stability and regulatory quality.
- **On other metrics, however, territorial disparities have grown and inequalities have deepened over the past decade.** For example, all but two *oblasts* and Kyiv City witnessed population declines. The reported population decline in several rural regions—where agriculture is the dominant economic sector—has been particularly stark, with some regions reporting a decline of over 10% between 2010 and 2021. In addition, between 2010 and 2019, the national economy became increasingly dependent on the Kyiv agglomeration, with other regions lagging behind. These trends set the backdrop against which Ukraine has designed and implemented its regional and local development policies. They should inform evidence-based decision making by national and subnational level policy makers as they advance with regional development policy in the context of reconstruction and recovery.

- **A robust policy framework for regional development was established between 2014 and 2021, enabling governments at all levels to collaborate in the design and implementation of regional and local development initiatives. At the same time, the implementation of the framework has faced obstacles that, unless addressed, could undermine post-war recovery.** For example, while strategic planning processes became more embedded at different levels of government, by 2021, mechanisms to help subnational governments implement regional development strategies were still embryonic. Moreover, by 2021, the main vertical and horizontal co-ordination bodies that were created to help implement the multi-level governance reforms were either not fully operational or lacked the systemic participation of municipal governments.
  - Enacting a national planning law that streamlines and clarifies planning requirements for all levels of government could support the coherent implementation of a national recovery plan, as well as Ukraine's State Regional Policy. This was already a priority before February 2022, as a proliferation of development strategies and plans that subnational governments were required to create risked generating an overlap among planning documents and a fragmented use of resources. Enacting a national planning law will be even more important in the post-war context, as subnational governments will be responsible for developing an increasingly wide array of strategies, plans and programmes, which could strain the scarce human and financial resources that are available for supporting a swift implementation of reconstruction projects.
  - Reactivating Ukraine's national co-ordination bodies to contribute to improving policy coherence and acting as a channel for national/subnational exchange can support the effective implementation of State Regional Policy and a national recovery plan at different levels of government. For example, ensuring that the Inter-Department Co-ordination Commission for Regional Development meets on a regular basis to review progress towards the country's regional development goals and to co-ordinate the design of corresponding financing mechanisms would be beneficial. Moreover, by granting municipalities a permanent seat in official sections of the Commission, Ukraine could improve opportunities for communication and exchange among different levels of governments. This could, for example, help to better identify cross-jurisdictional reconstruction and recovery needs, design tailored projects and track progress.
  - Generating and leveraging the participation of non-governmental actors throughout the regional and local development planning cycle is also critical for supporting the post-war recovery. Participation could be enhanced, for instance, by reinforcing their involvement in the design, implementation and monitoring of regional and local development strategies. This will be particularly important during the recovery phase, as the magnitude of reconstruction needs requires the contribution of civil society and other non-governmental actors. In doing so, the government could build on the invaluable support that civil society organisations, the private sector and individual citizens have provided to the country's response to the war.
- **Between 2015 and 2019, public funding for regional and local development increased significantly. However, several challenges undermined funding effectiveness and risked entrenching regional disparities.** While the creation of many new regional and local development grants increased subnational government access to funding, funding effectiveness, however, was constrained by a predominance of small projects with low economic impact. Another challenge has been the large number of grants for regional and local development, which often led to inefficiencies in spending and implementation. Moreover, there have been limited incentives for municipalities to develop joint investment projects that could address shared needs. Meeting these challenges will be even more important in the reconstruction and recovery phase, not least to ensure effective investment in (rebuilding) physical infrastructure and human capital.
  - As Ukraine advances in designing mechanisms to fund subnational recovery and contribute to long-term territorial resilience, bundling or consolidating funds (without reducing total funding values) could help to limit fragmentation. Moreover, prioritising the funding of projects that have a

cross-jurisdictional focus could ensure a more efficient and effective use of scarce public resources.

- **The differentiated territorial impact of the war highlights the importance of adaptable multi-level governance arrangements in the reconstruction and recovery process**. As it finalises and implements a national recovery plan, Ukraine should also look to address structural socio-economic development trends and governance challenges that pre-date the war.
  - Involving representatives of subnational governments in defining immediate recovery support schemes and more long-term development strategies can help Ukraine design and implement reconstruction initiatives that meet territorially-differentiated needs and strengthen resilience. Moreover, it can enable the government to leverage the skills and experience that municipalities gained since 2014 in strategic planning, budgeting and investment. At the same time, it is important to recognise that the war has severely affected the human resource and fiscal capacities of many municipalities, undermining the progress achieved prior to February 2022.
  - Establishing mechanisms that allow for the transparent use of recovery funding by subnational governments and strengthening anti-corruption efforts, which tend to be exacerbated in post-disaster contexts, will also be needed. For example, digital platforms could be established that enable governmental and non-governmental actors to track recovery funds and projects. The government should ensure that anti-corruption mechanisms are designed in such a way that they do not stifle municipal decision making or reduce local absorption capacity.

Part II: Making the most of decentralisation for post-war recovery

Building on its ambitious territorial reform process launched in 2014, Ukraine implemented an array of political, administrative and fiscal decentralisation reforms to improve service delivery and strengthen local democracy. These included the creation of 1 469 amalgamated municipalities, which were allocated new responsibilities and financial resources to execute their mandates. Despite these pre-war advances, there were a number of obstacles that still needed to be addressed. These relate to the incomplete nature of Ukraine's territorial-administrative reorganisation, the differentiated ability of municipalities to meet their responsibilities and the absence of a municipal performance measurement framework. Addressing these challenges will be equally important in the reconstruction and recovery phase to ensure absorption of local recovery funds, as well as the necessary capacity to design, implement and monitor projects, for example.

Key findings

- **The shift in tasks and responsibilities from deconcentrated *rayons* (districts) to municipalities has made them the locus of local development efforts.** Yet it also generated tension between different levels of subnational government and resulted in limited municipal oversight. Moreover, it accentuated a lack of clarity in the division of tasks and responsibilities among levels of government (e.g. in public transport and roads).
  - Adopting a constitutional amendment that replaces *oblast* (region) and *rayon* state administrations with a system of prefects, as Ukraine has been discussing at length in parliament, could help the country strengthen local administrative supervision and facilitate the co-ordination of national-level priorities at the municipal level. Oversight will be particularly important during the recovery period given the expected vast inflow of recovery funding and pressure on municipalities to allocate resources swiftly, efficiently and effectively. At the same time, the government should be mindful that efforts to strengthen oversight do not necessarily mean increasing control or burden, and need not undermine municipal autonomy or restrain municipal decision making.

  - Harmonising the legislative framework to remove duplication and provide clarity on the allocation of responsibilities in sectors where it is lacking will help all levels of government respond more effectively to reconstruction needs.
- **Decentralisation reforms had a positive effect on the administrative, human resource and fiscal capacities of municipalities, as well as on service quality.** The results of an OECD survey that was completed by 51% of Ukraine's 1 469 municipalities show that rural and settlement municipalities appear to have benefitted more than urban ones. At the same time, prior to February 2022, many municipalities, in particular rural ones, considered that they still lacked the human resource capacity to carry out key strategic planning, public investment and budgeting tasks. For example, while 80% of urban municipalities reported sufficient capacity to design development strategies, only 67% of rural municipalities felt the same way. These challenges are likely to have increased since the start of the large-scale invasion of Ukraine, increasing the urgency for action on this front.
  - Investing in a robust training strategy for municipalities that can be adapted to different territorial contexts and needs is essential for ensuring that all local governments have the necessary expertise to design and implement reconstruction projects, absorb recovery funding, and ensure service delivery. In the short term, capacity building efforts should prioritise areas that are particularly relevant for the post-war reconstruction period, such as strategic planning, project appraisal, procurement, implementation and transparency.
  - Promoting and facilitating peer-to-peer exchanges among municipalities on issues of local administrative performance, such as procurement and stakeholder engagement, can also foster the sharing of good practices and innovative ways of working. Moreover, facilitating peer-to-peer exchange with local governments in the European Union (EU) could support EU accession.
- **OECD analysis identified various elements that can explain variations in municipal performance and development. These include population size, differences in the amount of time since amalgamation, and variations in administrative and fiscal capacity**. These findings can help the government as it considers further territorial and multi-level governance reforms as part of national reconstruction and recovery efforts. Next steps could include legislative, regulatory and fiscal reforms to ensure that municipalities have the necessary resources and flexibility to carry out their mandates.
  - Increasing inter-municipal co-operation could be a particular focus as it can enable municipalities to pool scarce financial and human resources, share fixed costs and achieve economies of scale. During the recovery period, inter-municipal co-operation will be particularly important for enabling municipalities with fewer resources to rebuild critical physical infrastructure more efficiently. In order to do so, Ukraine could develop both financial incentives (e.g. granting a higher tax-share to municipalities that deliver joint services) and functional incentives (e.g. establishing a condition of municipal size for the delivery of services including utilities, healthcare, etc., which have been hit particularly hard by the war). However, such functional incentives can be politically sensitive and legally challenging to establish.
  - Setting up a robust municipal performance measurement framework is another area of importance, as it can help all levels of government identify where progress has been made and where gaps remain or indeed have increased or emerged since the war. It can also help improve accountability. This requires investing in the capacity to generate, collect and analyse territorially-disaggregated data on a wide range of socio-economic, demographic, fiscal, service delivery and governance indicators, as well as ensuring the data are widely accessible and regularly updated.

1 Assessment and recommendations

Overview

The parameters of this OECD publication were defined in 2020 and the data collection process was concluded prior to the Russian Federation's large-scale aggression against Ukraine on 24 February 2022. However, in order to ensure the work remains as relevant as possible given the context of the war, the OECD, the Government of Ukraine and the European Union (EU) agreed to expand the scope of the collaboration by including a focus on the role of effective multi-level governance for post-war reconstruction and recovery. The main findings and recommendations on these topics are summarised below, encapsulating the report's Part I, "Supporting post-war recovery with place-based regional development" (chapters 2-5), and Part II, "Making the most of decentralisation for post-war recovery (chapters 6-8).

In 2014, the Government of Ukraine embarked on an ambitious overhaul of its multi-level governance structures. The territorial organisation of public authorities was modified, resulting in the creation of 1 469 amalgamated municipalities from over 10 000 communities in 2014. At the same time, Ukraine enacted a decentralisation reform, giving these municipalities new responsibilities and additional financial resources. In 2015, Ukraine also established a legislative framework for its State Regional Policy, and implemented successive State Strategies for Regional Development that sought to boost competitiveness and territorial cohesion. Public funding for regional development increased significantly.

Despite these advances, prior to February 2022, there was still work to be done to better achieve the government's regional development and decentralisation objectives. On the regional development side, this included streamlining planning requirements for subnational governments and regional development funding mechanisms, as well as providing more systematic capacity building support to municipalities. In addition, space remained to strengthen stakeholder engagement in all stages of the regional and local development planning life-cycle. Furthermore, Ukraine's national co-ordination bodies needed to be reactivated in order to improve policy coherence and to act as a channel for national/subnational exchange, which in turn supports the successful implementation of State Regional Policy. On the decentralisation side, necessary actions included addressing tensions among different levels of government arising from overlapping mandates, and strengthening municipal capacity to meet administrative, financial and investment-related challenges.

Russia's large-scale aggression against Ukraine, with its profound territorial impact, has severely undermined progress made since 2014. It will likely accentuate pre-existing multi-level governance challenges and further exacerbate territorial disparities as some regions, such as Donetsk, Kharkiv, Kherson, Kyiv, Luhansk, Mykolayiv, Sumy and Zaporizhzhia have been particularly hard hit. At the same time, the vital role played by local officials, civil servants and non-governmental actors during wartime foreshadows the critical contribution that they can make to post-war reconstruction and recovery.

In light of this, Part I of this report first considers how adopting a place-based approach—taking into account territorially-differentiated needs and capacities, and the role that subnational authorities and non-governmental actors play in shaping development outcomes—can support post-war recovery and reconstruction at the subnational level. Second, it takes stock of regional economic and well-being trends

in Ukraine before February 2022, to inform the design of regional development policies needed during the recovery phase—notably to address territorial disparities. Third, it considers the strengths and weaknesses in Ukraine's strategic planning frameworks that are relevant to developing and implementing post-war reconstruction and recovery initiatives at the subnational level. Finally, it assesses the various public funding mechanisms used for regional and local development, and draws lessons from them in order to inform the design of funding tools that can support post-war recovery at the subnational level.

Part II of this report first addresses advances in Ukraine's decentralisation reform process since 2014, including improvements in local public service quality and administrative capacity, as well as ongoing challenges, such as the differentiated ability of municipalities to meet their responsibilities. Second, it includes a qualitative and quantitative assessment of the impact of amalgamation on municipal performance. Finally, it identifies a number of success factors that are key to improving municipal performance and outlines how performance measurement at the subnational level in Ukraine can be improved. This can help the government as it advances with finalising and implementing a national recovery plan.

Towards a place-based approach for effective post-war recovery

Prior to February 2022, Ukraine had made significant progress in addressing challenges to regional well-being, including a reduction in poverty from 52% to 23% nationally (as measured by the share of the population living below the nationally defined subsistence income level) with some variation across territories (CabMin, 2021[1]). However, a series of shocks, beginning with the 2008 global financial crisis, followed in 2014 by the Russian Federation's seizure of Crimea and its intervention in support of rebel separatists in the east of the country, and finally the COVID-19 pandemic in 2020-2021 put pressure on Ukraine's ability to generate economic growth, strengthen territorial cohesion and increase citizen well-being. These successive crises, and now the vast destruction wrought by the war, highlight the importance of strengthening Ukraine's capacities to manage shocks and subsequent recovery, including the capacities of subnational authorities.

Disaster management and the role of subnational governments

Ukraine is proving itself in terms of response capacity in the face of Russia's war. Immediately after the full-scale invasion began on 24 February 2022, Ukraine declared martial law and facilitated the creation of *oblast*, *rayon* and municipal military administrations. This included introducing legislation to clarify powers and responsibilities of subnational governments under martial law, such as giving subnational governments additional powers to transfer funds from local budgets to the armed forces and to inspect buildings and other infrastructure damaged by the war. Additionally, with the easing of criteria for civilians to become members of the territorial defence forces, 110 000 civilians had joined territorial defence units by early April 2022 (Romanova, 2022[2]).

Despite the fact that the war is ongoing, Ukraine is already thinking about reconstruction and recovery, particularly in the areas liberated by the Ukrainian army. Given the territorially differentiated impact of the war on Ukraine's regions and cities, as the government finalises and implements a recovery plan, attention will need to be focused on ensuring that the plan meets the specific needs of subnational governments and builds on existing capacities. Maintaining the dialogue it has launched with a wide range of stakeholders from the public and private sectors, civil society, academia, the international donor community and international experts to develop and advise the government on a national recovery plan will be critical as it considers and refines its short-, medium- and long-term priorities and goals.

Multi-level governance for effective disaster management and recovery can be strained

Ukraine's regions and municipalities are facing different levels of destruction and different types of immediate and long-term challenges as a result of the war. Thus, ensuring a degree of flexibility or adaptability in the multi-level governance arrangements supporting recovery will be important. This includes the level of government at which decisions are made and implemented, the co-ordination and communication mechanisms used, and a clear attribution of responsibilities. The extent to which a more centralised or decentralised approach to disaster management and recovery can be adopted in different regions will depend, at least in part, on the extent to which subnational governance structures are still functioning.

Effective disaster management and recovery depends on well-co-ordinated action and actors working together—be they public, private or third sector (civil society)—and at all levels of territorial governance. However, prior to February 2022, different national co-ordination bodies were either not fully operational or lacked the systematic participation of local authorities to support communication and exchange among and across levels of government. If national level co-ordination bodies, such as the Inter-departmental Co-ordination Commission for Regional Development, were more operational they could help the National Council for Recovery of Ukraine, an advisory body under the President of Ukraine, to ensure that recovery initiatives meet local needs and that reconstruction efforts are not fragmented. It could also help track progress on reconstruction initiatives and facilitate dialogue across and among levels of government. With additional financial and technical support, Ukraine's regional development agencies could also function as platforms to co-ordinate regional recovery efforts.

Ensuring that responsibilities are clearly attributed among different levels of government can also facilitate disaster management. Such clarity has been elusive in Ukraine's multi-level governance arrangements so far, and the recovery offers an opportunity to address this weakness. Many municipalities surveyed by the OECD in 2021 reported that responsibilities among levels of government were least clear in three areas that will be reconstruction priorities: public transport, roads, and energy/utility facilities (OECD, 2021[3]). The lack of clarity can hamper post-war reconstruction if different levels of government are unclear on who decides, who builds, and who maintains in the short, medium and long terms.

Applying a place-based approach to support post-war recovery in Ukraine

In April 2022, the government established the National Council for the Reconstruction of Ukraine, which is responsible for devising a national recovery plan. As Ukraine advances with this plan, it will be important not only to consider the damage inflicted by the war, but also how Ukraine's socio-economic development trends and governance challenges prior to the war could be addressed. Pre-existing territorial factors, such as historic regional differences in Gross Domestic Product (GDP), competitiveness, the size and skills of the labour force, and territorial differences in citizen well-being could affect the long-term success of the plan—unless they are also addressed in the recovery process. Post-war reconstruction and recovery can be used to improve on the past by introducing ambitious economic, social and governance reforms.

At the same time, policy makers should be aware that the public goodwill that often marks the first years of reconstruction and recovery is often short-lived. After a devastating conflict, people will want to regain the standard of living that they were used to as soon as possible and not wait for more ambitious reforms to generate tangible results. As such, the government will have to make sure that in the short term the delivery of basic services is restored, housing is provided and local economies are kick-started. This can sustain trust in government and donors, and generate a willingness to support more ambitious reforms. Leveraging local expertise is exceptionally important for a place-based approach to disaster management, as it can help channel resources where they can have the most impact. For example, Ukraine's different tiers of subnational government can support the development of an open-source national inventory of territorial needs, design and implement reconstruction projects, and track progress of local recovery efforts. Moreover, current legislation could be amended to enable greater involvement of non-governmental actors

(e.g. businesses, academia and citizens) in the design, implementation and monitoring of measures to support the reconstruction of their regions or municipalities.

Finally, the government, as well as international partners, should be prepared to mitigate the pre-existing risks associated with vested interests and corruption. These tend to be exacerbated in post-disaster contexts due to a combination of 1) an expected vast inflow of recovery funds; 2) pressure on authorities to allocate resources swiftly; and 3) strained absorption capacity in national and subnational institutions. Investing in community-based accountability processes as well as transparency and oversight mechanisms that can be established relatively rapidly would be important in the short term. For example, public expenditure tracking, citizen monitoring of public service delivery and citizen advisory boards are used in many countries. Digital platforms enabling governmental and non-governmental actors to track funds and projects are one option to support this.

Building on regional development successes

To support recovery efforts, it will be important for Ukraine to continue building on the regional development planning and funding frameworks developed since 2015. One essential step for regional development after the war will be updating the existing seven-year State Strategy for Regional Development (SSRD) (2021-2027), as well as regional and municipal development planning documents, while ensuring that strategic documents link to a final national recovery plan. At the same time, Ukraine should also consider streamlining the planning requirements for subnational governments in order to facilitate decisive recovery action. With the gradual rollout of the regional development reforms and decentralisation beginning in 2014, the number of territorial development strategies and plans that subnational governments were required to develop proliferated. This risks overlap among different planning documents, potentially resulting in a duplication of efforts, and may lead to a fragmented use of resources, particularly when the objectives of different strategies and plans are not well aligned.

Attention will need to be paid to ensuring that public spending on reconstruction and recovery at the regional level is optimised. Between 2015 and 2019, a total of 110 grants and subventions[1] linked to regional and local development were implemented by a wide array of institutions (U-LEAD, forthcoming[4]). This hampered the effectiveness of public spending, risked a duplication of efforts and increased the potential for misuse of public funds. These challenges were compounded by the absence of a formal body to co-ordinate regional development funding, a lacuna that should be addressed when designing and implementing the recovery and reconstruction funds at the national and subnational levels. Based on this experience, consideration could be given to establishing only a limited number of dedicated recovery funds and subventions and formally mandating a national-level body responsible for co-ordinating recovery funding.

Box 1.1. Key OECD recommendations for reinforcing a place-based approach to post-war recovery

The following recommendations should be considered in a timeframe that is appropriate to the current context of war and post-war reconstruction and recovery.

To enable reconstruction initiatives to meet territorially-differentiated needs and strengthen resilience, Ukraine is advised to:

- Ensure that recovery implementation and funding mechanisms reflect national priorities and specific regional and local needs and assets. This can be achieved by involving representatives of subnational governments in the definition of both immediate recovery support schemes and more long-term development strategies.
- Assess the extent to which existing regional development funding, implementation and co-ordination mechanisms can be leveraged and improved to support post-war reconstruction, for example by:
  - Building on the experience and skills in providing citizens with a wide array of public services and managing public investment funding that municipalities have gained since the 2014 start of the regional development and decentralisation reform process.
  - Mobilising existing co-ordination bodies—or establishing new ones—at the *oblast* level and in larger cities to allow public institutions, as well as non-governmental actors, to share information, co-ordinate activities and mobilise diversified resources.
- Build the capacity of weaker municipalities to develop and implement local reconstruction projects, monitor their results, and absorb recovery funding.
- Develop a robust municipal performance measurement framework, which can identify weaker municipalities in need of additional capacity building support. Such a framework could include socio-demographic, fiscal, operational and political system indicators applicable to all 1 469 municipalities.
- Promote and facilitate the involvement of non-governmental actors in the development, implementation and monitoring of recovery initiatives in the short term, and ensure increased public participation in decision-making processes after the initial reconstruction period.
- Establish mechanisms that allow for the transparent use of recovery funding by subnational governments and strengthen anti-corruption efforts, for example by:
  - Supporting municipalities on issues related to local public procurement and transparent decision making.
  - Strengthening mechanisms to control and oversee the spending of recovery funds.
  - Establishing a national-level body responsible for co-ordinating recovery funding.
  - Setting up digital platforms that enable governmental and non-governmental actors to track funds and projects.
- Invest in community-based accountability processes (e.g. public expenditure tracking and monitoring of public service delivery).

Setting the scene: A volatile context for regional development

The Russian Federation's large-scale aggression against Ukraine in 2022 has severely affected existing demographic, economic and well-being trends. Moreover, with no end in sight, it is difficult to predict what

the specific baseline of many development indicators will be in the war's aftermath. Despite this uncertainty, the data and analysis reflected in this report—conducted in large part in 2021—offer insights for policy makers in a recovery setting. Experience from different countries and regions that have implemented post-disaster recovery strategies shows that reconstruction efforts need to meet immediate needs while attempting to improve underlying governance, socio-demographic and economic conditions.

An analysis of demographic, economic and well-being trends at the national and subnational levels in Ukraine, as well as obstacles to regional development were compared with four benchmarks: i) former Soviet countries; ii) neighbouring countries; iii) the OECD average; and iv) the EU average. The results were mixed in terms of improved performance. In most dimensions—e.g. demographics, the economy and well-being—there were areas of significant improvement. For example, between 2015 and 2020, there was greater political stability, a strong increase in GDP per capita, and an impressive drop in poverty rates. At the same time, the contributions of most *oblasts* to aggregate Gross Value Added (GVA) did not change much between 2010 and 2019: there were generally low employment rates for the country as a whole, and there was a significant population decline in all *oblasts* except Kyiv City and Kyiv *Oblast*. On most other available metrics, territorial inequalities have become more entrenched or worsened.

The demographic dimension

By the end of 2021, almost all regions suffered from decreasing population, which was driven by a range of factors including external and internal emigration, low fertility, as well as ageing. The exceptions to the trend were Kyiv City, Kyiv *Oblast* and, to a much more limited extent, Zakarpattia. In addition, all regions, except Ternopil, were confronted with a shrinking labour force—even Kyiv City and Kyiv *Oblast* saw labour-force declines—mainly reflecting population ageing. This has significant implications for the cost of, and demand for, public services, not to mention productivity and economic development. Between 2011 and 2020, Kyiv City, Luhansk *Oblast* and Zaporizhzhia *Oblast* reported the country's strongest declines in the share of working-age persons in the total population (6.6, 4.4 and 3.8 percentage points, respectively) (CabMin, 2021[1]). With 5.8 million people having fled the country by July 2022, and millions more internally displaced, Russia's war against Ukraine has dramatically increased the scale of Ukraine's demographic challenge and the strain it puts on productivity and economic development (UNHRC, 2022[5]).

The economic dimension

Between 2014 and 2020, Ukraine suffered major political and economic shocks that hampered growth. These include the 2014 Euromaidan revolution, Russia's annexation of Crimea, the conflict in the Donbas region and the COVID-19 pandemic. Ukraine's proximity to the European market and the signing of various trade and co-operation agreements with 46 countries since 2014, however, opened a window to more international economic integration, with exports as an economic driver. Between 2014 and 2019, the volume of exports to the EU-26 increased by 43% in current USD terms (OECD, 2021[6]).

Regional productivity was affected by a number of factors prior to the war, which in turn could aggravate regional inequalities and affect subnational capacity for regional development and public service delivery, as well as recovery. Among these factors is limited labour-force participation, particularly among women and youth. To address this issue, Ukraine could enact tailored labour-market policies that are designed and implemented in a way that takes into account local barriers to increased female and youth participation in the labour force while building on territorial industrial structures and assets. Wage differentials among Ukraine's regions were also relatively large—ranging from an average monthly wage of UAH 17 086 in Kyiv City (the highest) to UAH 9 166 in Chernivtsi *Oblast* (the lowest) in 2020 (CabMin, 2021[1]). This is larger than wage differentials in many OECD member countries. Before the war, low wages were a key driver of outward migration.

The well-being dimension

Prior to the war, Ukraine's regions had markedly improved in terms of poverty. This was driven in part by real wage growth. Between 2015 and 2019, the share of the population living below the nationally defined subsistence income level fell by over half, from 52% to 23%. Lviv *Oblast* reported the largest reduction (47 percentage points) (CabMin, 2021[1]). Russia's invasion is likely to severely undermine the significant progress in poverty reduction that Ukraine's regions achieved between 2015 and 2019.

Internet access in Ukraine increased significantly over the past 20 years but remains below the OECD average (86%). In 2020, 84% of households in Kyiv City had internet access, the highest level in the country, followed by Dnipropetrovsk *Oblast* (79%). By contrast, only 49% of citizens had access to broadband services in Rivne *Oblast*, the region with the lowest level of internet access prior to the war (CabMin, 2021[1]). Ensuring continued digital connectivity and even expanding coverage is key to recovery efforts as it will support economic activity, enable citizens to stay abreast of relevant recovery initiatives, and facilitate access to different public e-services.

The COVID-19 crisis highlighted the need to address territorial disparities in Ukraine's healthcare system. In 2020, the number of hospital beds and doctors per 10 000 inhabitants varied significantly across regions, with some performing better than the OECD average (e.g. Chernivtsi, Ivano-Frankivsk and Ternopil). In 2020, Chernihiv *Oblast* reported the highest number of hospital beds per 10 000 inhabitants (80.4). Meanwhile, Zakarpattia had the lowest number—55.4 beds per 10 000 inhabitants, which was more than the majority of OECD member countries (Ministry of Health, 2020[7]). While territorial variation in access to healthcare is common in OECD countries, it can have important implications for a region's preparedness to deal with public health or disasters requiring medical attention, such as war. In a post-war context, Ukraine will not only have to invest in rehabilitating the damaged physical healthcare infrastructure, but also ensure access to mental health and psycho-social support, as mental disorders are prevalent in post-war settings.

Ukraine's regional and municipal development frameworks

Since 2015, Ukraine has established an elaborate legislative and policy framework for regional and local development and built up policy and service delivery implementation capacity at all levels of government. This was accomplished through the 2014 reform of local self-government and territorial organisation of power, the approval of a legislative framework for the country's State Regional Policy, the design and implementation of successive State Strategies for Regional Development (SSRD) and the creation of regional development agencies. Although these reforms had contributed to numerous advances, a number of key challenges remained at the outbreak of the war, primarily with respect to strategic planning frameworks, the multi-level governance mechanisms and planning instruments available to support these frameworks, and the need for additional information and expertise to advance regional development goals and implement programming in an effective manner.

The proliferation in the number of strategic frameworks for regional development, in addition to various national and subnational planning documents, can lead to uncertainty with respect to the goals of the State Regional Policy, fragmentation in policy implementation and sub-optimal use of scarce public services. Successfully operating a large number of plans to guide regional development requires effective national-level co-ordination of regional development efforts. This has been lacking and hampers the implementation of the country's State Regional Policy across sectors and among levels of government. The limited functionality of existing horizontal and vertical co-ordination mechanisms compounds the co-ordination problem, as these are necessary to increase policy coherence and effectiveness, and to generate trust-based partnerships among levels of government and with stakeholders.

Strategic planning, although vital, is only half of the equation. Implementation is just as important. Mechanisms for implementing the country's regional development policy and corresponding strategies, particularly at the *oblast* level, were embryonic at the outset of the war. At present, urgent attention needs to be paid to implementation issues if Ukraine is to meet its regional reconstruction and recovery objectives. The regional development agencies could be strong partners in helping articulate and implement regional and local development strategies throughout the recovery process and beyond. Non-governmental actors are also important contributors to strategy and policy implementation. Unfortunately, the structure of the SSRD limits their participation in its implementation. Civil society organisations, the private sector and academia can play a strong role in implementing, monitoring and evaluating strategies and their programming by providing local insight into development needs, priorities and results. Given the experience all levels of government are gaining by working with non-governmental groups to support the war effort, it would be valuable to carry this knowledge forward and apply it to post-war recovery activity as well.

Despite the advances stemming from decentralisation reform, many of Ukraine's 1 469 municipalities were still building the necessary technical expertise to effectively contribute to the implementation of the country's State Regional Policy on the eve of Russia's war against Ukraine. When a national recovery is adopted, this need for greater technical capacity will likely be even more urgent. Among the municipal capacity constraints that still needed to be addressed before the war were developing realistic strategic plans, effectively involving stakeholders (e.g. private sector, civil society, academia) in strategy development and implementation, and identifying targets and indicators to support performance measurement (monitoring and evaluation).

Prior to the war, most municipalities surveyed by the OECD reported that decentralisation reforms had a generally positive impact on municipal performance, particularly with respect to development planning, monitoring and evaluation. For example, 59% of the surveyed municipalities indicated that the reforms had improved their ability to design local development strategies (OECD, 2021[3]). The reforms have offered mixed results in stakeholder participation, however. For example, most municipalities considered that the decentralisation reforms had not increased the participation of businesses in municipal decision making. At the same time, municipalities reported that the reforms had a relatively positive impact on the participation of individual citizens in municipal decision making related to strategy design, though less so in identifying investment needs (OECD, 2021[3]). Legislation to clarify the tools and mechanisms through which stakeholders can participate in municipal decision making could help address these issues. This is particularly relevant for the post-war reconstruction and recovery phase. The immense cost of the reconstruction requires the involvement of non-governmental actors, who can contribute by identifying immediate needs and providing support to vulnerable populations, particularly in remote areas, as well as by contributing to the design, delivery and monitoring of recovery initiatives.

All levels of government need to enhance their capacity to produce, analyse and disseminate information on regional and local development performance. The government is aware of the data challenges it faces, particularly with respect to micro-level data on regional and local development. Prior to the war, a number of initiatives were launched to address this issue. These included a survey by the Ministry for Communities and Territories Development (MinRegion) that was sent to municipalities to gather suggestions on topics to include in a new system of local statistics; the Hromada Performance Monitoring Platform; and a move to develop a municipal performance management system together with USAID's DOBRE project. The findings associated with this project highlight the scarcity of information available to municipalities to assess their performance, particularly among municipalities that have recently amalgamated.

Addressing the very limited availability of territorially-disaggregated data may require continued capacity building among national and subnational governments to produce, analyse and share reliable data. In particular, it is important to substantially expand the list of well-being indicators for which local-level data are produced, moving well beyond the indicators presented on the Hromada Performance Monitoring Platform. Moreover, the government, aided by international partners, will need to support the capacity of

subnational governments and local non-governmental actors alike to provide up-to-date information on immediate and longer-term reconstruction and recovery needs.

Reinforcing the role of the State Statistics Service of Ukraine (SSSU) to support subnational data gathering could help all levels of government improve performance. As the central executive body responsible for statistics, it could play a key role in ensuring that the territorially disaggregated data needed for recovery are collected centrally and are presented on an easily accessible platform. This is essential for supporting evidence-based decision making on recovery and reconstruction, and tracking progress on meeting local needs. However, this requires revamping the SSSU's online portals, which do not meet the standards of modern statistical and geographic data reporting, limiting the ability of users to identify and use data for decision-making purposes.

Furthermore, there is no formal co-ordination mechanism to facilitate regular and systematic exchange between the SSSU and other government institutions to support the generation, analysis and dissemination of development statistics. One way to address this last issue is via an inter-agency statistics commission that could spearhead the creation of a publicly accessible platform for monitoring territorial recovery.

Box 1.2. Key OECD recommendations for reinforcing Ukraine's regional and municipal development frameworks

The following recommendations should be considered in a timeframe that is appropriate to the current context of war and post-war reconstruction and recovery.

To refine the strategic planning framework and support the implementation of the State Regional Policy at all levels of government, Ukraine is advised to:

- Strike a balance between development planning and implementation, and promoting horizontal and vertical policy coherence. The enactment of a national planning law that defines the short-, medium- and long-term planning documents needing to be developed, and who should be responsible for their design, implementation and monitoring, can help achieve this.

To strengthen the horizontal and vertical co-ordination of regional development, Ukraine is advised to:

- Provide MinRegion with more tools to ensure its contribution to policy development in sectors with a regional-/local-level incidence, for example by giving it a role in the review of draft policy proposals on issues such as transport and subnational economic development.
- Improve the functioning of existing horizontal and vertical co-ordination mechanisms. This could be accomplished, for example, by streamlining the Inter-Departmental Co-ordination Commission for Regional Development's broad set of responsibilities to ensure its meetings focus on key regional development issues and by creating (technical) working groups within the commission.
- Clarify the mandate and improve the capacity of regional development agencies to execute their tasks and responsibilities, for example, by setting up peer-to-peer learning trajectories to facilitate the exchange of good practices between Ukrainian regional development agencies and their peers from OECD member countries.

To strengthen the ability of municipalities to foster territorial development and contribute to the implementation of the State Strategy for Regional Development, Ukraine is advised to:

- Develop initiatives to increase the participation of non-governmental actors throughout the regional development planning cycle (e.g. making economic development funds for municipalities conditional on private sector involvement). The Working Groups established by the government for the National Recovery Council in which representatives from different sectors participate could serve as an example.

To strengthen effective data management for regional development policy, Ukraine is advised to:

- Increase the availability of up-to-date territorially-disaggregated information on a wide range of topics (e.g. economic, social, demographic). In particular, it is important to significantly expand the list of well-being indicators for which territorially-disaggregated data are produced, moving well beyond the indicators currently presented on publicly accessible platforms.
- Invest in the generation, analysis and dissemination of information on citizen experience with public services at the national, regional and local levels.
- Strengthen the role that the SSSU plays in gathering, analysing and disseminating data across ministries and among levels of government. The Cabinet of Ministers may be well positioned to support such efforts as it has been co-ordinating the activities of the SSSU since 2019. Alternatively, inter-agency commissions could be created—for instance for regional development—that are charged with defining sectoral data needs, establishing standards to generate and present statistics, and ensuring that current databases are up-to-date and new ones are developed.

Public funding for regional development in Ukraine

Beginning in 2015 and up until February 2022, subnational development funding increased significantly in Ukraine, highlighting the importance that the government placed on regional and local development. Between 2015 and 2019, central government budget allocations to regional and local development increased from 1.9 to 6.9% of the total national budget, i.e. from slightly over UAH 11 billion to almost UAH 76 billion (U-LEAD, forthcoming[4]). This marked increase reflected the creation of several subventions to fund subnational investment projects. Yet despite the increased funding, subnational government capacity to invest in regional development was limited by four principal challenges that could further entrench regional disparities: i) the structures underlying the allocation of the Personal Income Tax (PIT) to municipalities; ii) fragmentation in Ukraine's fiscal framework for regional development and a heavy focus on funding the maintenance of "hard" infrastructure; iii) a reliance on competitive funding and co-funding that hampers the ability of poorer municipalities to meet their investment needs; and iv) a divergence in the capacity of larger and smaller municipalities to fund investment projects through own-source revenue.

The impact of fiscal equalisation and PIT allocation on regional inequalities

Ukraine's approach to the distribution of PIT strongly affects the ability of subnational governments to fund basic service delivery and to undertake strategic investments. Ultimately, the current approach risks aggravating territorial disparities and undermining political accountability.

Currently, Ukraine allocates PIT revenues to the municipality where the employer is legally registered, rather than to the employee's place of residence. Thus, private companies play a large role in the distribution of PIT funds. Furthermore, large municipalities, where multi-office companies are registered, may benefit from PIT revenues at the expense of smaller municipalities, where workers actually work or reside. As companies can change the place where they are registered, the system renders PIT a potential bargaining chip, giving companies negotiating power over municipalities that do not want to risk losing revenue from PIT funds. Ukraine is encouraged to consider PIT reform based on place of residence. Such a shift has the potential to boost financial resources for many municipalities, helping them deliver better public services and undertake additional investment. It would also strengthen local political accountability. An ex-ante study, however, would be strongly advised in order to determine how the reform would affect the fiscal health of the national, regional and municipal governments. In addition, the size of the horizontal fiscal equalisation system necessary to offset, at least in part, territorial disparities in PIT revenues should also be assessed. Municipalities surveyed by the OECD consider changes to the PIT allocation system an urgent area of fiscal reform (OECD, 2021[3]).

Grants and subventions for regional development in Ukraine

In 2019, the government's financial support for regional and local development was almost four times greater than in 2015 (in real terms) (U-LEAD, forthcoming[4]). The creation of different intergovernmental grants and subventions contributed to this increase, but there were factors limiting the effectiveness of these funds. These included a fragmented and relatively unstable fiscal framework, an emphasis on funding "hard" regional and local infrastructure, and the tendency to use funds for small-scale local projects. Recalling the impact of these challenges and actively trying to avoid them when designing mechanisms to fund Ukraine's post-war reconstruction and recovery at the subnational level could be valuable for policy makers as they move forward with their planning.

Between 2015 and 2019, the share of subnational funding became more fragmented in terms of the number of grants and subventions available for regional and local development, and in terms of grant administration. The number of available grants—110 in total—led to increased administrative costs associated with managing development funding. Moreover, the administration of those funds was

fragmented across 20 different government entities. This fragmentation represented a co-ordination challenge that could potentially compromise spending efficiency, the quality of implementation and the effectiveness of the different intergovernmental transfers.

One way to address the fragmentation challenge is to reallocate a larger share of regional and local budget grants and subventions to a single fund, such as the State Fund for Regional Development (SFRD) managed by MinRegion. This would help ensure that overarching government objectives in the regional and local development sphere are met. It should be reinforced by a mandate for MinRegion to co-ordinate the different regional and local development funds, even when they are implemented by other ministries. Yet certain challenges would have to be overcome. First, adjusting the SFRD distribution formula could help improve regional convergence, e.g. by linking the formula to the population and GDP per capita of *rayons* instead of *oblasts*. However, if Ukraine decides to implement PIT reform based on place of residence—which may affect GDP per capita of *rayons*—the government should consider reviewing the manner in which GDP per capita of *rayons* is calculated in order to ensure that it adequately reflects local economic activity. Second, shortfalls in the level of funds attributed to the SFRD would need to be avoided. As of 2022, it was mandated to receive 1.5% of planned General Budget fund revenues (up from the original 1%). In practice, the funding level fluctuated between 0.43% and 0.79% between 2015 and 2021 (Verkhovna Rada, 2015[8]; Verkhovna Rada, 2020[9]).

Many of Ukraine's largest subnational subventions, including the SFRD, were awarded competitively and required municipalities to meet co-funding criteria. Given vast differences in the fiscal capacity of municipalities, such criteria risk undermining the ability of poorer municipalities to obtain the funding needed to fulfil their investment needs. Approximately one in three municipalities surveyed by the OECD in 2021 reported that their financial situation was the key impediment to obtaining SFRD funding (OECD, 2021[3]). To address this challenge, ideally municipalities with the weakest fiscal capacity could be exempt from providing co-funding, barring this, they should be eligible for a significantly reduced co-funding requirement. This is particularly relevant in the post-war reconstruction and recovery phase, as the fiscal capacity of many subnational governments has been severely weakened.

The effectiveness of regional development funding has also been hampered by a heavy concentration of small projects with relatively low economic impact, risking non-strategic use of resources. Between 2015 and 2018, 63% of SFRD-funded initiatives targeted single municipalities, while less than 10% of projects had a more regional-level focus (U-LEAD, 2018[10]). To increase the strategic use of the SFRD and achieve economies of scale, prioritising projects with a cross-jurisdictional focus would be important. This also applies to mechanisms to fund subnational reconstruction and recovery projects. Determining the right territorial scale of subnational recovery initiatives requires a solid assessment of the particular needs of municipalities across the country and where these coincide or diverge. To the extent possible, this needs to be combined with feasibility studies and robust cost-benefit analysis to make sure that recovery funds are spent effectively and efficiently.

Finally, intergovernmental spending on regional development has mostly focused on "hard" infrastructure. Over the 2015-2019 period, spending on this type of infrastructure accounted for close to two-thirds of all regional development spending (U-LEAD, 2018[10]). While investment in hard assets (e.g. reconstruction of roads, schools, hospitals, electricity grids) should be the priority during the reconstruction and recovery period, complementary investments in human capital as well as support for small and medium-sized enterprises will be essential. Striking the right balance between investment in "hard" and "soft" infrastructure is particularly important in the context of Ukraine's post-conflict recovery, as many skilled workers have fled the country. This means that the upskilling of internally displaced people may be necessary to facilitate their economic integration into their host communities.

Subnational public investment capacity

Between 2015 and 2020, direct investment by subnational governments increased in real terms by 26%. However, the share of subnational direct investment as a percentage of total public direct investment dropped by 21 percentage points (IMF, 2022[11]; World Bank, 2021[12]). Moreover, local authorities in particular witnessed a decline in investment. For example, between 2016 and 2018, the share of investment as a percentage of total spending by amalgamated municipalities fell sharply, from 33% to 19% (SKL International, 2019[13]). To boost the investment capacity of smaller municipalities, there are several options to consider. For example, a block grant could be provided to fund projects linked to both regional and local development plans. Another possibility is to expand municipal power to set the tax base and rates for own-source taxes, possibly within a nationally determined range in order to avoid too much variation among municipalities, and an excessive tax burden on citizens. This would improve municipal fiscal capacity, provide more flexibility to fund initiative that meet local needs, and could boost accountability to citizens. Building up the skills of subnational government staff, particularly with respect to investment management, would also prove beneficial, especially in light of funding and financing that will be available for post-war recovery.

Under certain conditions and strict control mechanisms, public-private partnerships (PPPs) can be a mechanism to diversify funding for regional and local development projects, particularly when a government is faced with budgetary and funding constraints. However, PPPs are subject to the same fiscal or willingness-to-pay constraints as traditional public projects. In both cases, strong institutional capacity at all levels of government is required for effective project delivery. Moreover, PPPs involve significant risk, including regulatory capture, conflict of interest and corruption, and long-term constraints on government fiscal capacity. PPPs should not be used to overcome budget constraints. Rather, they should be used only when they can produce greater value for money than would be provided by the delivery of public services or investment through traditional means.

Efforts to build the capacity of subnational governments to manage public investment for regional development—including for post-war territorial recovery—need to include measures to mitigate the misuse of funds. This is particularly important given a 2019 audit by the Accounting Chamber of Ukraine that revealed significant outstanding systemic issues, including misuse of budget funds and violation of legislation in the field of planning and budgeting, as well as a significant number of unfinished construction projects. To improve the legal and efficient use of financial resources by subnational governments, the government is advised to prioritise boosting the capacity of municipal authorities to conduct internal audits and channelling international aid to support this.

Box 1.3. Key OECD recommendations for reinforcing public funding for regional development in Ukraine

The following recommendations should be considered in a timeframe that is appropriate to the current context of war and post-war reconstruction and recovery.

To help Ukraine optimise the effects of the equalisation system on regional convergence and growth, it is advised to:

- Modify legislation to allocate the Personal Income Tax (PIT) based on place of residence, thereby increasing its potential to provide municipalities with financial resources commensurate with the demand for public services and investment in their territory.
- Conduct an ex-ante study to determine how the different proposals to reform the PIT allocation system under consideration by parliament would affect the fiscal health of the national, regional and municipal governments, as well as the size of the horizontal fiscal equalisation system necessary to offset, at least in part, territorial disparities in PIT revenues.

To help Ukraine capture the benefits of its intergovernmental transfers for regional development, it is advised to:

- Streamline the number of grants and subventions for regional development, without reducing their value, to increase spending efficiency, avoid overlap and strengthen the quality of implementation. One way to achieve this is by reallocating a higher share of regional and local budget grants and subventions to a single fund managed by MinRegion.
- Balance investment in "hard" (e.g. roads, bridges, railways) and "soft" infrastructure (e.g. innovation, research and development) as a means to promote balanced regional development. This could be accomplished by, for example, ensuring that funds and subventions with a cross-sectoral focus, such as the SFRD, promote and facilitate investment in areas such as innovation and skills, as well as physical infrastructure.
- Level the playing field so that municipalities with limited technical and financial capacities, as well as those most affected by Russia's war against Ukraine, can compete for regional development funding against municipalities that are wealthier or have greater technical capacities. This could be achieved by, for example:
    - Linking co-funding requirements to the fiscal capacity of municipalities.
    - Setting up a complementary general block grant that provides all *oblasts* and municipalities with a minimum level of funding to implement their respective regional and local development strategies. This must be coupled with robust oversight mechanisms to ensure that investment projects meet clear local and/or cross-jurisdictional needs.

To help strengthen the ability of municipalities to fund local development and investment, Ukraine is advised to:

- Develop and implement methodologies that municipalities can use to identify investment needs, given the scarcity of territorially-disaggregated data, and to effectively engage with governmental and non-governmental actors.
- In collaboration with international development partners, provide training and advice to municipalities, particularly those with more limited capacities, in areas such as stakeholder engagement, and monitoring and evaluating investment projects.

To improve the legal and efficient use of regional development funding, Ukraine is advised to:

- Mandate internal auditing by all municipal governments. This requires, among other elements, providing municipalities with financial and capacity building support to conduct reliable and effective internal audits, and learn from audit results.

To increase the responsible use of public-private partnerships (PPPs) as a means to finance regional and local development, Ukraine is advised to:

- Improve outreach to larger municipalities and the private sector about the potential of PPPs, the regulatory framework and, in particular, the multiple risks involved in setting up and managing a public-private collaboration. Guidance should also seek to ensure that subnational governments are well-informed regarding alternatives to PPPs, and the potential benefits and risks of these.
- Develop and disseminate training material for municipalities on assessing the value-added and risks of PPPs, managing such partnerships, as well as establish a transparent system to track the use of public funds and determine their effectiveness.

Advances in Ukraine's decentralisation process since 2014

Six years into the reform process, in 2021, many municipalities reported improvements in the quality of local public services (such as administrative services and education), as well as a consolidation of their administrative capacity. These advances, which were achieved despite the absence of a constitutional amendment to institutionalise the territorial-administrative structure that had been modified through regular legislation, are highly relevant in the context of the current war. They have provided municipalities with expertise and tools to meet the exigencies of the war, and positioned them to more effectively support place-based reconstruction and recovery in the medium to long term.

Decentralisation created new responsibilities and resources to municipalities

Ukraine's decentralisation reforms sought to reinforce democratic governance by adjusting subnational political power; reinforcing public service delivery at the local level; simplifying the territorial-administrative structure; and clarifying the responsibilities attributed to each level of government. Initially intended to be introduced through a constitutional amendment and then reinforced through adjustments in legislation, the fact that, on different occasions, the government was not able to obtain the votes necessary to pass a constitutional amendment led it to rely strictly on legislative and regulatory changes to carry out its initiative.

There were several key elements underscoring the reform process. First, the municipal amalgamation process reduced the number of local councils from more than 10 000 in 2015 to 1 469 by 2020. Second, local democracy and accountability were bolstered by simplified electoral voting and registration laws, and a move to institutionalise *starostas*—local community officials responsible for representing the interests of residents. Third, administrative decentralisation transferred responsibilities to municipalities in key service areas, including administrative services, education, healthcare, waste, water and sanitation and housing, leading to improvements in service quality, as reported by the municipalities. Fourth, fiscal decentralisation led to greater municipal budget capacity and more room for autonomous fiscal decision making, as municipal reliance on intergovernmental transfers decreased in favour of revenues from shared and local taxes. This was the result of various government financial incentives to spur municipal mergers, including increased revenues from PIT, as well as access to regional and local development funding through the SFRD and the Local Infrastructure Subvention.

Despite these successes, at the start of the war, municipalities still faced a number of territorial-administrative challenges, often linked to the country's multi-level governance arrangements and the way in which the decentralisation process was implemented. These shortcomings include legislative discrepancies in the assignment of responsibilities among levels of government, a lack of municipal oversight, a need for better vertical and horizontal co-ordination, and a need to build municipal capacity in a number of areas (e.g. planning, human resources, fiscal and investment management). Furthermore, municipal economic development remains limited and there is room to further reinforce local democracy and accountability.

Addressing tensions between the rayon and municipal levels of government

The absence of a constitutional reform meant that, as the decentralisation reform process advanced, inconsistencies increased between the Constitution of Ukraine and various pieces of legislation on the respective functions of municipalities and *rayon* state administrations. In addition, the different legislative and regulatory reforms that guided the transfer of tasks and responsibilities to amalgamated municipalities resulted in a lack of clarity about the division of tasks and responsibilities across levels of government in different sectors (e.g. public transport and roads). The government should look to harmonise the legislative framework in order to provide clarity on the responsibilities of different levels of government and ensure an effective and efficient allocation of recovery funding.

There are also concerns about the absence of clear guidance on whether *oblasts* and/or *rayons* are responsible for overseeing the legality of municipal decisions and activities. This can be problematic given the vast increase in administrative and service delivery responsibilities of amalgamated municipalities and the relative inexperience of some municipal governments in executing their acquired mandates. This calls for redefining the role of *rayon* state administrations as territorial actors, particularly in light of their highly reduced administrative and service delivery responsibilities. The latest attempt to address both issues came in 2021, when the government drafted a constitutional amendment proposing the creation of a prefecture-like system to replace the *oblast* and *rayon* state administrations (Office of the President of Ukraine, 2021[14]). According to this proposal, prefects would be responsible for overseeing the legality of municipal decisions and have the power to temporarily suspend legislation deemed inconsistent with Ukrainian law. This latest attempt to resolve the challenges related to oversight over municipal decisions was not adopted before Russia's large-scale invasion on 24 February 2022. As long as martial law is place, no constitutional amendments can be made.

While there has been agreement among many national and subnational government representatives that updating the role of *oblast* and *rayon* levels and clarifying the mechanisms for oversight over municipalities is important, there has been ample debate about how to balance the powers of each level of government. Any future reform should ensure that increasing oversight over municipal decisions does not impinge on local democracy or stifle municipal decision making.

Revisiting co-ordination mechanisms for municipal governance

Limitations in the country's vertical and horizontal co-ordination mechanisms risk hindering the effective implementation of the decentralisation reforms, as well as national reconstruction and recovery initiatives. Municipalities often fail to fully understand the rapidly evolving legal framework that supports decentralisation. At the same time, while successive governments have invested in the creation of different multi-level co-ordination bodies, as well as *ad hoc* consultation of local leaders, municipalities often struggle to communicate their needs and challenges to higher levels of government.

These challenges could be overcome by reinforcing the participation of municipalities in the Inter-Departmental Co-ordination Commission for Regional Development (ICC) and the Congress of Local and Regional Authorities. In the case of the ICC, which is tasked with the design, implementation and

monitoring of Ukraine's regional development policy at the municipal level, among other responsibilities, this could be achieved by providing a representative cross-section of municipalities with a permanent seat in the Commission's meetings (Verkhovna Rada, 2015[15]). In the case of the Congress, which was set up to represent and advance the interests of regional and local authorities, this could be achieved by ensuring that two chambers are established, as envisioned when the Congress was created: one for municipalities and another for regions. Actions such as these would be particularly valuable during the reconstruction and recovery process given that municipalities will likely play a major role in defining and/or implementing reconstruction projects, making effective co-ordination even more important than ever.

Strengthening municipal capacity to meet administrative, financial and investment-related challenges

The differentiated process and timeline by which municipalities received their responsibilities through the amalgamation process accentuated existing differences in municipal capacity in planning, administration, finance and investment. Ensuring that municipal capacity continues to be built will help reinforce the benefits accumulated throughout the decentralisation process. It will also enable municipalities to contribute to post-war recovery efforts.

Municipal strategic planning capacity will be essential in a post-war period to ensure that recovery initiatives match local needs and realistic with respect to local capacities. Just prior to the war, research indicated that experience in strategic planning was not uniform among municipalities. For example, about half of the municipalities surveyed by the OECD did not have an officially approved strategy, which limited their ability to guide local development efforts. Additional capacity gaps associated with strategic planning include monitoring and involving non-government actors in all phases of the strategic planning life-cycle.

In order to advance post-war recovery processes and further meet decentralisation objectives, building civil servant capacity in strategic planning, economic development, financial management and donor relations is of the essence. This requires improving the training framework for civil servants, as there are indications that local civil servants are not staying up-to-date on training, which may reflect dissatisfaction or disinterest in the training that is being provided. Reinforcing the capacity of municipal civil servants would become even more urgent if the government were to reduce the number of civil servants, for example due to budgetary constraints or to increase efficiency. In parallel, the government should promote peer-to-peer exchanges by the different local government associations to help municipalities learn from good practices. Facilitating peer-to-peer exchange with local governments in the EU could also support EU accession. In addition, the government should prioritise updating the 2001 Law "On Service in Local Self-government", introducing mechanisms for professional development and merit-based recruitment. It should also seek to reduce the gap in the remuneration of national and local civil servants, which hampers the ability of municipalities to attract and retain skilled staff.

Prior to the war, municipalities were already facing fiscal pressures. Many local governments felt that the increase of administrative and service delivery responsibilities had not been met with a sufficient increase in municipal revenues, which raised the risk of mandates being underfunded. Moreover, there has been a relatively inequitable distribution over time of fiscal incentives for amalgamation. For example, municipalities that merged voluntarily received a 60% share of the locally-levied PIT (Verkhovna Rada, 2021[16]). Municipalities that did not amalgamate voluntarily were not eligible for these tax revenues until they were mandatorily merged in 2020. Furthermore, they could not access funds from different regional and local development grants and subventions. Thus, they have had less time to generate own-source revenues and spend resources according to local needs. Russia's war against Ukraine has only increased fiscal pressures, as municipalities have assumed wartime responsibilities and expenditures. In the first months of the war, municipalities saw large drops in local budget revenues. Increased deficits limit local government's ability to contribute to financing targeted recovery activities.

Public investment capacity among municipalities was also limited prior to the war. Capital expenses as a percentage of total spending by amalgamated municipalities declined from 31% to 15% between 2016 and 2020 (CabMin, 2021[17]). Possible reasons for this include the gradual increase in the minimum wage of civil servants, and a steady decline of revenue that individual amalgamated municipalities received from funds created to encourage amalgamation. Evidence also indicates that in 2021 many municipalities did not believe that decentralisation reforms had improved their ability to identify and refine investment needs in partnership with non-government actors. This can limit their ability to establish investment priorities that meet the needs of different stakeholders (OECD, 2021[3]).

Decentralisation had an uneven effect on local service quality. While most municipalities indicated that reforms had helped improve local service delivery in areas such as education, and social care, the opposite was true for water and sanitation management, as well as housing. Rebuilding and further improving public service delivery after the war may depend on stronger inter-municipal co-operation.

Inter-municipal co-operation arrangements have gradually increased among local authorities. Between 2014 and 2020, 769 inter-municipal co-operative agreements were established, the majority in 2018 and 2019 (MinRegion, 2022[18]). However, there appears to be ample room for improvement. In 2021, municipalities reported that the decentralisation process had had little noticeable effect on co-operation among peers. This appears to be due to a lack of understanding of the advantages of such arrangements and limited capacity to establish them. Overall, improving knowledge and awareness of the advantages of inter-municipal co-operation and facilitating these arrangements could be an advantage in the post-war recovery period. It could help boost local service delivery in terms of quality and/or mix, and relieve financial pressure on municipalities. This could be achieved, for instance, by providing municipalities with additional support materials and advice on how to set up and manage inter-municipal co-operation.

Box 1.4. Key OECD recommendations for strengthening institutional capacity at the subnational level in Ukraine

The following recommendations should be considered in a timeframe that is appropriate to the current context of war and post-war reconstruction and recovery.

To improve the oversight of amalgamated municipalities, Ukraine is advised to:

- Reinforce municipal oversight, for example by adopting a constitutional amendment that replaces *oblast* and *rayon* state administrations with a system of prefects at the *oblast* level, as discussed at length in parliament, in order to provide local administrative supervision and facilitate the co-ordination of national-level priorities at the local level.

To strike a better balance in territorial reform and ensure the conditions for successful decentralisation, Ukraine is advised to:

- Harmonise the legislative framework to remove duplication and provide clarity on the allocation of responsibilities in sectors where it is lacking (e.g. public transport and roads).

To further strengthen vertical and horizontal co-ordination mechanisms, Ukraine is advised to:

- Strengthen the Congress of Local and Regional Authorities by creating a separate municipal chamber, and ensuring a transparent and equitable process that enables municipalities to participate on a rotating basis.
- Reinforce the Inter-Departmental Co-ordination Commission for Regional Development by granting municipalities a permanent seat in its official sessions.

To consolidate subnational strategic planning capacity, Ukraine is advised to:

- Develop and implement training modules on areas of local administrative performance where municipalities are lagging (e.g. citizen engagement, performance monitoring).
- Support national and international peer-to-peer exchanges between municipalities on issues of local administrative performance to foster the sharing of good practices and innovative ways of working.

To strengthen subnational human resource capacity, Ukraine is advised to:

- Develop and periodically update a subnational strategy for human resource management, including an expanded list of standardised training programmes with improved mechanisms for quality control of teaching content.
- Amend the Law “On Service in local self-government” to require local civil servants to be politically neutral and ensure open and merit-based recruitment, and performance management, while also setting out effective mechanisms for professional development.

To improve subnational fiscal and investment capacity, Ukraine is advised to:

- Ensure that poorer municipalities and those with limited technical and financial capacities can compete on an equal footing with their stronger (in terms of technical capacity and funding) peers for regional development funding by linking, for instance, co-funding requirements to the fiscal capacity of municipalities.

To increase the uptake of inter-municipal co-operation arrangements, Ukraine is advised to:

- Provide municipalities with additional support materials on inter-municipal co-operation (e.g. on relevant legislation, good practices, draft co-operation agreements, etc.).
- Develop guidance for municipalities on how to set up and manage inter-municipal co-operation, particularly in sectors where uptake has been weaker in the past.

Amalgamation and its impact on municipal performance

Understanding the impact of the decentralisation reforms on municipal performance in Ukraine prior to Russia's large-scale invasion can provide insight into municipal success factors that can underpin local development outcomes post-war. It also helps reveal why improvements in municipal performance have not been uniform across the country. Such information can help regions with weaker performance 'catch-up' to their more successful peers and identify how 'leading' municipalities could continue to strengthen their performance.

In this regard, the OECD assessment of municipal performance focuses on different performance areas including administrative and human capacity, service delivery, local democracy and co-ordination. These areas were examined using a qualitative municipal self-assessment, with information obtained through a questionnaire sent to all 1 469 municipalities in 2021. There was a total response rate of 741 municipalities in 119 *rayons* and 24 *oblasts,* as well as Kyiv City, yielding a highly representative sample. In addition, a quantitative Data Envelopment Analysis (DEA) of relative efficiency in public service delivery was used. The DEA built on the data available from the Hromada Performance Monitoring Portal to identify how much local taxpayers receive in return for their tax contributions. The results of these two analyses lay the foundation for the OECD's assessment of success factors in municipal performance in Ukraine. It is important to note that the conditions under which the information for these analyses was gathered have changed dramatically since Russia's war against Ukraine.

Before February 2022, municipalities generally perceived a large increase in their ability to carry out administrative, planning and investment tasks, as well as an increase in public service quality and improved relationship with higher levels of government. This applied, in particular, to rural and settlement municipalities, which also began to see improvement in democratic governance, for example through increased citizen participation in municipal planning. At the same time, the way in which the decentralisation reforms were implemented has widened capacity gaps among different types of municipalities (rural, settlement and urban). Understanding capacity gaps and development needs can help national and subnational officials, as well as development partners tailor technical and financial support during the recovery period. The following sections outline factors contributing to successful municipal performance that were identified by the OECD, while also highlighting capacity gaps across rural, settlement and urban municipalities.

Municipal success is linked to population size and time to build institutional capacity

According to OECD analysis, municipal performance is contigent on two factors in particular: size (i.e. population) and the number of years a municipality has had to build institutional capacity. The DEA identified that more populous municipalities tend to be more efficient in terms of providing and maintaining physical municipal infrastructure. The assessment also identified that municipalities with fewer than 10 500 inhabitants tended to be in the bottom 5% of the efficiency index. This may seem intuitive. Yet there is no one-size-fits-all solution in terms of optimising cost efficiency or scale. It depends on the country, the subnational institutional and financial context, and the services being delivered.

The time that municipalities have had to build institutional capacity is a particularly crucial element. Many of Ukraine's urban municipalities that were formerly categorised as cities of *oblast* significance were

delivering an extensive set of responsibilities before the decentralisation reforms were launched in 2014. These municipalities, which obtained relatively high efficiency scores in the DEA, have had more time to build and consolidate institutional capacities (e.g. administrative, strategic, fiscal and financial management, service delivery) than many others. At the opposite end of the spectrum are some smaller and less capacitated municipalities that received their responsibilities in 2020 when they were administratively amalgamated. These findings, which are based on pre-February 2022 data, indicate that it is inherently unfair at this stage of the decentralisation process to compare or expect the same performance from the different types of municipalities. Thus, time must be recognised as a success factor, as it is a key ingredient in building institutional capacity.

Sufficient fiscal capacity is a prerequisite for successful municipal performance

Fiscal capacity, and in particular the ability to raise own-source revenues, is another important element behind municipal success. The DEA found that capacity to raise own-source revenue was a key factor in municipal performance. In most *oblasts,* the more efficient municipalities were those that received at least 15% of their revenues from local taxes, highlighting the importance of a minimum level of local financial autonomy. Creating the conditions for greater fiscal autonomy of municipalities should be a priority, as an increase in own-source revenue can generate a stronger sense of ownership over local budgets, leading to improved public accountability. In this regard, rural and settlement municipalities appear to have made the most improvements since 2014. For example, in 2021, 87% of rural municipalities reported an increase in own-source revenue compared to 62% of urban municipalities (OECD, 2021[3]).

In addition, sufficient fiscal capacity is fundamental to avoiding un- or underfunded mandates. This will be particularly important in the recovery period, given the significant costs associated with rehabilitating or rebuilding municipal infrastructure. Achieving sufficient fiscal capacity will require fiscal reforms, including a potential shift away from earmarked grants to general or block grants. Moreover, in order to ensure that municipalities with relatively limited fiscal capacity do not miss out on recovery funding, national and regional governments should keep track of which municipalities are applying for funds, while remaining vigilant regarding those that are not, in order to determine whether this is due to a lack of need or a lack of capacity to apply for funding. This should be coupled with the establishment of transparent monitoring and accountability frameworks that show how recovery funds are spent.

Increased public investment capacity contributes to municipal success

Enhanced public investment capacity, in terms of accessing local development funds and of effective investment management, also appears to contribute to municipal success. Making sure that all municipalities have a fair chance to access regional development funds is a factor to consider. For example, only 50% of municipalities that, prior to 2021, had applied for regional development funds from Ukraine's State Fund for Regional Development reported having received any funds (OECD, 2021[3]). This suggests that a significant number of municipalities are not tapping into an important source of funding for local investment projects, thus limiting their ability to develop. It also runs the risk of deepening territorial inequalities.

Various factors may contribute to this situation, ranging from an inability of less affluent municipalities to meet co-financing requirements, to a lack of municipal capacity to develop and submit project proposals of sufficient quality. With regard to the latter issue, there are significant differences in the self-reported capacity of rural, settlement and urban municipalities to carry out investment-related tasks. About 87% of urban municipalities reported sufficient human resource capacity to identify investment needs and develop project proposals, compared to only 66% of rural municipalities (OECD, 2021[3]).

Building expertise to manage investment planning and ensure more equitable access to investment funding and financing should be priorities in the recovery period. Both will help municipalities meet

territorially-differentiated reconstruction needs and support greater territorial cohesion and resilience in the longer term. In addition, the enormous volume of investment that will be required to support reconstruction and recovery at the local level accentuates the need for effective public engagement in municipal decision making.

Strategic planning capacity is essential for guiding municipal development

Municipal performance and development are also supported by strategic planning capacity. The OECD assessment identified large variations in the strategic planning capacities of municipalities. For example, while 80% of urban municipalities reported sufficient capacity to design development strategies, only 67% of rural municipalities felt the same way. This difference was similar when considering monitoring and evaluation capacities (OECD, 2021[3]). These perceived capacity gaps may be explained by the fact that, until 2022, legislation did not mandate municipalities to develop a local development strategy (Verkhovna Rada, 2015[15]).

Gaps in municipal planning capacities can undermine development efforts. The challenge to build or rebuild physical infrastructure and ensure service delivery during the war and forthcoming recovery period highlights the need for strong strategic planning capacities—from diagnosis and objective setting, to action identification, implementation, and monitoring and evaluation. Limited capacity in these areas can affect municipal ability to develop and implement local reconstruction projects, absorb recovery funding and monitor results.

Inter-municipal co-operation can advance municipal success

Inter-municipal co-operation appears to also boost local performance, as it can contribute to municipal scale (beyond what the amalgamation process accomplished), help manage service delivery and administrative costs, and potentially expand the service delivery mix. In general, municipalities reporting that they had an inter-municipal co-operation agreement in place (56%) tended to be more likely to report having the necessary capacity to fulfil their entire remit versus those that did not have such agreements (29%). Typological differences are at play, with 56% of rural municipalities reporting that the decentralisation reforms had had a positive effect on co-operation with other municipalities, compared to 48% of settlement municipalities and 38% of urban municipalities (OECD, 2021[3]). The post-war recovery process could benefit from good co-operation among municipalities in order to support public service delivery in municipalities where public infrastructure (e.g. hospitals, schools, etc.) has been damaged or destroyed, and/or where human and financial resources are very limited.

Box 1.5. Key OECD recommendations for the continued progress of the decentralisation reforms, in the context of reconstruction and recovery

The following recommendations should be considered in a timeframe that is appropriate to the current context of war and post-war reconstruction and recovery.

To build up a more professionalised municipal civil service, Ukraine is advised to:

- Establish a reconstruction and recovery training strategy for municipalities that can be adapted to different territorial contexts and needs. The strategy should prioritise capacity building in areas that are particularly relevant for the post-war recovery period, such as strategic planning, project appraisal, procurement, implementation, transparency and stakeholder engagement (including with donors).

To strengthen local accountability and public engagement, Ukraine is advised to:

- Reinforce legislation making public consultation a systematic component of development and investment planning at the subnational level. However, the government should be careful not to overwhelm municipalities with requirements to organise public engagement processes, as this might stifle municipal decision making and lead to 'consultation fatigue'.

To improve the quality of municipal service delivery, Ukraine is advised to:

- In the context of the highly territorially-differentiated impact of the war on municipal service delivery capacity, adopt and/or facilitate flexible and shared public service delivery models, such as co-operation, collaboration, co-production, collocation and flexible service provision.
- Increase outreach to and capacity building of municipal leaders on the value of inter-municipal co-operation and developing financial and functional incentives:
  - Financial incentives could include providing a higher tax-share for delivering joint services and awarding additional points in the selection process of competitive regional and local development grants to project proposals developed by two of more municipalities.
  - Functional incentives could include establishing a condition of population size for the delivery of different services (e.g. utilities and healthcare), thereby encouraging co-operation between smaller municipalities.

Municipal performance measurement

Russia's war in Ukraine is bringing to the fore the pivotal role municipalities play in providing public services and supporting the well-being of their communities in times of crisis. Since 24 February 2022, municipalities have had to meet new challenges, such as providing housing, supporting territorial defence and organising the allocation of humanitarian assistance. The centrality of municipalities in public efforts to strengthen local economics and communities, and boost citizens' well-being is likely to be consolidated further in the post-war recovery period. Effective action on the part of national and local policy makers will require a solid understanding of the relative performance of municipalities on a large range of indicators, far beyond what is currently available. This implies, for example, generating and disseminating data on the quality of and/or access to a range of public services (e.g. education, healthcare, basic utilities, etc.).

A more robust performance measurement framework can support post-war recovery

In order for the government and international partners to tailor reconstruction initiatives and funds to local needs and build longer-term resilience, a robust local performance measurement framework based on clear objectives, measurable targets, and appropriate indicators would be valuable. This was much needed before February 2022, and it will become even more critical in the years to come, particularly since 67% of surveyed municipalities indicated that in 2021 they were not yet executing all of their responsibilities effectively. A solid performance measurement framework can help municipalities make informed decisions on how to prioritise reconstruction initiatives, rebuild local economies, redress territorial inequalities and improve the well-being of local communities. It can also help the national government determine the next steps in the decentralisation process, as it contemplates how to best support place-based reconstruction and recovery. Such a framework will undoubtedly aid in the EU accession process, as well.

In addition, improved municipal performance measurement will hinge on developing a comprehensive monitoring and evaluation framework that permits comparability across local governments and can reveal where capacity gaps exist. Such a framework would need to capture outputs and outcomes in order to identify the extent to which i) different municipalities deliver on their objectives and responsibilities in an efficient and effective manner; and ii) formal and informal mechanisms, practices, rules and arrangements contribute to or hinder municipal performance.

In the forthcoming reconstruction and recovery period, municipal efficiency should continue to be evaluated in order to ensure that local development initiatives are not resulting in cost overruns or an inefficient allocation of public resources. The metrics supporting this include revenues, expenditures and debt data, as well as measures of built or rebuilt social infrastructure facilities in a given territory. Much information is already available through the Ministry of Finance's Open Budget Portal, for instance. However, these datasets need to be complemented with regularly updated population statistics to enable in-depth, cross-municipal comparison.

Municipal effectiveness is often evaluated in terms of the quality, equity and accessibility of public services in a specific territory. Measurements can include the number of cubic metres of drinking water supplied by a municipality or the proportion of households covered by drinking water supply, for example. Citizen satisfaction data is a good complement to operational metrics, and is frequently faster and less expensive to gather.

Developing a performance measurement framework for municipalities requires continued investment in the production, analysis and tools to share reliable data, and expanding the indicator set beyond what is currently available. A comprehensive set of municipal performance and development indicators should be developed for all municipalities—for which data are collected annually and shared through a publicly accessible digital platform. The information obtained could reinforce evidence-based decision making, for example on legislation and regulatory reforms affecting municipalities, Budget Code amendments, and on service delivery and citizen well-being. In addition to a dedicated local performance measurement framework, international benchmarks and indicators, such as the OECD Infrastructure Governance Indicators, could serve as a useful basis for developing tools to monitor municipal performance over time, particularly as Ukraine's regions and municipalities rebuild damaged or destroyed public infrastructure.

Box 1.6. Key OECD recommendations for strengthening municipal performance measurement in Ukraine

The following recommendations should be considered in a timeframe that is appropriate to the current context of war and post-war reconstruction and recovery.

To support evidence-based decision making for improved municipal development outcomes, Ukraine is advised to:

- Develop a set of municipal performance and development indicators (e.g. socio-demographic, fiscal, operational, political system) applicable to all 1 469 municipalities, that capture:
  - Outputs establishing to what extent formal or informal mechanisms, practices, rules and structures exist to help facilitate municipal performance.
  - Outcomes determining to what extent different municipalities are able to deliver on their objectives and responsibilities efficiently and effectively.
- Link the available statistics (on municipal revenues, expenditures and debt) to up-to-date data on the population of each municipality in order to facilitate in-depth cross-municipal comparisons.
- Ensure that data on municipal performance and development are widely accessible and regularly updated.
- Invest in the generation, analysis and dissemination of information on citizen satisfaction with public service delivery.

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Note

[1] The Budget Code of Ukraine defines subventions as inter-governmental transfers of funds to be used for specific purposes through procedures defined by the authority that decides to provide the subvention (Verkhovna Rada, 2021[16]).

Part I Supporting post-war recovery with place-based regional development

2 Towards a place-based approach for an effective post-war recovery

This chapter explores the importance of effective multi-level governance to support Ukraine's post-war recovery and reconstruction by adopting a disaster management approach. It highlights the role of subnational governments in the different phases of the disaster management cycle, including recovery and reconstruction. It also explores the importance of adaptable and "fit-for-purpose" co-ordination and communication mechanisms to help communities prepare for and respond to emergencies, and increase their resilience to future shocks. Finally, the chapter reflects on how a place-based approach can support effective post-war recovery and reconstruction at the subnational level in Ukraine.

Introduction

Until the Russian Federation's large scale aggression against Ukraine in February 2022, and from 2014 onwards, Ukraine had made substantial progress in addressing regional disparities in various areas, such as poverty and access to broadband internet. Moreover, it had made considerable progress implementing ambitious judicial and governance reforms. In particular, success was achieved at the subnational level, through a significant expansion of the administrative and service delivery mandate of municipalities. Despite these advances, however, Ukraine's ability to generate economic growth, stimulate territorial cohesion and increase citizen well-being throughout the country had been strained by several shocks. These included the occupation of Crimea by the Russian Federation in 2014, as well as the most active period of the Donbas conflict (between 2014 and 2015). Ukraine's socio-economic development was also severely restricted by the 2008 global financial crisis and the COVID-19 pandemic, which tested the crisis management and recovery capacities of national and subnational governments around the world.

As this report shows, crises such as these have highlighted the importance of multi-level governance, regional development and effective decentralisation arrangements, and in turn the importance of a place-based approach to disaster management and recovery. Furthermore, they have underscored the role that trust in public institutions, availability of adequate human and financial resources, and the power of effective communication with stakeholders play in preparing for and responding to disasters.

These successive crises have also highlighted the immediate need for adaptability and flexibility at and by all levels of government. This holds particularly true for Ukrainian municipalities during the war. National, regional, and local governments can seldom count on following a pre-established and perfectly sequential course of policy-action to manage, exit and recover from major shocks. Furthermore, the territorially differentiated impact of the recent emergencies demonstrates the value of place-based regional development as a tool for building territorial resilience, including through a mix of public services that is tailored to local needs. These lessons are not only crucial for Ukraine, they also hold true for other countries and regions as they deal with or prepare for the consequences of both man-made and natural disasters.

The vast destruction that has been wrought by Russia's war against Ukraine (Box 2.1) highlight the importance of strengthening Ukraine's capacities to effectively manage shocks and subsequent recovery. Strong institutional capacity to manage and recover from shocks will also be needed to help governments around the world to address other challenges, such as more frequent and severe natural disasters exacerbated by climate change (IMF, 2017[1]). With this in mind, this chapter has two objectives. First, it seeks to contribute to the growing discussion on how to strengthen multi-level governance systems, so that they can effectively respond to the differentiated needs of regions and cities during and after a disaster. Second, it analyses how Ukraine can support effective post-war recovery at the subnational level by building on the advances it has made in regional development and decentralisation since 2014, and by adopting a place-based approach.

Box 2.1. Scale of the destruction caused by the 2022 Russian aggression against Ukraine

Russia's large-scale aggression against Ukraine, launched in February 2022, unleashed a catastrophe in the country. It has triggered the largest wave of refugees in Europe since World War II. By July 2022, 5.8 million people had fled the country, and millions more are internally displaced. On 1 August 2022, the Office of the UN High Commissioner for Human Rights (OHCHR) recorded 12 584 civilian casualties in the country: 5 327 killed and 7 257 injured. The actual figures are expected to be considerably higher, as information from some parts of the country where intense hostilities are ongoing or that are now controlled by the Russian Federation is sparse or difficult to verify.

Russia's aggression has also had a devastating impact on Ukraine's economy. By August 2022, damage to Ukraine's buildings and infrastructure as a result of the war was estimated at over USD 108 billion, and will likely continue to rise. Up to 129 000 residential buildings, over 9 600 healthcare institutions, 235 000 kilometres of roads and 2 200 education institutions have been destroyed or damaged. It is projected that the war is causing USD 4.5 billion in damage per week to Ukraine's infrastructure and its economy is expected to shrink by 45% in 2022.

The war has also had a profound environmental impact. With a steady barrage of strikes on refineries, chemical plants, energy facilities, industrial depots or pipelines, the country's air, water and soil have been polluted with immediate and longer-term consequences for human health and ecosystems across Ukraine and in the wider region. Moreover, with fighting take placing close to the Zaporizhzhia nuclear power plant, the threat of nuclear pollution looms large.

While the war has touched all of Ukraine's regions, there are profound differences in how different parts of the country have been affected. The regions that border the Russian Federation and the Black Sea have been on the frontline throughout the war and have grappled with the widespread destruction of homes, lives and critical infrastructure. Despite Ukraine's recent territorial gains, large parts of the Donbas region are occupied by Russian forces (as of September 2022). At the same time, many of the country's western regions have been affected by a vast influx of internally displaced people and a shortage of essential supplies, as well as significant pressure on infrastructure and the provision of basic services.

Note: The data presented in this box was collected in August 2022.
Source: Author's elaboration, based on (OHCHR, 2022[2]; World Bank, 2022[3]; IMF, 2022[4]; The Guardian, 2022[5]; KSE, 2021[6]; OECD, 2022[7]).

This chapter introduces the different stages of the disaster risk management cycle and discusses the role of subnational governments in disaster management, recovery and reconstruction, particularly in the context of the war in Ukraine. Second, it reflects on how a country's degree of decentralisation can affect its disaster management capacity. Third, the chapter addresses the value of adaptable and "fit-for-purpose" co-ordination and communication mechanisms, and briefly discusses how these could apply in Ukraine, given the highly asymmetric impact of the war on regions and municipalities. Finally, the chapter reflects on how Ukraine can support subnational recovery and reconstruction efforts, at the appropriate time, to address urgent humanitarian needs, rebuild regional and municipal economies and communities and strengthen their resilience. In doing so, it builds on the data and analysis presented in the following chapters of this report that are focused on: regional demographic, economic, labour and social trends in Ukraine (see Chapter 3); the country's regional and municipal development policy frameworks (see Chapter 4) and the framework surrounding regional and local development funding (see Chapter 5).

Box 2.2. Recommendations to support Ukraine's post-war recovery at the subnational level

The following recommendations should be considered in a timeframe that is appropriate to the current context of war and post-war reconstruction and recovery.

To allow reconstruction and recovery efforts to meet territorially differentiated needs and strengthen resilience going forward, Ukraine is advised to:

- Ensure that the recovery and reconstruction plans adopt a short-, mid- and long-term perspective and address regional demographic and socio-economic disparities and governance challenges that existed before 2022, while taking into account changes that may have occurred as a result of the war.
- Sequence recovery efforts in a clear way, making sure that citizens regain their pre-war standard of living quickly and do not have to wait for more ambitious reforms to bear fruit, which would hamper trust in the recovery process.
- Ensure that the recovery implementation and funding mechanisms, while reflecting national priorities, can also take account of specific regional and local needs and assets. This can be done by:
  - Involving subnational governments and their representatives (e.g. different associations of local governments) in the design of immediate recovery support schemes, as well as more long-term strategies to boost territorial resilience.
  - Encouraging subnational governments to take a national inventory of territorial needs, design and implement reconstruction projects and track progress of local recovery efforts.
  - Establishing a formal national-level body that is responsible for co-ordinating recovery funding that incorporates representatives from subnational governments so that the design of the funding mechanisms takes into account territorially differentiated needs and absorption capacities.
- Leverage the potential of existing regional development funding, implementation and co-ordination mechanisms to support post-war reconstruction and recovery, for example by:
  - Building on the experience and skills that municipalities have gained since the start of the 2014 regional development and decentralisation reform process in providing citizens with a wide array of public services, as well as managing investment funding.
  - Ensuring the Congress of Regional and Local Authorities meets on a regular basis to facilitate upward and downward exchange between the different levels of governments, identify cross-jurisdiction recovery needs, design tailored projects and track progress.
  - Mobilising existing co-ordination bodies—or establishing new ones—at the *oblast* level and in larger cities to allow public institutions, as well as (international) non-governmental actors to share information, co-ordinate activities and mobilise diversified resources.
  - Updating Ukraine's seven-year State Strategy for Regional Development (2021-2027), as well as its regional and municipal development planning documents, to ensure they are linked to the recovery plan.
  - Considering a shift in the overall aim of Ukraine's State Regional Policy by placing more emphasis on increasing territorial resilience.
- Build capacity of weaker municipalities to develop and implement local reconstruction projects, monitor their results, and absorb recovery funding, for example by:
  - Promoting and facilitating national and international peer-to-peer learning initiatives.

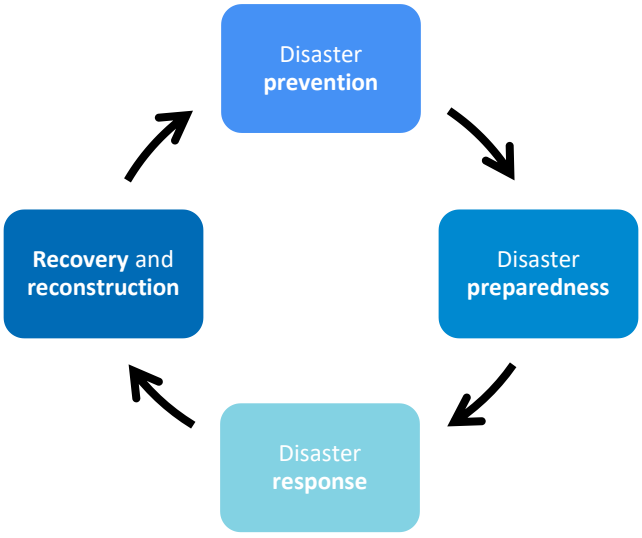
- Encouraging or even temporarily requiring increased cross-jurisdiction co-operation whereby subnational governments share staff and expertise or the provision of services (including contracting out certain services).

- Promote and facilitate the involvement of non-governmental actors in the development, implementation and monitoring of recovery and reconstruction initiatives in the short term, and ensuring increased public participation in decision making processes after the initial reconstruction period.
- Establish mechanisms that allow for the transparent use of recovery funding by subnational governments and strengthening anti-corruption efforts, for example by:
  - Balancing the provision of direct aid to municipalities and aid that is managed by higher levels of government.
  - Supporting municipalities on issues related to local public procurement and transparent decision making, for example by providing targeted training or developing easy-to-use procurement guidelines.
  - Setting up digital platforms that enable governmental and non-governmental actors to track funds and projects.
  - Investing in community-based accountability processes that can be established relatively rapidly (e.g. participatory budgeting, public expenditure tracking and monitoring of public service delivery).
- Invest in subnational government capacity to produce and disseminate publicly accessible, up-to-date information on the results of reconstruction efforts. To prevent overburdening subnational governments, in the short term, they are advised to focus on a limited number of indicators on which they can easily report. If necessary, this list can be gradually expanded as the recovery progresses.

Disaster management and the role of subnational governments

A variety of disaster risk reduction models have been developed to understand better the management of emergencies. The cyclical nature of these models highlights that managing emergencies is an ongoing process that requires continuous effort on the part of governmental and non-governmental stakeholders involved in the process. While the number of stages in the cycle can vary among models, they generally cover the same basic elements: prevention, preparedness, response and recovery (Figure 2.1). While the stages of the cycle can be applied to emergencies as diverse as natural disasters, civil unrest and war, the specific measures related to each situation differ significantly. The following sections will focus on the application of disaster management, recovery and reconstruction in the context of war and draw on examples from Ukraine.

Figure 2.1. Disaster risk reduction life-cycle



Source: Author's elaboration, based on (Australian Council of Social Service, 2015[8]; Federal Emergency Management Agency, 2013[9]; University of Central Florida, 2022[10]; WHO, 2017[11]; Bello, Bustamante and Pizarro, 2021[12]).

Prevention

The first stage of the cycle focuses on disaster prevention. This means identifying potential hazards and their drivers, as well as mapping the populations and infrastructure that are at risk before, during or after an emergency. The relevance of mapping and securing such critical assets is underlined by the Russian Federation's recent use of the Zaporizhzhia nuclear power plant in southern Ukraine as a base for storing and launching weapons, creating significant risk of nuclear pollution (The Wall Street Journal, 2022[13]). In recent years, there have been calls in Ukraine for the development of a state system for the protection of critical infrastructure. If properly embedded in legislation, this would establish criteria for classifying critical infrastructure, as well as clarify the division of tasks and responsibilities for critical infrastructure protection (Ivanenko, 2020[14]).

Prevention measures also include actions to reduce the likelihood that risks will materialise (University of Central Florida, 2022[10]; UNDRR, 2015[15]; Bello, Bustamante and Pizarro, 2021[12]). For example, depending on the context, the organisation of military exercises and investment in (local) defence capabilities might function as deterrents to armed conflict. Although prevention involves putting mechanisms and capacities in place to avoid disaster, it is important to recognise that emergencies cannot always be foreseen or even prevented.

Preparedness

As preventive measures might fail, investing in disaster preparedness is a prerequisite for effectively managing an emergency. It requires administrative and analytical capacity to detect a potential disaster and monitor its development, as well as the ability to design and regularly update strategic response plans. Preparedness primarily encompasses measures being taken before emergencies happen, such as the creation of early warning systems, conducting emergency simulations or creating emergency and evacuation plans (UNDRR, 2015[15]). The creation of territorial emergency plans is particularly relevant as the risks associated with potential disasters, as well as the capacities to effectively respond to shocks, tend to vary across regions.

Effective disaster preparedness requires building the necessary financial and human capacity of the actors involved. Effective horizontal and vertical co-ordination and communication mechanisms must also be set

up. These enable the swift communication of disaster risks and ensure that different governmental and non-governmental actors know what to do and how to respond when a disaster is detected. They can also be used to co-ordinate disaster response and recovery efforts across sectors and jurisdictions (e.g. regions and/or municipalities).

Ukraine offers several examples of disaster preparedness measures. In recent years, it adopted a series of norms (State Standards) for the different stages of disaster management. These deal with, for example, emergency response requirements, as well as information sharing in pre- and post-disaster contexts (Terentieva et al., 2021[16]). In addition, in the months leading up to the 2022 war, Kyiv City created local evacuation commissions to be activated in the case of an attack by the Russian Federation (Zerkalo Nedeli, 2022[17]). In addition, on 1 January 2022, a new law entered into force that clarified the roles and responsibilities of the different levels of government related to territorial defence. The law indicates that *oblast* (region), *rayon* (district) and municipal councils are responsible for supporting the preparation and implementation of tasks involved in national resistance and ensuring adequate funding for territorial defence measures (Verkhovna Rada, 2022[18]). In response, in January and February of 2022, several *oblasts* and municipalities approved programmes to fund such measures (Romanova, 2022[19]). These have facilitated the formation of volunteer (paramilitary) units at the municipal level, thereby complementing the activities of the Armed Forces of Ukraine, and have helped municipalities to resist invasion.

Response

The response stage refers to the efforts of public and non-governmental actors to reduce a disaster's harmful impact when it occurs. During this stage, contingency plans are put into action and the available human and material resources are deployed.

Disaster response activities may require legislative action. For instance, to enable an effective response to the Russian aggression, on 24 February 2022, Ukraine declared martial law, a general mobilisation and a ban on male citizens between the ages of 18 and 60 from leaving the country (President of Ukraine, 2022[20]). It also facilitated the creation of regional, district and municipal military administrations. Following this, complementary legislation was passed to clarify the powers and responsibilities of subnational governments under martial law. For example, subnational authorities were allocated additional powers to transfer funds from local budgets to Ukraine's armed forces and to inspect buildings and structures damaged as a result of the war. Furthermore, the conditions for the creation of local military administrations were clarified. These include potential situations where municipal administrations, or their mayors, fail to execute their constitutional or legislative mandate (Association of Ukrainian Cities, 2022[21]). In late February 2022, the government also eased the criteria for civilians to join the territorial defence forces. As a result, by early April 110 000 civilians had joined territorial defence units across the country and subsequently supported the defence of critical infrastructure (Romanova, 2022[19]).

Given that disasters tend to play out in unexpected ways, responding effectively requires a significant degree of adaptability on the part of the involved stakeholders, as well as for disaster response mechanisms.

Recovery

The recovery phase can be split into different stages. The first involves emergency measures aimed at attending to the affected population, as well as getting the essential physical and economic infrastructure back into operation (Calame, 2005[22]). This means rebuilding the capacity to provide basic services to citizens and normalising production activities (Bello, Bustamante and Pizarro, 2021[12]). For example, in the wake of the 1999 Kosovo war, different international institutions worked together to assess Kosovo's urgent reconstruction needs. Based on this assessment, a variety of international donor conferences were held to raise funds for Kosovo's reconstruction. The needs assessment identified short-term reconstruction priorities, including housing, water and sanitation, energy, telecommunications and economic infrastructure.

The second stage of recovery involves reviewing and upgrading strategic infrastructure and mechanisms to prevent the reoccurrence of the hazard that triggered the disaster, as well as any other threats to which the territory is exposed. It is crucial to learn from current disasters to prevent those risks from reoccurring. An effective recovery response often requires the development of an integrated recovery strategy that identifies short-, mid- and long-term reconstruction priorities and establishes the means of implementation.

Measures related to different stages of the disaster management cycle may have to be implemented in parallel, depending on the type and scale of the disaster. For example, as the war in Ukraine has affected regions and municipalities in vastly different ways and moments in time, in some cities such as Irpin and Bucha, reconstruction efforts are already underway, whereas in others that are still on the frontline, disaster response measures are still required.

Subnational governments play a crucial role in risk management and recovery

Effective disaster management is best achieved with the active participation of all levels of government, as well as civil society organisations, the private sector, local leaders, and individual citizens. The role of subnational governments is particularly noteworthy. As the institutional level closest to citizens, regional—and especially local—governments are often the first to identify an emergency (or predict a potential emergency) and are generally at the forefront of disaster response and recovery efforts. This is exemplified by the actions of Ukrainian municipalities post-24 February 2022, many of which swiftly responded to the changing security environment and needs of their populations, for example by working with volunteers to organise aid for the military and internally displaced people.

The growing recognition of the role of subnational governments with respect to disaster management is illustrated by different mechanisms and guidelines put forth by international organisations. For example, the Sendai Framework for Disaster Risk Reduction 2015-2030 aims for “the substantial reduction of disaster risk and losses” (United Nations, 2015[23]). The Framework recognises the vital role subnational governments play in achieving this goal, explicitly calling for empowering subnational governments through regulatory and financial means to collaborate and co-ordinate with relevant stakeholders in disaster risk management at the local level. For example, the Framework indicates that “while the enabling, guiding and coordinating role of national and federal State Governments remain essential, it is necessary to empower local authorities and local communities to reduce disaster risk, including through resources, incentives and decision making responsibilities, as appropriate” (United Nations, 2015[23]).

The central role subnational governments play in disaster management and recovery is also highlighted in the *OECD Recommendation of the Council on the Governance of Critical Risks* (OECD, 2014[24]). It proposes actions that all levels of governments can take, in collaboration with the private sector and with each other, to better assess, prevent, respond to and recover from emergencies (Box 2.3).

Box 2.3. OECD Recommendation on the Governance of Critical Risks

The *OECD Council Recommendation on the Governance of Critical Risks* recommends that OECD Member (and non-Member) countries should:

- Establish and promote a comprehensive, all-hazards and transboundary approach to country risk governance, to serve as the foundation for enhancing national resilience and responsiveness;
- Build preparedness through foresight analysis, risk assessments and financing frameworks, to better anticipate complex and wide-ranging impacts;
- Raise awareness of critical risks to mobilise households, businesses and international stakeholders and foster investment in risk prevention and mitigation;
- Develop adaptive capacity in crisis management by co-ordinating resources across government, its agencies and broader networks to support timely decision making, communication and emergency responses;
- Demonstrate transparency and accountability in risk-related decision making by incorporating good governance practices and continuously learning from experience and science.

Source: Author's elaboration, based on (OECD, 2014[24]).

Regional and local governments can play an important role in all phases of the disaster management cycle. Their first-hand knowledge of the community's social, economic, infrastructure and environmental needs and assets leaves them ideally placed to detect potential hazards, map physical and economic damage, and identify particular groups that may be at risk in emergency situations. Subnational governments can also build the response capacity of local civil servants and non-governmental stakeholders through education programmes on disaster prevention (UCLG, 2015[25]). Furthermore, they can adopt local disaster risk reduction strategies, and set up multi-actor disaster prevention co-ordination platforms (Malalgoda, Amaratunga and Pathirage, 2010[26]). Such platforms are used to communicate disaster risks and ensure that different governmental and non-governmental actors know what to do when a disaster is detected and how to respond. They can also be used to co-ordinate disaster response and recovery efforts. In addition, subnational governments can organise periodic emergency simulation exercises. Furthermore, as discussed below, they are often called upon to lead the response when an emergency is detected and provide information on urgent local needs to higher levels of government.

Despite the recognised value of subnational governments in supporting disaster management efforts, they often lack the financial and human resources to carry out disaster risk reduction and resilience-building actions (Malalgoda, Amaratunga and Pathirage, 2010[26]). In addition, regional and local governments often face challenges related to effective co-ordination and communication with other levels of government and with non-governmental actors. In this regard, the multi-level governance arrangements that are in place are crucial because they set subnational government mandates, support their ability to act, and provide the necessary resources and mechanisms to carry out tasks—all essential elements in assessing the ability of subnational governments to support disaster management.

Adaptable multi-level governance arrangements for effective disaster management and recovery

This section reflects on the pros and cons of adopting a decentralised approach to disaster management, recovery and reconstruction. It addresses the value of adaptable co-ordination and communication

mechanisms, and discusses the benefits of adopting a place-based approach to disaster management. This is followed by a discussion of how and under what conditions the clear assignment of responsibilities among and across levels of government can help governments prepare for, respond to and recover from emergencies.

The trade-offs between decentralisation and centralisation for disaster management

Several arguments can be made in favour of adopting a decentralised approach to disaster risk management. For example, the strong understanding that regional and local governments have of local contexts and vulnerabilities can help them prepare for the specific types of natural or man-made disasters that could occur in their territory. In addition, as disasters may occur unexpectedly, subnational governments are, in principle, well-positioned to detect emergencies and mount an immediate response (Bae, Joo and Won, 2016[27]). Furthermore, in a recovery and reconstruction scenario, a decentralised approach may better support the provision of emergency relief that is tailored to local needs. Finally, it can also facilitate innovation, as disaster management and recovery measures can be tested quickly and scaled-up if successful (Hermansson, 2018[28]; OECD, 2021[29]).

There are, however, also arguments in favour of a more centralised approach to disaster management. For instance, it can enable political control and reduce short-term co-ordination costs through top-down decision making. Moreover, decentralisation can generate a more fragmented government response to disaster, undermining its effectiveness. The decentralisation of disaster management can also lead to more complex accountability systems, creating opportunities for different levels of government to avoid taking responsibility or shifting blame when faced with public criticism (Hermansson, 2018[28]). Furthermore, and particularly in the case of mega-disasters, subnational governments may not have the necessary human and material resources to mount an effective response (Bae, Joo and Won, 2016[27]). The United States (US) Army Corps of Engineers offers one such example. In the US, emergency preparedness and response are primarily state and local responsibilities. However, when the scale of a disaster exceeds subnational capabilities, the Army Corps of Engineers can provide state and local governments with technical advice, engineering services and emergency contracting support (Center for Homeland Defense Security, n.d.[30]).

There is limited evidence of clear links between a country's degree of political, administrative or fiscal decentralisation and the quality of its disaster management and recovery efforts. Ultimately, it depends on the type and scale of emergency, the quality of the multi-level governance system and decentralisation design, including the clear assignment of responsibilities across and among levels of governments and the extent to which the involved levels of government have adequate human and financial resources to fulfil their mandate (Hermansson, 2018[28]; OECD, 2021[29]). Moreover, it depends on whether disaster management follows a place-based approach, if there is effective co-ordination and communication among actors (Box 2.4) (Bae, Joo and Won, 2016[27]).

Box 2.4. Effective disaster management requires a place-based approach

Whether man-made or natural, crises tend to have territorially differentiated causes and effects. As such, disaster management and recovery efforts can benefit from a place-based approach.

A place-based approach assumes that a territory's social, economic, environmental and institutional characteristics matter. It also presupposes that the involvement of subnational actors is important, whether solely to identify and articulate local needs and priorities or also to implement specific actions.

A place-based approach to disaster management and recovery refers to a set of measures and actions that are adapted to the most pressing territorial needs and the preparedness of specific local actors. This approach can be applied to all stages of the disaster management cycle, from the design of local early-warning systems and establishment of local co-ordination bodies, to the development and implementation of territorial disaster management plans and recovery strategies.

There is evidence that at the local level, in the wake of violent conflict and emergencies, the capacities to contribute to reconstruction and recovery are higher than at higher levels of government. For example, a World Bank report on aid programmes in fragile countries found that place-based approaches can produce constructive results if their design is based on: (1) an assessment of local characteristics and local stakeholder consultation, and (2) if the implementation is flexible and allows local input to be considered. For example, in the 1990s, the Sheila Programme was created to support Cambodia's post-conflict recovery. The programme channelled funds through provincial governments to finance small infrastructure projects that were designed with input from residents. A crucial element of the programme's success was a willingness of the programme's managing authorities to make regular adjustments based on the needs and concerns of different (local) stakeholders.

Source: Author's elaboration, based on (Barca, McCann and Rodríguez-Pose, 2012[31]; UNDP, 2008[32]; World Bank, 2007[33]).

The scale of destruction in Ukraine, which differs across regions and municipalities, means that a mix of both the centralised and decentralised approaches may be needed. In large swaths of the country, regional and municipal governance structures still function relatively well and allow local self-governments to continue to provide basic services to citizens, despite the severely strained conditions. In such places, a decentralised approach can support the design and implementation of recovery efforts that are tailored to local needs. Such an approach can also be beneficial for mobilising the contribution of local communities and testing innovative local recovery measures. At the same time, there are many municipalities where most infrastructure has been destroyed, a large part of the population displaced and municipal government severely weakened or missing altogether. In such instances, a more centralised approach to disaster management and recovery may be necessary if local human, material and financial resources are inadequate to mount an effective response.

Good co-ordination and communication reduce the risk of disaster management failures

Disasters often transcend local, regional or even national boundaries. Therefore, effective risk management at the subnational level is dependent upon multi-level and cross-jurisdiction co-ordination and collaboration (Wilkinson, Comba and Peters, 2014[34]). Due to their multi-dimensional effects, emergencies, whether caused by an armed conflict or a natural disaster, cannot be addressed by a single sector (e.g. defence, healthcare). Instead, they require a horizontally-integrated response. Such a response could involve, for example, the ministries in charge of economic development (to provide financial relief and recovery measures), social services (to reinforce social safety nets), as well as institutions

responsible for public safety and security (to effectively respond to violence, enforce public order or provide logistical support) (Bello, Bustamante and Pizarro, 2021[12]).

The importance of striking a balance among diverse forms of co-ordination

A co-ordinated response among and across levels of government can minimise disaster management failures. There are different forms of co-ordination that can be used, ranging from centralised command structures to more or flexible multi-actor networks. The main risk of non-coordinated action in a disaster situation is to "pass the buck" to other levels of government, which can result in a disjointed response and generate collective risk. For example, there may be limited incentives for cross-jurisdiction co-operation (e.g. sharing equipment, skilled personnel, etc.) if supporting a neighbouring municipality may undermine one's own ability to adequately respond to a disaster situation (OECD, 2014[24]; OECD, 2021[29]).

In the face of a disaster, co-ordination arrangements need to respond to different needs. For instance, there is often a demand for solid leadership and central direction, clearly defined responsibilities and well-established chains of command through hierarchical structures (Christensen et al., 2015[35]). A good example of this comes from Ukraine. Early in February 2022, the country's central military command, together with representatives of national and subnational governments, participated in a meeting of the Congress of Regional and Local Authorities in which the head of the armed forces presented how local governments could contribute to the country's territorial defence in case of an emergency (Romanova, 2022[19]).

Networks for disaster management have become another important tool in the response to complex crises and necessitate the engagement of multiple stakeholders (Kapucu and Garayev, 2016[36]). For example, co-ordination networks can be particularly helpful when many national and international development organisations and civil society actors are implementing disaster response and recovery actions.

While centralised and networked approaches to disaster co-ordination each have their advantages, sometimes they are not effective. This can happen, for example, when hierarchal structures do not allow bottom-up learning to take place or take a predominantly sectoral approach to managing a multi-dimensional disaster. Likewise, without careful design and commitment from the involved stakeholders, flexible network arrangements might not be effective (Christensen et al., 2015[35]). For instance, in the wake of 2011 Great East Japan Earthquake, there were few co-ordination mechanisms in operation to leverage the support provided by the networks of non-governmental organisations, undermining the effectiveness of their efforts (Ranghieri and Ishiwatari, 2014[37]).

A key question for policy makers is how to set up disaster management co-ordination mechanisms that strike a balance between organisational stability, specialisation, and rapid response, while allowing for adaptation in the face of changing circumstances. The answer to this question should be based on a close assessment of a country's multi-level governance arrangements. For example, the more decentralised the country, the greater the need may be to establish vertical co-ordination platforms to minimise the risk of a fragmented policy response. In this regard, associations of subnational governments can play a fundamental role in facilitating vertical co-ordination and communication efforts—by disseminating information, identifying and sharing solutions, and supporting the implementation of emergency measures by their members (OECD, 2021[29]). In Ukraine, for example, the different associations of local governments contributed to the development of legislation on the tasks and responsibilities of municipalities under martial law, thereby addressing the needs of their members. They have also organised meetings with national and international partners to mobilise support for Ukrainian municipalities.

The question of how to set up disaster management co-ordination mechanisms depends on the scale and type of disaster that a government faces. For example, vertical co-ordination may be particularly valuable in situations where the impacts of a shock are considered of national importance and where regions may be affected in similar ways. For shocks that affect a small number of regions, a more decentralised approach may be beneficial as it enables the implementation of more tailored solutions and may facilitate

a swift response. Due to the scale of the destruction caused by the war in Ukraine, as well as its territorially differentiated impact on regions and cities, the work of national co-ordinating bodies may be complemented by more flexible networks at the regional and municipal levels. Such networks can pool expertise from governmental and non-governmental actors to address specific local challenges, be they military, humanitarian, economic or environmental.

Depending on the type of disaster and its territorial impact, cross-jurisdiction co-ordination mechanisms can also be established. For example, in the wake of hurricane Andrew, several southern US states created a mutual aid system to facilitate the sharing of resources (Box 2.5). Similarly, in Ukraine, *oblasts* located farther from the frontline have provided humanitarian aid to *oblasts* more affected by the war. They have also facilitated the evacuation of citizens (PROSTO, 2022[38]).

Box 2.5. United States Emergency Management Assistance Compact

The Emergency Management Assistance Compact (EMAC) was originally designed as a mechanism that states could use to quickly provide material and human resources in response to the early stages of a disaster. Later, the compact was expanded into a nationwide, state-to-state mutual aid agreement that has facilitated inter- and intra-state support for disaster management and recovery.

During governor-declared states of emergency, whether man-made or natural, the Compact offers assistance through a system that allows state governments to send staff and equipment to support the disaster response and recovery efforts of other states. Deployments are co-ordinated with the federal response to avoid duplication of efforts.

The strength of EMAC lies in its relationship with federal agencies, national organisations and subnational authorities. At the same time, success depends on the familiarity of subnational governments with the system and how prepared they are to provide designated personnel and other resources.

Source: Author's elaboration, based on (Waugh, 2007[39]; EMAC, 2022[40]).

Clear co-ordination and communication among all parties is fundamental

In the context of disaster management and recovery, co-ordination across and among levels of government, and co-ordination with non-governmental actors is equally important. Often the scope of crises goes beyond a government's ability to cope with the disaster on its own. For example, citizens might be required to comply with emergency measures such as evacuation or shelter-in-place orders. Likewise, businesses can be called upon to produce supplies deemed necessary for managing a disaster and recovery, as per the example of United States Defense Production Act (Federal Emergency Management Agency, 2021[41]). Consequently, public-sector disaster management efforts should be co-ordinated with businesses, civil society organisations and individual citizens.

Involving governmental and non-governmental actors in the development of disaster management plans and organising communication campaigns about emergency prevention and control can help mobilise diverse actors quickly to meet disaster-induced challenges. Furthermore, organising disaster simulation exercises can provide insight into the effectiveness and efficiency of the different types of co-ordination mechanisms, build understanding of the responsibilities of the relevant stakeholders involved, and test lines of communication.

Effective disaster communication depends on the relationships among all levels of government and with the public and private sectors. It means communicating early, clearly, regularly and with a coherent message. Stakeholders need to know what is happening, what is expected of them, and feel reassured

that they are being supported during an uncertain and difficult period (OECD, 2021[29]). This can be particularly challenging as different actors may push opposing narratives about the disaster, its causes and development, such as in the case of the Russian aggression against Ukraine. In addition, the evolving nature of a disaster means that messaging may have to be adjusted to match new realities or/and understanding of the emergency. This challenges the ability of governments at all levels to be consistent and may give the impression that communication is incoherent. Furthermore, social media has become a key communication tool during disasters. Its widespread use, however, raises particular challenges, for example regarding the ability of governments and citizens to cope with a vast amount of information and to determine its credibility.

Clear assignment of responsibilities can facilitate disaster management

An effective emergency response depends on the clear assignment of responsibilities among levels of government. However, determining the appropriate level at which public tasks and responsibilities ought to be carried out is complex and depends on different elements. These include the availability of human and financial resources, as well as oversight mechanisms. The latter can include formal audits of disaster response and recovery efforts, as well as more bottom-up strategies, such as social audits, public expenditure tracking and monitoring by citizens.

For many countries, responsibilities are not clearly assigned among levels of government. This may generate major obstacles to ensuring overall efficiency and local political accountability. A lack of clarity may stem from poorly-defined policy areas, as well as the fact that functional responsibilities (e.g. tasks related to planning, funding, implementation, oversight and control) are not clearly defined or are inconsistent (Allain-Dupré, 2018[42]). An unclear allocation of responsibilities and tasks is particularly notable in policy areas that are the most “shared” among levels of government, such as education, healthcare and infrastructure management (Allain-Dupré, 2018[42]). This can undermine the effective delivery of public services and accountability as actors may avoid taking responsibility by “passing the buck” to other levels of government. These challenges are especially problematic in the context of a disaster, which requires swift, co-ordinated and decisive action, as well as clear communication and accountability structures.

Improving the legislative and regulatory framework is a basic step in deploying subnational governments in disaster response (Yilmaz and Boex, 2021[43]), which “allows multi-agency, multi-sectoral response actions by identifying mutual and dynamic tasks rather than individual and static roles” (Yilmaz and Boex, 2021[43]). The legal and regulatory framework developed by Colombia (Box 2.6) can serve as an example of how to improve legislation and regulation supporting disaster management and recovery. This example is particularly instructive as the renewed framework enables complementary high-level and decentralised co-ordination bodies to be established.

Box 2.6. Legal and regulatory framework for improved disaster management in Colombia

In 2012, the Government of Colombia adopted the National Policy on Disaster Risk Management and established a corresponding National System for Disaster Risk Management (NSDRM). Among other elements, the policy defines the oversight and co-ordination bodies and mechanisms for the NSDRM, as well as their role and responsibilities.

The legal and regulatory framework facilitates high-level oversight through the National Council on Risk Management, the members of which include the President, as well as line ministers. It also calls for decentralised co-ordination through provincial, district and municipal Disaster Risk Management Councils, which are tasked with disaster risk management within their respective territorial jurisdictions. While these councils are normally composed of the governor or mayor and representatives of their administrations, depending on the disaster, experts, representatives of civil society associations or universities can be invited to participate in the meetings to discuss issues relevant to risk management. This gives the subnational councils the flexibility to engage with multiple public and non-governmental stakeholders.

Source: Author's elaboration, based on (The Congress of Colombia, 2012[44]; UNDP, 2020[45]).

A lack of clarity in the assignment of responsibilities is often accompanied by resource deficits. In some instances, there may be insufficient guidance for allocating revenues, identifying spending requirements, or building capacity. In other instances, even when subnational government responsibilities are clearly defined, the human and financial resources that would be a prerequisite to successfully carrying out their tasks might not be available (Garschagen, 2016[46]). Across OECD member countries, there are myriad examples of unfunded or underfunded mandates where subnational governments have the responsibility to provide services or manage policies but lack the much-needed financial resources (OECD, 2019[47]). For example, in the wake of devastating earthquakes in 1999, the Republic of Türkiye gave governors and municipal authorities more responsibilities to manage crises. However, this was not accompanied by an investment in upskilling subnational staff or a significant increase in subnational revenues, undermining the effectiveness of the disaster management reforms (Hermansson, 2018[28]).

The importance of a clear assignment of responsibilities among levels of government, and the provision of adequate (recovery) funding are highlighted by the results of a 2020 survey of 300 subnational governments, conducted by the OECD and the Committee of the Regions (CoR) during the early months of the COVID-19 pandemic. Seventy-five percent of respondents indicated that funding was one of the most helpful levers for addressing the next crisis (OECD-CoR, 2020[48]). In addition, national government support was considered particularly welcome in relation to clearly establishing roles and responsibilities among levels of government (58%) (OECD-CoR, 2020[48]).

Moreover, as recovery may be funded through different sources, for example inter-governmental transfers, national and subnational taxes, international aid, private sector financing and community contributions, etc., governments should establish mechanisms for tracking both official and private funds. This can build confidence among donors and citizens alike in how disaster management and recovery funding and financing is managed and can help mobilise additional funds (World Bank, 2015[49]). The website recovery.org, which was established in the wake of the 2008 global financial crisis as part of the 2009 American Recovery and Reinvestment Act, serves as an example. It enabled the public to track the spending of funding that was awarded as part of the federal stimulus package (OECD, 2020[50]).

To assess and improve the effectiveness of the assignment of responsibilities for disaster management, policy makers could consider applying a subsidiarity framework (Melo Zurita et al., 2015[51]). This is based

on the principle that tasks and responsibilities should be allocated to the lowest competent authority (Box 2.7).

Box 2.7. Subsidiarity framework for assigning responsibilities among levels of government

The subsidiarity framework centres on four basic questions whose responses can help policy makers determine whether tasks and responsibilities can or should be effectively assigned to subnational governments. They also enable the authorities to identify what measures need to be taken to ensure that the necessary mechanisms and resources are in place to allow the subnational governments to adequately execute their mandate.

1. **Is there an area of shared competence?** Answering this question facilitates the mapping of possible overlapping responsibilities and functions.
2. **Is there a need to act in concert?** The answer to this question will depend on the nature and territorial scope of the disaster, among other elements. For example, cross-jurisdictional or cross-border co-operation might be necessary.
3. **Is the task execution feasible?** It could be that a particular level of government does not possess the administrative, financial or material resources or even the constitutional mandate to effectively implement specific disaster management and recovery tasks. If so, responsibilities may have to be allocated to a higher level.
4. **Are mechanisms in place to ensure the transparent and accountable execution of tasks and responsibilities?** By answering this question authorities can identify whether oversight mechanisms are in place or could be set up to ensure that the relevant levels of government can be held accountable. If this is not the case, the assignment of disaster management and recovery functions might create the risk of misallocation of funds or the abuse of disaster management powers.

Source: Author's elaboration, based on (Melo Zurita et al., 2015[51]).

Clarity in the assignment of responsibilities in fields that are not exclusively related to disaster management is also vital as it may facilitate the rebuilding of key infrastructure in the wake of a disaster. For example, the reconstruction of roads, broadband networks or water systems can be problematic if different levels of government are not sure about the scope and limitations of their responsibilities (World Bank, 2015[49]). This is one of the challenges that Ukraine will have to address when mounting a comprehensive recovery and reconstruction strategy that focuses on immediate humanitarian needs, as well as on rebuilding local economies, infrastructure and service delivery.

Already prior to the 2022 aggression by Russia, the assignment of responsibilities among levels of government in Ukraine required clarification in several sectors. Responses to a 2021 OECD survey of Ukrainian municipalities[1] indicated that the areas in which surveyed municipalities reported least clarity with respect to responsibilities are public transport and roads, support to small and medium-sized enterprises (SMEs), and energy (OECD, 2021[52]). This is borne out by current legislation, which, for example, does not clearly stipulate which level of subnational government is in charge of funding and undertaking the construction and maintenance of local roads. Indeed different laws assign the responsibility to *oblasts, rayons* or municipalities (Verkhovna Rada, 2021[53]; Verkhovna Rada, 2021[54]; Verkhovna Rada, 2021[55]). In the context of post-war reconstruction, this could hamper Ukraine's swift reconstruction of critical road infrastructure, unless the government opts for a fully centralised approach to road construction and maintenance, which might not take sufficient account of local needs and capacities.

The pre-war challenges related to the lack of clarity in the division of tasks and responsibilities among levels of government and the availability of funding to carry out their legal mandate are compounded by the war itself. While the fiscal capacity of all subnational governments has weakened, some frontline municipalities also face an important reduction in staff, as civil servants may have fled or joined the war effort. In other municipalities, the service delivery demands have increased drastically due to the influx of internally displaced people. Thus, while some subnational governments are still able to carry out most administrative and service delivery tasks, others are not. To address this challenge, the government could request that *oblasts*, *rayons* and municipalities indicate whether they can (temporarily) carry out specific functions. Based on this information, the national government could, for example, encourage or even temporarily require increased cross-jurisdiction co-operation whereby subnational governments share staff and expertise or service provision (including contracting out certain tasks).

Applying a place-based approach to support post-war recovery in Ukraine

Drawing on lessons from the recent reconstruction experiences of countries such as Afghanistan or Iraq can be problematic. The nature of their conflicts, the level of ethnic divisions within the countries, and the relative strength of their governance structures going into and coming out of the war were highly different from those of Ukraine. Given this, the experience of the post-1945 recovery of Western European states may hold more relevance for Ukraine. For example, Ukraine's technical and institutional capacity is more comparable to that of post-World War II Western Europe than that of many countries that have received post-war recovery and reconstruction support in recent decades (Centre for Economic Policy Research, 2022[56]). In addition, just as the Marshall Plan provided an impetus for regional economic integration, industrialisation and building confidence about the future of post-World War II Europe, a national recovery plan for Ukraine could contribute to the necessary conditions for EU integration. For example, reconstruction support could help the country further align its legislative and regulatory environment with EU standards, as well as facilitate peer-to-peer learning trajectories with EU member countries. Accession to the EU is one of the main aims of the National Council for the Reconstruction of Ukraine, and an important step was taken in June 2022 when Ukraine was granted EU candidate status.

How and when Russia's invasion of Ukraine might end is, of course, not yet clear. Ukrainian and international policy makers have already taken a series of important steps towards post-war recovery. In April 2022, the Government of Ukraine established the National Council for the Reconstruction of Ukraine, which is responsible for devising a national recovery plan. During the Ukraine Recovery Conference in Lugano, Switzerland, the draft recovery plan for Ukraine was presented by the Prime Minister, and the Lugano Declaration, highlighting principles for the recovery process, was agreed by most of the participants (Box 2.8).

Box 2.8. Draft national recovery plan and the Lugano Declaration

A draft national recovery plan

An early draft plan for post-war recovery prepared by the Government of Ukraine identifies 15 strategic areas of recovery intervention, including EU integration, strengthening the business environment, energy independence, and modernising regions among others. Strengthening institutional capacity is considered a pre-requisite for the successful implementation of the plan. To this effect, the draft plan identifies several priority initiatives such as improving access to digital registers to strengthen transparency and accountability; finalising the anti-corruption system reforms; digitalising public service delivery; and professionalising the public service. To implement the draft plan, the government estimates it needs USD 750 billion (375% of Ukraine's GDP in 2021), of which two-thirds would have to be provided by international partners.

Lugano Declaration

During the Ukraine Recovery Conference 2022, the EU outlined plans for the development of the Ukraine Reconstruction Platform co-led by the EU and Ukraine to monitor progress towards recovery and support donor co-ordination. The Government of Ukraine also presented a Ukraine-led recovery platform. In addition, over 40 countries and several international organisations, including the OECD, agreed on seven principles for the recovery process, forming the Lugano Declaration:

1. **Partnership.** The recovery process is led and driven by Ukraine and conducted in partnership with its international partners.
2. **Reform focus.** The recovery process has to contribute to accelerating, deepening, broadening and achieving Ukraine's reform efforts and resilience, in line with Ukraine's European path.
3. **Transparency, accountability and rule of law**. The recovery process has to be transparent and accountable to the people of Ukraine.
4. **Multi-stakeholder engagement.** The recovery process has to facilitate collaboration between national and international actors, including from the private sector, civil society, academia and local government.
5. **Democratic participation.** The recovery process has to be a whole-of-society effort, rooted in democratic participation, local self-governance and effective decentralisation.
6. **Gender equality and inclusion**. The recovery process has to be inclusive and ensure gender equality and respect for human rights, including economic, social and cultural rights.
7. **Sustainability**. The recovery process has to rebuild Ukraine in a sustainable manner.

Source: Author's elaboration, based on (Ukraine Recovery Conference, 2022[57]; National Recovery Council, 2022[58]).

With so much of the country's physical and human capital having been destroyed, adopting a disaster management framework and implementing it in a place-based manner can help Ukraine plan for and implement recovery and reconstruction measures. Even though the causes of the destruction of livelihoods and infrastructure differ per disaster, disasters share the same management principle: designing and implementing a long-term, integrated recovery and reconstruction strategy and bolstering resilience, rather than merely rebuilding the damaged infrastructure. The OECD's eight guiding recommendations for building resilient regions after a natural disaster (Box 2.9) can be a useful input as the National Council for the Reconstruction of Ukraine advances with the design and implementation of a long-term national recovery plan.

Box 2.9. Guiding recommendations for building resilient regions after a natural disaster

In the wake of the 2009 earthquake that struck a wide area of Italy, with the city of L'Aquila at its epicentre, the OECD assisted the Italian government in designing a long-term strategy to re-launch the economy of the Abruzzo region. Drawing on this collaboration, as well as experiences from other OECD regions where natural disasters had prompted the rethinking of development models, the OECD formulated eight policy recommendations for building resilient regions after a disaster.

1. **Ensure that short-term decisions do not constrain long-term options.** Recovery efforts should be integrated into a coherent strategy of economic and social development focused on the long-term economic potential and job creation of the affected areas.
2. **Identify the economic base and the socio-economic drivers specific to the region to increase its resilience.** Since recovery may take time, it is essential to identify the actions with the greatest potential for rapid impact on the economy and society. Finally, sequencing priorities will help to provide a feasible timeline for recovery and give early success signals to create endorsement and ownership.
3. **Develop an integrated strategy for redevelopment after a disaster by strengthening the dialogue among stakeholders to raise the profile of needed reforms and quality of decisions.** Co-operation among public-private actors and different levels of government is needed, as bearing the social cost of a disaster goes beyond the financial and organisational capacity of the affected region.
4. **Strategic choices should be locally led.** While the required resources, whether financial, organisational, or of capacity, cannot be entirely devolved to local institutions, the strategic choices for the development of the region and the policy instruments to implement that development should be locally led.
5. **Use the occasion of a disaster to introduce reforms or standards for the country**. Because national resources and capacity play a role in defining the development strategy for post-disaster regions, once the disaster is over, standards beneficial for the entire country in case of future shocks should be drawn.
6. **Foster public participation to help decision making**. Disasters undermine not only physical capital but also the social and cultural fabric of territories. Therefore, recovery strategies should understand and reflect a community's vision.
7. **Make public deliberation a regular component of the regional development strategy.** Subnational governments are advised to identify physical and online spaces for community deliberation as well as to organise institutional meetings to discuss progress, and to ensure that the opinions expressed have an effective influence on decision making related to the recovery.
8. **Build trust, increase accountability of policy-making and improve capacity of administrations**. The accessibility, quality and disclosure of information on reconstruction expenditures, criteria and timelines are fundamental to build trust in the recovery. This should be paired with investment in skills and funds to set up public performance monitoring systems.

Source: Author's elaboration, based on (OECD, 2013[59]).

National and local policy makers can also use the *resilience systems analysis* tool developed by the OECD to help governments identify and integrate risk and resilience into their strategies and programme planning (OECD, 2014[60]). This tool can help national and local governments increase resilience by building three capacities (OECD, 2014[60]; UN-ADB-UNDP, 2018[61]):

1. **Absorptive capacity**: the ability of a system to prepare for or prevent shocks, and/or cope with their negative impact.
2. **Adaptive capacity**: the ability of human systems to adapt in response to multiple, long-term and/or future risks. It also refers to the ability to learn from and adjust after a disaster materialises.
3. **Transformative capacity**: the ability to take deliberate steps to change existing human systems so that (potential) shocks will no longer have any impact.

Addressing persistent challenges and building on existing assets using a place-based approach

Taking a place-based approach to disaster management and recovery could help Ukraine overcome territorial development challenges that existed prior to the war, while also supporting territorially differentiated reconstruction needs. Adopting such an approach is particularly important as the war has affected regions and municipalities in vastly different ways, with some communities being destroyed, while others continue delivering basic services and have governance structures that remain largely intact. Furthermore, taking a place-based approach would allow Ukraine to tailor recovery measures to the capacity of subnational authorities and non-governmental actors, which differs from place to place. Ukraine could support this effort by building on the successes of its regional development and decentralisation reforms introduced in 2014.

Post-disaster reconstruction can provide an opportunity to overcome pre-existing development challenges

Short-term reconstruction decisions will affect the options available for long-term sustainable and equitable development. Thus, recovery efforts should be integrated into a coherent strategy of socio-economic development focused on the long-term economic potential and job creation of all affected territories and sectors, as well as the well-being of their citizens. In doing so, policy makers should pay close attention to the national and territorial socio-economic development trends and governance challenges in Ukraine prior to the 2022 aggression by the Russian Federation, and how they may have shifted or exacerbated by the war.

Ensuring that recovery efforts meet specific regional and local needs requires strengthening subnational government capacity to absorb financial aid. It also depends on boosting their ability to adequately mobilise the material and financial contribution of non-governmental actors. Finally, as in many post-conflict and post-disaster situations, once the emergency subsides, more ambitious reforms can be explored, including a revised longer-term regional development strategy. This is particularly important as Ukraine considers the economic, institutional and governance reforms that are necessary to advance towards EU membership.

Post-war reconstruction can create the conditions to improve on the past by introducing radical reforms, for example, or possibly even skipping certain policy or development stages entirely (OECD, 2009[62]). The recovery strategy developed by Puerto Rico after it was hit by hurricanes Irma and Maria in 2017 is a relevant example of a planning document that takes into account the damage caused by a disaster, as well as pre-existing conditions, while also articulating a vision for future development (Box 2.10).

Box 2.10. Puerto Rico's reconstruction strategy

In the aftermath of the 2017 hurricanes that devastated Puerto Rico, causing widespread destruction to homes, lives and critical infrastructure, its government developed an economic and disaster recovery plan. Despite the vast differences in terms of landmass and population, and the type of disasters that hit both countries, the recovery efforts of Puerto Rico may hold relevant lessons for Ukraine.

Similar to Ukraine, Puerto Rico was faced with depopulation, which was undermining economic growth. In response, Puerto Rico's recovery strategy placed particular emphasis on rebuilding a strong and competitive economy to which migrants who had left the island prior to or in the wake of the disaster would want to return.

The recovery plan, which was developed with input from municipal governments, as well as non-governmental actors, among others, was cast as an opportunity to transform the island by implementing solutions that were forward-looking and could revitalise growth. Its main objective was to: "build the new Puerto Rico to meet the current and future needs of the people through sustainable economic development and social transformation; transparent and innovative approaches to governance; resilient, modern, and state-of-the-art infrastructure; and a safe, educated, healthy, and sustainable society."

The plan differentiated between needs and priorities in the short (1–2 years), medium and long term (3-11 years). Short-term priorities included re-establishing the delivery of key public services and infrastructure (e.g. water, transportation, electricity) and rebuilding homes. Longer-term objectives included stemming the flow of outgoing migration by lowering the costs of doing business, stimulating formal employment, and broadening the tax base. The plan also incorporated actions for upgrading the island's workforce, stimulating increased digitalisation and expanding opportunities for entrepreneurship.

The estimated cost of implementing the recovery plan was USD 139 billion, equivalent to 138% of the island's GDP in 2018, the year the recovery plan was presented. By 2021, USD 63 billion had been allocated for disaster relief and reconstruction activities, of which USD 18 billion was actually spent.

Source: Author's elaboration, based on (World Bank, 2022[63]; Government of Puerto Rico, 2018[64]; CSIS, 2022[65]; CNE, 2021[66]).

The shocks induced by the war can be a catalyst to break historic paths for regions that were previously struggling. For example, most regions in Ukraine were dealing with declining populations and labour forces (see Chapter 3). In addition, the national economy was increasingly reliant on Kyiv City and Kyiv *Oblast*, with other regions failing to catch up. There were also vast regional differences in labour informality. While in 2020, almost half of the total workforce of Chernivtsi *Oblast* and Rivne *Oblast* was informally employed, in other *oblasts*, it was only 10% (CabMin, 2021[67]). In its efforts to regenerate its economy and rebuild communities, Ukraine, supported by its international partners, could design specific programmes that seek to address such challenges. For example, enhanced access to (international) funding and financing could help to reduce labour informality. It could also target investment in the digitalisation of services and the creation of one-stop-shops to increase the access of informal workers to public resources (e.g. information on business registration and funding for start-ups, social security benefits, etc.).

There is evidence to suggest that the pre-existing strengths and challenges of subnational governments are often amplified in the course of recovery efforts. For example, cities that were growing at a rapid pace before suffering vast damage caused by war tend to recover quickly. Conversely, cities whose development was stagnant or declining prior to war may even witness an acceleration of their decline (Calame, 2005[22]). As such, Ukraine's territorial economic and well-being trends, as well as governance

strengths and challenges, should be taken into consideration when developing recovery and reconstruction plans that seek to rebuild critical infrastructure and increase territorial resilience.

Consideration should also be given to ensuring that the country's territorial-administrative structure is functional for the post-war period. As Ukraine advances with the design and implementation of a national recovery plan, it may be opportune to address the inconsistencies that exist between the Constitution and legislation related to the territorial-administrative organisation of power. Key issues to be resolved include finding a new role for the *rayon* level of government, which has seen its local-level responsibilities and funding hollowed out as a result of the amalgamation and decentralisation reforms; strengthening the implementation capacity of *oblasts*; and establishing adequate oversight mechanisms among levels of government (e.g. through the introduction of prefectures) (see Chapter 4).

At the same time, policy makers should be aware that public goodwill and the hope that often marks the first years of reconstruction tend to be short-lived (USAID, 2022[68]). Analysis from different post-war settings shows that in most countries, people become frustrated and lose trust in the reconstruction process within three to six years. After a devastating conflict, people want to regain the standard of living that they were used to, as soon as possible, and are impatient for more ambitious reforms to bear fruit (Galtung, 2008[69]). This means that the government, supported by international partners, will have to clearly sequence recovery efforts and make sure that in the short term the delivery of basic services is restored, housing is provided and local economies are kick-started. Achieving progress in these areas quickly can sustain trust in government and donors and generate buy-in for more ambitious reforms.

A national recovery plan should build on territorially differentiated needs and assets

Since the war began, many countries and international organisations have provided financial and in-kind support to help Ukraine continue its military operations, provide humanitarian relief, pay salaries to civil servants and ensure the ongoing delivery of services, such as healthcare, drinking water and electricity. Significant financial and technical support, whether from national governments, international organisations or private sources (e.g. private foundations and diaspora) will likely be mobilised to fund and finance Ukraine's reconstruction. This is exemplified by the results of the Ukraine Recovery Conference in Lugano, during which multilateral development banks, including the European Investment Bank, announced the creation of different multi-donor trust funds (European Union, 2022[70]).

In line with the principles of the Lugano Declaration (Box 2.8), recovery objectives—as well as funding and financing provided by the international community—should reflect national priorities. However, they should also be tailored to meet territorially differentiated needs (Box 2.11) and local absorption capacities.

Box 2.11. The differentiated needs of Ukrainian municipalities during wartime

To understand how the war has affected Ukrainian municipalities, different categories can be identified:

- **Municipalities located behind the frontline** with a relatively undamaged physical infrastructure that have been able to continue providing basic services, such as education, healthcare, water and electricity. Many have seen a large inflow of internally displaced people who are in need of housing, food and other necessities.
- **Municipalities on the frontline** that continue to contend with the destruction of homes, lives and critical infrastructure and whose delivery of basic services has been severely affected. Municipalities in this category often face human resource challenges, as key staff may have joined the military, fled, been injured or killed.
- **Municipalities that were occupied by Russia but have been liberated**. These municipalities face particular challenges such as rehabilitating damaged homes and civilian infrastructure, managing the slow return of civilians who fled the violence, as well as managing any adverse effects of the occupation on social cohesion. The possible presence of landmines creates a particularly acute security risk. In addition, the demand for mental health services may be particularly high in these municipalities.
- **Besieged municipalities** face severe security challenges. Such municipalities may be cut off from outside support and food, fuel, water and medicine might be in very short supply. Often many residents, including local civil servants, have either joined the military or fled to safer places. In addition, some besieged municipalities have been unable to maintain regular contact with the *oblast* administration, leaving them to manage the crisis autonomously.
- **Temporarily occupied municipalities** in which the official governing structures are either absent or have been replaced by the occupying force. There tends to be limited information about the specific humanitarian needs. However, needs are likely related to the destruction of homes, lives and critical infrastructure, interruptions in the delivery of basic services, human resource shortages stemming from mass flight of the local population to other parts of Ukraine or to other countries. Moreover, citizens in these municipalities are likely to have significant mental health needs.

Source: Author's elaboration, based on (PROSTO, 2022[38]).

Already prior to the war, the fiscal and human resource capacity of different types of municipalities to carry out their mandate varied significantly (see Chapters 4 and 5). For example, responses to the 2021 OECD survey of Ukrainian municipalities showed that 83% of the 741 responding urban municipalities considered that they had the necessary human resources to carry out their tasks. For settlement and rural municipalities[2] this was 73% and 62% respectively (OECD, 2021[52]). This may give some indication of their ability to absorb investment funding. However, effectively managing investment funding is complex and depends on more than just the availability of human resources.

The demands on subnational governments are increasing with the war as new challenges are added—ranging from supporting territorial defence, to clearing debris and repairing damaged infrastructure. To compound the situation, some municipalities' financial capacities may be diminished as revenues plummeted. However, the degree of change varies significantly across regions. For example, municipalities that were besieged (or continue to face attack) often have less human resource capacity than prior to the war, as civil servants may have fled to safer places, for example. In addition, while all subnational governments' fiscal capacity dropped precipitously in the first few months of the war, the revenues of several regions and municipalities that are not on the frontline have slowly started to recover (Onyshuk,

2022[71]). As such, the territorially differentiated impact of the war may contribute to deepening existing regional divisions, particularly between the east and west of the country.

As it advances with the design and implementation of a national recovery plan, the government would do well to tailor support to meet the different needs and capacities of municipalities throughout the country and ensure that no place is left behind. Failing to do so will not only thwart the rebuilding of local economies and livelihoods, it may also create the impression that reconstruction is not equitable, undermining trust in the government and donors. The categories presented in Box 2.11 can provide a useful starting point for implementing specific recovery initiatives that meet local demands.

Ukraine can build on the success of its post-2014 regional development and decentralisation reforms

Defining the recovery vision and policy at the highest levels of government is necessary to ensure acceptance and coherent application across policy sectors. However, as it finalises and implements a national recovery plan, Ukraine should be careful not to adopt a heavily centralised approach. This would ignore the important potential for support that subnational governments, especially municipalities, can contribute to the reconstruction efforts. Instead, the government should pursue a place-based recovery as a basis to return to integrated regional development. The proposals for reinforcing public administration through a national recovery plan represent a good starting point from a multi-level governance perspective. These include improving co-ordination and collaboration among municipalities, *rayons, oblasts* and the national government; increasing the skills of subnational public servants; updating the division of tasks and responsibilities among levels of government; and ensuring that subnational governments have sufficient financial resources to execute their mandate (National Recovery Council, 2022[58]).

Close attention should be paid to how subnational governments can be effectively involved throughout the reconstruction process, including in the finalisation of a national recovery plan, the design of mechanisms to fund and finance recovery, and the implementation and monitoring of specific projects. In addition, policy makers need to ensure that *oblasts, rayons* and municipalities have the capacity to deliver on national and local recovery priorities.

The government is advised to assess to what extent existing regional development funding, implementation and co-ordination mechanisms can be leveraged and improved to support post-war recovery and reconstruction. National and international policy makers should build on the success of Ukraine's post-2014 regional development and decentralisation reforms, which led to more robust regional development planning and improved local public service delivery. With these reforms, the national, regional and municipal levels of government have gained ample experience in designing and implementing strategies for territorial development (see Chapter 4).

The regional development and decentralisation reforms also introduced new inter-governmental transfers for regional development (see Chapter 5). This allowed local governments throughout the country to implement territorially-specific development projects. It also provided subnational governments with new skills to manage investment funding. The government should leverage these skills to support subnational recovery and reconstruction efforts. Furthermore, the reforms created regional development agencies, as well as different vertical and horizontal co-ordination bodies that can support the coherent implementation of Ukraine's State Regional Policy at all levels of government, particularly if a series of financial, administrative and operations challenges are overcome (Chapter 4). The reforms also resulted in the development of a more robust framework of complementary regional development plans and strategies at the national and subnational levels. These achievements can function as steppingstones for rebuilding Ukraine's local economies and communities.

Partnering with subnational governments and civil society in recovery efforts

In post-conflict countries where the international community has supported the implementation of recovery programmes, there is evidence that local and community-driven development efforts tend to be more effective in addressing recovery needs than those developed and implemented by higher levels of government (World Bank, 2007[33]). At the same time, care needs to be taken that reconstruction and recovery efforts do not get diluted (or fall apart entirely) due to local power dynamics, limited oversight and a lack of accountability mechanisms.

Subnational governments can support recovery efforts with existing policy and service delivery tools

Across Ukraine, despite the war, and thanks at least in part to Ukraine's decentralisation reforms, many of its subnational governments have been able to make the most of the administrative and service-delivery responsibilities and skills gained post-2014. For example, municipal administrative service centres (ASCs) that were established as part of the decentralisation reform process are now being used to register internally displaced people and give them access to social benefits. Some ASCs are also functioning as co-ordination centres for humanitarian aid (PROSTO, 2022[38]). As such, the role of ASCs has moved beyond merely providing administrative services. Under these circumstances, municipal governments may have a better sense than the national government of urgent needs and particularly vulnerable populations. There are also examples of municipalities located in the west of the country that have provided space for businesses that operated close to the frontline to relocate their production facilities. Moreover, municipalities facing a host of challenges (e.g. drop in revenues, particularly in the first few months of the war, an influx of internally displaced people, etc.) have developed action plans to cut back on non-essential expenditures, while continuing to provide key services (U-LEAD, 2022[72]).

To support these efforts, many national and international development partners, such as the EU-funded U-LEAD initiative, have adjusted programming to meet the needs of municipalities during the war. For example, U-LEAD has used its network of regional offices throughout the country to provide municipalities with technical and material support. Municipalities received emergency aid packages to clear debris or accommodate internally displaced people. In addition, U-LEAD has organised numerous in-person and virtual training sessions, international workshops and peer-to-peer exchanges for municipalities on topics such as recovery and reconstruction through municipal partnerships, the implications of martial law for local administration and service delivery, and how to promote the return of refugees to their home communities (MinRegion, 2022[73]; MinRegion, 2022[74]; MinRegion, 2022[75]).

Leveraging local expertise is exceptionally important for a place-based approach and to channel resources where they can have the most impact (OECD, 2022[76]). This makes it vital for the national government to create space for, promote and facilitate the active participation of subnational authorities in defining immediate recovery support schemes, as well as more long-term strategies to boost territorial resilience. In particular, the different associations of local governments (e.g. the Association of Ukrainian Cities and the Association of Amalgamated Territorial Communities) can be called upon to ensure that the prioritisation of recovery efforts and the distribution of financial and material support is tailored to territorial needs and local absorption capacity. In addition, Ukraine's different tiers of subnational government can support the development of an open-source national inventory of territorial needs, design and implementing reconstruction projects and track progress of the local recovery efforts.

There are, however, some areas in which municipalities may need support to ensure that they have the necessary capacity to manage reconstruction efforts (see Chapter 4). For example, responses to the 2021 OECD survey of Ukrainian municipalities indicate that about 40% of the 741 responding municipalities did not consider they had the necessary expertise to involve the private sector and individual citizens in the design and implementation of development plans (OECD, 2021[52]). However, this challenge is particularly acute for rural municipalities and less so for settlement and urban municipalities. Thus, while rural

municipalities may need some form of technical support to adequately design and implement local recovery projects, the urban and settlement municipalities might be more favourably positioned to engage in recovery early on.

To support this effort, Ukrainian and international policy makers are advised to promote and facilitate national and international peer-to-peer learning initiatives, such as the European Alliance of Cities and Regions for the Reconstruction of Ukraine that was launched in June 2022. This initiative aims to bring together regional and local authorities in Europe to support reconstruction efforts, for example by organising training sessions, mobilising material and financial support for local projects and supporting the further integration of Ukraine's subnational governments into European networks. Policy makers should ensure that such peer-to-peer learning initiatives are tailored and targeted to the recovery challenges of each type of local community (urban, settlement, and rural) as their specific recovery needs will likely be different.

Many subnational governments might not have the specific technical expertise to estimate the cost of complex local recovery projects, which could lead to an over- or underestimation of the financial resources necessary for project implementation. Building the capacity of subnational governments to carry out project appraisals, which refers to the process of assessing the costs, benefits and risks of project alternatives, is recommended to support evidence-based decision making on recovery. Furthermore, with many people having fled the violence, skilled labour (e.g. engineers, electricians) might be in short supply. As such, the national and subnational government levels are advised to collaborate with vocational and higher education institutions to build up the type of knowledge that is needed to design and implement initiatives to repair damaged or construct new roads, bridges, schools, electrical grids, etc.

The magnitude of post-conflict reconstruction requires the involvement of civil society and other non-governmental actors

The cost of rebuilding critical infrastructure and re-establishing the delivery of basic public services will likely go far beyond what the national government and international community are able to mobilise in the short and medium term. To facilitate Ukraine's recovery and reconstruction, it will be pivotal to promote and facilitate the contribution of the private sector, academia, civil society organisations (CSOs), social economy organisations (e.g. associations, foundations, co-operatives, mutual organisations and social enterprises) and individual citizens.

Non-governmental actors can contribute to identifying and verifying local needs, while defining reconstruction priorities. For example, facilitating stakeholder engagement in developing urban reconstruction plans can help determine whether cities should focus almost exclusively on rehabilitating damaged infrastructure or also seek to address urban challenges that existed prior to the war (e.g. limited access to public transport). For instance, in the wake of World War II, there was significant diversity in how heavily damaged cities decided to reconstruct. While some targeted rebuilding (historic) infrastructure, others, such as Coventry in the United Kingdom focused more on addressing user needs and key urban functions. Throughout Europe, urban policy makers often had to balance the public's wish for rebuilding "cherished scales, monuments, and details" with "[f]unction-oriented goals for urban renewal" (Calame, 2005[22]). Carefully designing stakeholder engagement mechanisms can help ensure that urban reconstruction efforts take into account the specific demands of citizens, which can support public ownership of and trust in urban reconstruction efforts. Participatory budgeting, which allows citizens to propose or prioritise public expenditure, is one such tool.

Non-governmental actors may also provide financial, material and human resources to implement reconstruction projects, and to monitor the adequate use of funding. In addition, they can provide grassroots knowledge and capacity to deliver services in places that subnational governments may not be able to reach on their own, particularly in the early post-conflict stage. Similarly, social economy organisations are important partners to mitigate the impacts of disasters. They pioneer resilient business

models to provide essential services by espousing solidarity, putting people ahead of capital considerations, and encouraging participative governance (OECD, 2022[77]). For example, the Mondragon Corporation, a federation of worker co-operatives, helped restore employment and drive economic development in the Basque region following the Spanish Civil War, and is still active today (OECD, 2020[78]). Moreover, during the 2008 Global Financial Crisis, social economy organisations were important sources of job creation. While in 2008 employment in the public and private sectors fell in Belgium and Italy, employment in social enterprises in both countries grew by 11.5% and 20% respectively (European Union, 2016[79]). More recently, social economy organisations were at the forefront of the crisis-response to the COVID-19 pandemic, during which they addressed urgent health and social needs (OECD, 2020[50]). Japan's experience in using public-private partnerships to support recovery and reconstruction efforts in the wake of the 2011 Great East Japan Earthquake can serve as an example (Box 2.12).

Box 2.12. Example of public-private partnerships to support Japan's 2011 recovery

Following the 2011 Great East Japan Earthquake, the government of Japan launched an innovative cash-for-work project to support people who had lost their jobs due to the emergency. As part of this initiative, over 31 000 jobless people were hired to work on reconstruction projects, support local governments issue resident cards or perform need assessments at evacuation centres. This scheme allowed the government to incorporate women and the elderly, groups which are often overlooked in post-emergency recovery projects.

By setting up partnerships with private staffing agencies, the government reduced red tape related to the hiring of public servants. This allowed it to quickly employ affected people to work in disaster-response organisations and municipal governments.

The efforts by Japan's national and subnational governments were supported by non-governmental organisations that launched a project to hire jobless people to support reconstruction projects. Their income was financed through national and international private contributions.

Likewise, in the immediate aftermath of the earthquake, social economy organisations rapidly provided relief services such as free meals, housing, childcare and volunteer co-ordination. During the recovery process, municipal governments partnered with social economy organisations to organise debris removal and set up logistic support systems.

Source: Author's elaboration, based on (Ranghieri and Ishiwatari, 2014[80]; Saito, 2020[81]; Sakamoto, 2012[82]).

Despite the significant amount of international support received by municipalities, the bulk of humanitarian aid has been raised by Ukrainian sources: civil society, local businesses, churches, and individuals (PROSTO, 2022[38]). In fact, ever since the Maidan Revolution and the start of the Donbas war in 2014, the country has witnessed an impressive mobilisation of volunteers who have helped localities manage successive crises. In many municipalities, volunteers support local authorities, for example by organising the delivery of aid to residents, the military, internally displaced people and temporarily occupied territories (U-LEAD, 2022[72]).

Recovery and reconstruction can create space to address pre-existing development challenges. In Ukraine, efforts by non-governmental actors to support the country's response to the war have been invaluable. Yet, current legislation leaves relatively little room for non-governmental actors such as social economy organisations to contribute to the design and implementation of territorial development strategies (see Chapter 4). Moreover, there is no legal framework in Ukraine for the overall social economy (European Commission, 2018[83]). As such, many social economy organisations have limited access to support measures such as tax benefits, preferential borrowing rates or access to public tenders, which risks limiting

their overall social impact (European Commission, 2018[83]; OECD, 2022[84]). This, in turn restricts the ability of subnational governments to leverage the support of businesses, academia and citizens to meet territorial development objectives.

Local power dynamics and limited oversight may hamper recovery and reconstruction

Subnational government involvement in reconstruction and recovery processes can make for more successful outcomes. However, to ensure this, the government, as well as international partners should also be prepared to mitigate the pre-existing risks associated with vested interests and corruption, which tend to be exacerbated in post-disaster contexts. This is due to a combination of a vast inflow of recovery funds, pressure on authorities to allocate resources swiftly, and strained absorption capacity in national and subnational institutions (Transparency International, 2012[85]).

Important lessons can be learned from the post-war reconstruction of Bosnia and Herzegovina, during which different international actors dealt with whichever local authority had direct control over physical infrastructure. This practice enabled unofficial power structures to benefit from the reconstruction initiatives both materially (e.g. through provision of goods and services to international reconstruction agencies), and politically (e.g. by being able to nominate the beneficiaries of international aid) (Cox, 2001[86]). This reflects a need for policy makers to strike a balance between providing direct aid to municipalities and aid that is managed by higher levels of government. It also underscores the importance of anti-corruption, accountability and transparency efforts. This is particularly relevant in Ukraine, as assessments of the legal and efficient use of communal resources published by the State Audit Service prior to the war revealed major violations and shortcomings (CabMin, 2021[87]). As such, the government and international partners should support municipalities on issues related to local public procurement and transparent decision making. For instance, targeted training or developing easy-to-use procurement guidelines could be provided.

Experience from other post-war reconstruction settings indicates that anti-corruption efforts are often not adequately prioritised, particularly early on. During the first stage of recovery, expectations from local communities and donors are high, there is a low demand for accountability, a very high inflow of external funding and fighting corruption can be considered an obstacle to achieving “quick wins”. This tends to be followed by a period when corruption becomes entrenched and the initially high expectations for recovery turn into frustrations as the public perceptions of corruption rises (Galtung, 2008[69]).

Ukraine’s government has been explicit about the corruption risks posed by the recovery and the need to address this head on. As indicated in Box 2.8, the draft national recovery plan identifies finalising the anti-corruption system reforms that were initiated after the Maidan-revolution as a key priority area. Such high-level reforms, however, may take time to produce tangible results. To reduce the risk of corruption in the short term, national policy makers and donors should consider investing in community-based accountability processes that can be established relatively rapidly. For example, citizen-based accountability mechanisms such as participatory budgeting, public expenditure tracking, monitoring public service delivery and citizen advisory boards are used in many countries (Galtung, 2008[69]; World Bank, 2004[88]). For these mechanisms to work, though, citizens must have access to quality data on planned budget expenditures, public procurement, budget execution and the results of recovery activities (USAID, 2022[68]). Therefore, the government should consider setting up digital platforms that enable governmental and non-governmental actors to track funds and projects.

An assessment of (international) reconstruction assistance in eight post-conflict settings found that up-to-date information on aid flows was difficult for local CSOs and local communities to obtain. Moreover, in the few cases where international development partners made efforts to communicate aid results, documents were often not accessible or only available in English (Galtung, 2008[69]). The online aid information management system in Myanmar, which is called Mohinga, serves as an example. Launched

in 2015, it provides publicly accessible information and analysis on donor spending by sector and region using the International Aid Transparency Initiative (IATI) format (GPEDC, 2019[89]).

To strengthen transparency, as well as donor and government accountability to citizens, the government should also support the capacity of subnational government to produce and disseminate updated information on the results of reconstruction efforts. This is essential for keeping the public informed about the country's progress in meeting recovery targets. It can also improve evidence-based decision making on recovery and reconstruction. However, prior to the war, the capacity of subnational governments to generate territorially differentiated data was limited (see Chapter 4). As such, in the early phase of the reconstruction, the government should identify a limited number of indicators on which subnational governments can report. This list can be gradually expanded as the recovery progresses.

Ukraine could also consider establishing recovery communication focal points in *oblasts* and municipalities who can provide information to the public about the status of projects, funding and procurement processes, etc., thereby managing expectations about the speed and success of recovery. Doing so can contribute to sustained public confidence in the government's recovery efforts, as well as in the support provided by international partners. Box 2.13 presents examples of recommendations from Chapter 4 on how effective data management for regional development policy in Ukraine can improve evidence-based recovery decision making, accountability and transparency.

Box 2.13. Strengthening effective data management: some possible actions for Ukraine

The following recommendations are based on the data and analysis provided in Chapter 4. They focus on the generation, analysis and sharing of territorially-disaggregated data related to regional development. However, they can also contribute to evidence-based decision making for recovery and reconstruction and support public accountability.

- Invest in the generation, analysis and dissemination of information on citizen experience with public services at the national, regional and local levels.
- Strengthen the role that the State Statistics Service of Ukraine (SSSU) plays in gathering, analysing and disseminating data across ministries and among levels of government. For example, this could entail:
  - Expanding the available territorially-disaggregated data on the SSSU portal and integrating data presented on the portals of other state institutions.
  - Identifying functional urban areas (FUAs) that can serve as a basis for reconstruction and recovery policies in urban areas. A FUA consists of a densely inhabited city and of a surrounding area (commuting zone) whose labour market is highly integrated with the city.
  - Creating inter-agency commissions—for instance for regional development—that are charged with defining the sectoral data needs, establishing standards to generate and present statistics, as well as ensure current databases are up-to-date and new ones are developed.

Note: The full list of recommendations for strengthening effective data management for regional development policy in Ukraine can be found in Chapter 4.

Building on regional development and decentralisation successes to advance recovery planning and implementation

To support the regional and local reconstruction and recovery objectives of a national recovery plan, ensuring effective co-ordination of the various specific initiatives and actors will be essential for aligning

objectives, agreeing upon priorities, and establishing responsibilities for action. The National Council for Recovery may need additional support in co-ordinating efforts at the subnational level, and could make use of existing co-ordination bodies. In addition, Ukraine's regional and local governments have been gaining experience with regional development planning, as well as regional development funding and investment mechanisms since 2014. These recently honed capacities can be further refined to meet the specific demands of investment in a reconstruction and recovery context.

Existing co-ordination bodies can be used to ensure policy coherence

The co-ordination bodies supporting Ukraine's regional development and decentralisation reforms can also help the National Council for Recovery to track progress and facilitate dialogue across and among levels of government on recovery and reconstruction. These include the Congress of Local Authorities and Regions and the Inter-Departmental Co-ordination Commission for Regional Development (ICC). An important task for these bodies could be to ensure that recovery initiatives meet local demand but do not lead to a fragmented approach that undermines funding effectiveness and efficiency. This requires strong national and subnational government co-ordination to identify inter-locality/cross-jurisdiction needs and design tailored projects. The Congress and ICC could also help to co-ordinate the support that other countries, as well as subnational governments from around the world, are providing to Ukrainian *oblasts* and municipalities. At the same time, the government and international partners should be cognisant of and address challenges that have limited the effectiveness of both co-ordination bodies (see Chapter 4). This includes upward and downward communication between the national government—in particular with the National Council for Recovery—and subnational authorities.

International experience shows that effective co-ordination of the many national and international organisations involved in post-disaster reconstruction activities can be a challenge, particularly at the subnational level. As such, *oblasts* and larger municipalities should consider establishing recovery co-ordination bodies—or mobilising existing ones—that allow public institutions, as well as (international) non-governmental actors to share information, co-ordinate activities and mobilise diversified resources (Ranghieri and Ishiwatari, 2014[37]). Ukraine's regional development agencies could possibly function as platforms to co-ordinate recovery regional efforts. However, this would require significant external support as, already prior to the war, the financial, material and human resource capacity of regional development agencies varied significantly, with most agencies facing staffing problems (see Chapter 4).

Box 2.14 presents examples of recommendations from this report on how to strengthen horizontal and vertical co-ordination mechanisms, particularly in the field of regional development, which can also support the co-ordination of recovery efforts.

Box 2.14. Strengthening co-ordination bodies: some possible actions for Ukraine

The following recommendations are based on the data and analysis provided in Chapter 4. They focus on the vertical and horizontal co-ordination bodies supporting regional development and decentralisation. However, they can also contribute to the coherent implementation of recovery and reconstruction initiatives across and among levels of government.

- Reinforce the Inter-Departmental Co-ordination Commission for Regional Development (ICC). This could be accomplished, for example by streamlining the ICC's broad set of responsibilities to ensure its meetings focus on key regional development issues and by creating technical working groups within the ICC. These working groups could focus more in-depth on technical questions, such as the monitoring and evaluation of the State Regional Policy, as well as on regional development funding mechanisms.
- Improve the effectiveness of the Congress for Local and Regional Authorities to facilitate debate and exchange among levels of governments. One approach is to establish a transparent process for selecting which subnational representatives can take part in the meetings of the Congress.

Note: The full list of recommendations for strengthening the horizontal and vertical co-ordination of regional development in Ukraine can be found in Chapter 4.

Experience with regional development planning and funding can support reconstruction

As it implements a national recovery plan, it will be important for Ukraine to continue building on the regional development planning and funding frameworks, which have been developed since 2015. These frameworks provide the national and subnational governments, as well as non-governmental actors, with relative clarity regarding the government's territorial development aims, as well as possible funding and implementation mechanisms. The government should also learn from the challenges that subnational governments have faced in funding and financing, as well as implementing local development projects.

One essential step for post-war regional development will be updating the existing seven-year State Strategy for Regional Development (SSRD) (2021-2027), as well as regional and municipal development planning documents, with an eye on ensuring that strategic documents link to a national recovery plan. In particular, it should ensure alignment with the section dedicated to "Recovery and Stimulation of Regional Development". In addition, in the light of the destruction that has been wrought by the war, policy makers should reflect on whether it is necessary to modify the overall aim of Ukraine's State Regional Policy going forward, for example by placing more emphasis on bolstering territorial resilience. This would require amending article 2 of the Law "On the Principles of State Regional Policy", which specifies the purpose of the State Regional Policy. This move could also entail integrating aspects related to territorial resilience into the SSRD results framework, such as strengthening subnational disaster management capacities.

To ensure the effective delivery of a recovery and reconstruction plan, Ukraine should also consider streamlining the planning requirements for subnational governments in order to facilitate decisive recovery action. With the gradual rollout of the regional development reforms and decentralisation beginning in 2014, there was a proliferation of required territorial development strategies and plans for subnational governments to develop. These risks overlap among different planning documents, potentially resulting in a duplication of efforts. It also has the potential to create confusion regarding the hierarchal relationship among the different strategies and plans and can lead to a fragmented use of resources, particularly when the objectives of the different strategies and plans are not aligned. Furthermore, "regional and local planning should be considered in the choice of the short, medium and long-term investments that allow for

immediate needs of different regions to be met, but also facilitate the achievement of longer-term priorities, such as supporting the green and digital transitions" (OECD, 2022[76]) Box 2.15 presents examples of recommendations from this report on strengthening strategic planning for regional development to contribute to Ukraine's longer-term recovery.

Box 2.15. Strengthening strategic planning: some possible actions for Ukraine

The following recommendations are based on the data and analysis provided in Chapter 4. They focus on the strategic planning framework for regional development. However, they can also contribute to the place-based implementation of a national recovery plan, particularly in the mid to long term.

- Ensure continued alignment between the State Strategy for Regional Development and subnational development strategies. This can be done by modifying the legal framework to establish that—after the first three or four years of implementation—state, regional and municipal authorities should conduct a mandatory assessment of the strategies in light of any significant economic, social, environmental or political changes.
- Strike a balance between development planning and implementation, and promoting horizontal and vertical policy coherence. The enactment of a national planning law that defines the long-, medium- and short-term planning instruments to develop, and who should be responsible for their design, implementation and monitoring can help accomplish this.

Note: The full list of recommendations for strengthening Ukraine's strategic planning framework for regional development can be found in Chapter 4.

Ukraine can also build on the experience that subnational governments have gained since 2015 in managing regional development funding (see Chapter 5) through several regional development grants and subventions[3], including the flagship State Fund for Regional Development. Ukraine's framework for funding regional development has been very fragmented. Between 2015 and 2019, a total of 110 grants and subventions linked to regional and local development were implemented by a wide array of institutions. This hampered the effectiveness of public spending and risked a duplication of efforts. These challenges were compounded by the absence of a formal body—such as an inter-ministerial commission—to co-ordinate regional development funding. Efforts should be made to avoid this when designing and implementing the recovery and reconstruction funds at the national and subnational levels.

The vast destruction caused by the war has drastically increased the need for investment in roads, bridges, hospitals, factories and other crucial "hard" infrastructure, particularly in areas that were at the frontline. Repairing roads, electricity networks and schools, among other assets, can support the delivery of basic services and utilities and facilitate the relaunch of economic activity. At the same time, investments in physical infrastructure should be complemented by investments in human capital development, and support for the development of small and medium-sized enterprises (see Chapter 5). OECD analysis highlights that investing in "hard" infrastructure alone has little impact on regional growth unless it is combined with "soft" investments (OECD, 2009[90]; OECD, 2020[91]). This is particularly important in the context of Ukraine's post-conflict recovery, as many skilled workers have fled the country. In addition, the upskilling of internally displaced people may be necessary to facilitate their economic integration into their host communities. Stimulating territorial economic development is of crucial importance for rebuilding communities and encouraging residents who have fled to return. To support this effort, the government can consider requiring international development partners to contract a certain percentage of their goods and services from local businesses.

Box 2.16 presents examples of recommendations from this report on how to improve the effectiveness of regional development funding and investment, which may be relevant in the context of Ukraine's post-war reconstruction.

Box 2.16. Strengthening public funding and investment: some possible actions for Ukraine

The following recommendations are based on the data and analysis provided in Chapter 5. They focus on funding regional development. However, they can also help increase the effectiveness and efficiency of recovery funding at the subnational level.

- Streamline the number of grants and subventions for regional development (but not reducing their value) to increase spending efficiency, avoid overlap and strengthen the quality of implementation.
- Strike a balance between investment in "hard" and "soft" infrastructure to promote balanced regional development, for example by:
  - Ensuring that funds and subventions with a cross-sectoral focus, such as the State Fund for Regional Development, facilitate investment in areas such as innovation and skills, as well as "hard" infrastructure.
- Develop and implement methodologies that municipalities can use to identify investment needs, given the scarcity of territorially-disaggregated data, and to effectively engage with governmental and non-governmental actors.
- Provide training and advice to municipalities, particularly those with more limited capacities, in areas such as stakeholder engagement, procurement, and monitoring and evaluating investment projects.

Note: The full list of recommendations for improving the effectiveness of Ukraine's grants and subventions for regional development can be found in Chapter 5.

Based on these lessons, Ukraine is advised to establish only a limited number of dedicated recovery funds and subventions. In addition, the government should consider introducing a formal national-level body that is responsible for co-ordinating recovery funding and financing. This body could be linked to the National Council for Recovery, and should incorporate representatives from subnational governments so that the design of the funding mechanisms takes into account territorially differentiated needs and absorption capacities. This body could manage the open-source digital platform to track funds and projects mentioned earlier. Mexico's former Trust Fund for Natural Disasters (*Fideicomiso Fondo de Desastres Naturales*, FONDEN), which was created in 1999 and dissolved in 2020, could serve as an example, provided robust oversight mechanisms are established. FONDEN's governing bodies, in which representatives from various national ministries were represented, assessed funding applications from national and subnational governments, and tracked reconstruction and funds. FONDEN was supported by state-level natural disasters funds. Moreover, in the immediate aftermath of disaster, a committee to assess damages would be convened in which national and state-level representatives participated (World Bank, 2012[92]; Helfgott, 2021[93]).

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Notes

[1] The online survey was completed by 741 municipalities (51% of all Ukrainian municipalities in 2021).

[2] In Ukraine, municipalities are qualified as rural, settlement and urban depending on a number of factors, including population size.

[3] The Budget Code of Ukraine defines subventions as inter-governmental transfers of funds to be used for specific purposes through procedures defined by the authority that decides to provide the subvention (Verkhovna Rada, 2021[94]).

3 Setting the scene: A volatile context for regional development

This chapter provides an overview of regional demographic, economic, labour and social trends in Ukraine prior to Russia's large-scale invasion of the country in February 2022, laying the groundwork for the policy assessment and recommendations in the following chapters. By analysing Ukraine's strengths and challenges with regard to various economic and well-being indicators at the regional level, this chapter updates the 2018 OECD report *Maintaining the Momentum of Decentralisation in Ukraine*, and focuses on issues relevant to regional and local development.

Preface: Regional development trends in the context of the invasion of Ukraine

This chapter identifies demographic, economic and well-being trends at the national and subnational levels in Ukraine, based on data gathered in 2021. The Russian Federation's invasion deep into government-controlled areas of Ukraine in February 2022 has severely affected the trends presented and discussed in this chapter. However, by highlighting the progress made by Ukraine before the war in reducing regional disparities, as well as the factors underpinning that progress, it provides powerful insights that can help inform and support regional development policy after the war has ended. Indeed, experience from different countries and regions that have implemented post-disaster recovery strategies shows that reconstruction efforts need to respond not only to immediate necessities, but also build on underlying governance, socio-demographic and economic conditions (Government of Puerto Rico, 2018[1]; Ranghieri and Ishiwatari, 2014[2]).

The following paragraphs discuss the relevance and implications of some of the chapter's main findings for Ukraine's recovery and reconstruction. They include links to relevant boxes, tables and charts included in the chapter.

The governance dimension

From 2014 onwards, Ukraine made important progress in implementing a series of ambitious judicial and governance reforms (Box 3.2). Particularly strong steps were made at the subnational level, resulting in a significant expansion of the administrative and service delivery mandate of municipalities. This enabled many municipalities to continue ensuring basic service delivery during Russia's invasion, and to co-ordinate the delivery of emergency support with non-governmental actors. The government should build on this capacity by involving municipalities in the design and implementation of immediate and longer-term recovery efforts. Due to their proximity to citizens, subnational governments are more likely to be well-apprised of local needs in a recovery context, and can partner with local private sector and civil society organisations to ensure the joint implementation of recovery projects, as well as continued service delivery.

Notwithstanding the important advancements in governance since 2015, by 2021 Ukraine still ranked relatively low in several categories of the Worldwide Governance Indicators (e.g. rule of law and control of corruption) (Figure 3.4). As such, it is essential that a national recovery plan further strengthens the rule of law, transparency and oversight, in order to ensure that financial support for recovery projects is effectively administered and accounted for.

The demographic dimension

Over the past decade, Ukraine's regions have been characterised by population decline (Figure 3.6) and a shrinking labour force (Figure 3.9). The war has aggravated this, with 5.8 million people having fled the country by July 2022, and millions more internally displaced. This has dramatically increased the scale of Ukraine's demographic challenge, and the strain it brings to productivity and economic development, post-war (UNHRC, 2022[3]). This means that, when implementing a national recovery plan, Ukraine will need to emphasise rebuilding a strong and competitive economy that can attract migrants who left the country before or during the war. Among other elements, this requires ensuring adequate service delivery throughout the country, including in areas that witnessed an important population decline over the past years. In the short term, this also means identifying ways to help internally displaced people contribute to recovery efforts and the economic development of their (temporary) host communities.

The economic dimension

Prior to the invasion, Ukraine's economic growth was constrained by a number of crises (e.g. the Global Financial Crisis, COVID-19, Donbas war). By May 2022, the International Monetary Fund (IMF) expected that in 2022, Ukraine's GDP would shrink by 35%, an output shock from which the country will take years to recover (IMF, 2022[4]). The trade and co-operation agreements Ukraine has signed with over 40 countries since 2014, however, provides it with a strong basis from which to support an economic recovery

in the medium to long term. Ukraine could focus on strengthening its value chains with foreign markets and boost its industrial capacity to export more high value-added manufactured goods, thereby becoming less dependent on the export of primary resources.

Between 2010 and 2019, Ukraine's economy became increasingly dependent on the Kyiv agglomeration, with other regions lagging behind (Figure 3.10). This was caused, in part, by the Donbas war that sparked a drop in the gross value added of Donetsk and Luhansk. Given the ongoing nature of the war, two developments are to be expected in terms of regional economic growth. On the one hand, the contribution of eastern regions—where much of the fighting has been concentrated—to the national economy will continue to decline. These regions, in particular, will require extensive support to ensure their recovery. On the other, the economic significance of *oblasts* located in the west of the country (where agriculture, wholesale and retail trade have been the dominant sectors in terms of employment) will likely increase, as these remain relatively well-connected to the European Union.

The invasion will most likely lead to a large increase in labour informality, which was already very high in several *oblasts* (Figure 3.15), particularly those in the west of Ukraine. These are the same regions that have received a major influx of internally displaced people. Given this, recovery efforts should reactivate and protect employment, placing a special emphasis on the most vulnerable, excluded and informal groups. There is some evidence that in the immediate aftermath of a disaster, government-led cash-for-work policies can help provide a basic income to people who have lost their jobs and livelihoods, while contributing to recovery efforts (Ranghieri and Ishiwatari, 2014[2]).

The well-being dimension

Russia's invasion is likely to severely undermine the significant progress in poverty reduction that Ukraine's regions achieved between 2015 and 2019 (Figure 3.17). At the same time, the continued payments of pensions and functioning of the banking sector, for example, have undoubtedly cushioned the economic blow felt by some households (Ukrposhta, 2022[5]; National Bank of Ukraine, 2022[6]). Besides investing in subnational economic development and job creation, Ukraine's recovery initiatives should also contemplate financial and material support for particularly vulnerable populations (e.g. internally displaced people, the elderly, children) to make sure that they are able to meet their basic needs.

Prior to the war, the number of hospital beds and doctors per 10 000 inhabitants varied significantly across regions (Figure 3.21), with some performing better than the OECD average. These healthcare assets have proven critical for providing medical support during the war. However, many hospitals have been attacked during the invasion, hampering their ability to provide medical relief (Reliefweb, 2022[7]). In a post-war context, Ukraine will not only have to invest in rehabilitating the damaged physical healthcare infrastructure, but also ensure access to mental health and psycho-social support, as mental disorders are prevalent in conflict settings.

Given the scale of destruction in many cities, providing housing should be a key pillar of Ukraine's recovery initiatives. This not only includes rehabilitating or replacing damaged housing stock. It also involves building new homes, particularly in Ukraine's western regions where many Ukrainians have sought refuge. Indeed, some of the internally displaced people may not return to their former communities. In this regard, attention should be paid to rural-urban linkages. In rural areas close to cities, the cost of land is often lower than in cities, making them attractive places for new housing development. However, policy makers need to ensure that infrastructure for basic service delivery (e.g. water, electricity, sewage, transport, water, education, etc.) and business opportunities are available or will be developed to match the demands of residents.

Over the past two decades, Ukraine has made large strides in expanding internet access throughout the country (Figure 3.18). This has proven essential for keeping even relatively remote communities, and those under siege, connected to the internet during the invasion. It has also enabled the continued flow of information among citizens, the government and the international community, as well as access to online

public services. Ensuring continued digital connectivity and even expanding coverage is key to recovery efforts as it will support economic activity, allow citizens to stay abreast of relevant recovery initiatives, and facilitate access to different public e-services. This will have to be coupled with the development of user-friendly digital services and business digitalisation.

In different parts of the country, online education has continued throughout the invasion (Specia and Varenikova, 2022[8]). This has been possible due to the experience gained during the COVID-19 pandemic and continued access to the internet. Considering the importance of access to quality education, rehabilitating damaged schools and resuming in-class education should be a priority for the country's recovery, as well as ensuring access to education for adults, in particular war veterans. In doing so, Ukraine can, among other elements, build on the many secondary education institutions that operated prior to the 2022 invasion (Figure 3.20).

Introduction

The 2018 OECD report, *Maintaining the Momentum of Decentralisation in Ukraine,* was completed four years after the Government of Ukraine began its ambitious decentralisation and regional development reforms (OECD, 2018[9]). The report began with an overview of mainly regional economic trends in Ukraine, highlighting territorial disparities, as well as progress made to redress them. This chapter, which is based on data gathered prior to Russian Federation's large-scale aggression against Ukraine that began in February 2022, updates and adds to the 2018 work. It evaluates development trends through to 2021, capturing the effects of more recent political and economic shocks, notably the COVID-19 pandemic. Moreover, in comparison to the 2018 report, it explores Ukraine's national and territorial performance on several well-being indicators. Russia's war in Ukraine has severely affected the trends presented and discussed in this chapter. However, by highlighting the progress the country made before the war in reducing certain regional disparities and detailing where others widened, it provides relevant insights that can help inform Ukraine's post-war reconstruction and recovery.

In line with the 2018 report, Ukraine's decreasing population is a major concern. The chapter finds that almost all of Ukraine's regions suffer from decreasing populations and shrinking labour forces, with significant implications for labour productivity and economic development as well as the cost of and demand for public services. In addition, it finds that several of Ukraine's regional economic and well-being disparities are becoming more entrenched, with the national economy increasingly reliant on Kyiv City. This prompts the question of how to strike a balance between the objectives of achieving regional convergence and stimulating economic growth.

These issues notwithstanding, the chapter outlines how, over the past decade, Ukraine has made significant progress in addressing various regional disparities, especially on issues such as poverty reduction and access to the internet. Even on these issues, however, large regional differences persist. To address regional economic and well-being disparities across the entire country, the chapter recommends that the government reinforce its approach to developing and implementing place-based regional and local development policies that take account of local challenges and strengths. Moreover, the development of COVID-19 recovery policies provide an opportunity for the government and Ukrainian subnational authorities to adopt measures to address growing territorial disparities.

The first part of this chapter provides an overview of Ukraine's macroeconomic context, including trade indicators. It also chronicles the 'high-level developments' that have affected Ukraine's macroeconomic picture, such as domestic and international crises (prior to February 2022) and institutional reform processes. The second part of the chapter looks at economic and well-being trends in Ukraine. It assesses the national performance and compares this with international benchmarks (Box 3.1), as well as exploring how regional performance has changed over time. In so doing, it draws on a range of indicators including demographic trends, regional economic patterns, employment, poverty, internet access, education and healthcare.

Box 3.1. International benchmarks

To compare its regional performance against relevant countries, the analysis provided in this chapter relies on four international benchmarks:

- **The post-Soviet states benchmark** includes 14 states that were part of the Soviet Union before its dissolution in 1991.
- **The neighbouring countries benchmark** consists of the seven countries with which Ukraine currently shares a border.
- **The OECD benchmark** uses the average of the 38 OECD member countries to compare Ukraine's national performance with that of the OECD.
- **The European Union (EU) benchmark** uses the average of EU member countries to compare Ukraine's national performance with that of the EU.

Note: See full list in Annex Table 3.A.1. Some countries are featured in different benchmarks. For example, Moldova and the Russian Federation are part of post-Soviet state and neighbouring countries benchmarks.
Source: Author's elaboration.

This chapter also reflects upon how the scarcity of available data at the territorial level, particularly in the field of well-being, limits the ability of policy makers to assess regional performance. Chapters 4 and 5 of this report cover each of these topics in more detail. In addition, a box evaluating Ukraine's implementation of the 2018 report's recommendations related to regional development is included in Annex Table 3.B.1.

Macroeconomic performance and 'high-level' developments in Ukraine

Ukraine is the largest country in continental Europe in terms of landmass. It is a unitary state, with twenty-four *oblasts* (regions), the Autonomous Republic of Crimea and two 'special status' cities: Kyiv and Sevastopol. According to estimates, as of December 2021, Ukraine had 41.2 million inhabitants (down from 42.6 million in December 2016) making it the eighth-most populous country in Europe (SSSU, 2021[10]). Access to the Black Sea, through the ports of Odessa, Yuzhne and Mykolaiv, places Ukraine at the intersection of trade routes between Europe, Asia and the Middle East, giving the country potential to become a significant regional trading hub.

Since declaring independence in 1991, Ukraine has effected a three-decade-long transition away from its communist legacy towards a market economy and democratic state. By 2019, its economy had specialised in services (68.4% of GDP) and industrial production (22.6%). The country is home to several major firms in mining, chemicals, the automotive sector, and the aircraft and aerospace industry. Its third largest sector was agriculture (9%), driven primarily by grain production. In 2020, Ukraine was among the world's top ten exporters of wheat and maize (Datawheel, 2022[11]; RFI, 2022[12]).

Half of its total national land is considered fertile, which explains the large agricultural capacity. It has significant mineral wealth, including the world's largest deposits of commercial-grade iron ore, and the second largest mercury deposits, which are mainly concentrated in the east. Ukraine also has the world's seventh largest coal reserves, which have historically been an important driver of economic growth. In the context of this significant hydrocarbon wealth and the contribution it makes to national output, transitioning to a zero-net carbon economy will be a major challenge (Ukrinform, 2021[13]).

Ukraine's economy also boasts an extensive though ageing transport infrastructure that, even before Russia's large scale aggression, was in critical need of maintenance. In 2021, the road network had a length of 169 652 km, including 47 000 km of state roads and 122 000 km of local roads (United States

Department of Commerce, 2021[14]). Since the 1990s, the quality of road infrastructure in Ukraine has deteriorated, while rapid population growth in and around large urban agglomerations (notably Kyiv City) has left existing road and public transport networks unable to keep pace with regional mobility needs (World Bank, 2019[15]; TomTom, 2020[16]). Between 2015 and 2020, a large share of investment for regional development in Ukraine was directed towards maintenance and upgrading of roads and other "hard" infrastructure.

A summary of Ukraine's macroeconomic performance

Ukraine's economic performance can be explored through a range of indicators, from the consumer price index (inflation) to the employment rate and composition of exports (Annex Figure 3.C.1; Annex Figure 3.C.2; Annex Figure 3.C.3, respectively). These indicators were also at the centre of the OECD's macroeconomic analysis conducted for previous territorial reports on Ukraine (OECD, 2014[17]; OECD, 2018[9]). The bullet points presented below provide a snapshot of Ukraine's economic evolution:

- **Inflation.** Ukraine has experienced significant fluctuations in the price of goods and services over the past decade. In the wake of the Donbas war, inflation rose sharply—peaking at nearly 50% year-on-year in 2015—followed by a sustained but gradual disinflation in the years leading up to Russia's full-scale invasion.
- **Employment rate.** Between 2014 and 2019, Ukraine's employment rate gradually declined whereas that of the benchmark countries improved. The poor performance largely reflects Ukraine's ageing population and outgoing labour migration. In the context of the COVID-19 pandemic, the decrease in Ukraine's employment rate was more profound than that of neighbouring and post-Soviet countries, but on par with that of the OECD.
- **Volume of exports/imports of goods.** Ukraine's trade balance has generally been negative since the early 2000s, but has oscillated over time as a result of currency fluctuations. Improved productivity and new free trade agreements saw expanded access to high-value markets (e.g. Europe), which might be further strengthened if Ukraine becomes an EU Member State.
- **Composition of exports.** In 2020, Ukraine's top export category was plant and animal products, and oils (38%), which reflects its substantial agricultural production capacity. The second highest export category was base metals and preparations (19%), which reflects the country's mineral wealth.

Ukraine's economic strategy is centred around free trade and competitiveness

In recent years, Ukraine's economic policy has taken a more open stance towards international trade, which centres on boosting domestic production and strengthening relationships with trade partners through bilateral trade agreements. The country aims not only to strengthen its economy, but also to reinforce its diplomatic ties with Euro-Atlantic partners (EC, 2015[18]). In particular, Ukraine has moved to align itself with European and international economic standards and open its market to free trade through a series of actions that include:

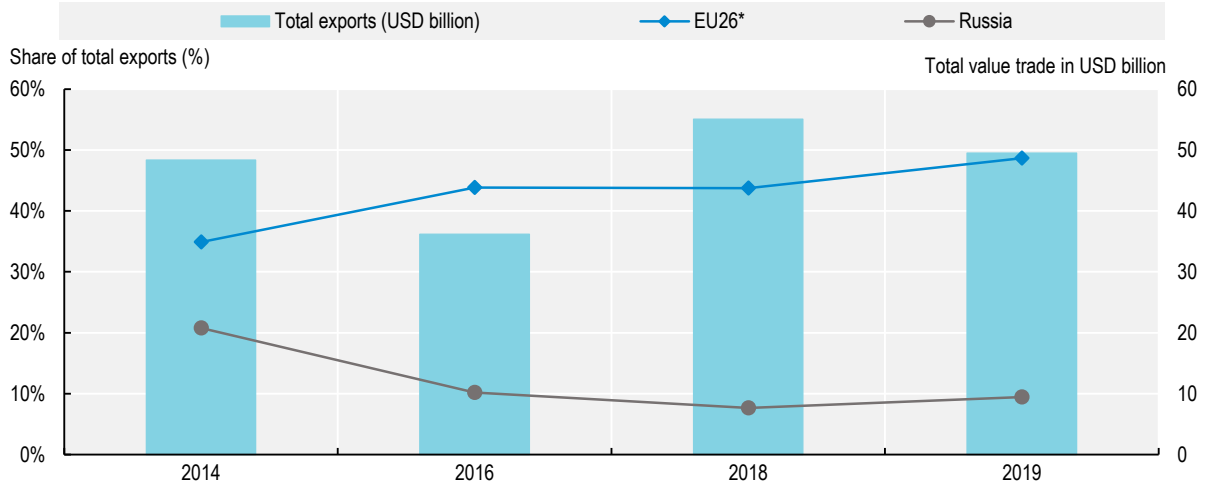
- Signing an Association Agreement with the European Union (EU) in 2014, including a Deep and Comprehensive Free Trade Agreement, which entered into force on 1 January 2016 (EC, 2015[18]).
- Signing over 17 free trade agreements with 46 different countries, including Canada and the United Kingdom.

In June 2022, the European Council granted EU candidate status to Ukraine, opening the way for increased economic, regulatory and political relations (European Council, 2022[19]).

Diversification of trade partners is an important strategy to reduce external vulnerability. In 2019, Ukraine's most important export destinations were the Russian Federation (USD 4.7 billion), China (USD 3.9 billion),

Germany (USD 3.1 billion), Poland (USD 2.8 billion), and Italy (USD 2.6 billion) (Datawheel, 2021[20]). As an economic bloc, however, the EU's share in Ukraine's export mix since 2014 has risen sharply, while that of the Russian Federation has declined substantially (Figure 3.1). This is, in part, the result of the removal of trade barriers that has stemmed from the signing of the EU-Ukraine Association Agreement (EC, 2015[18]). The EU accounted for just under half of Ukraine's total exports in 2019 (48.7%), whereas the Russian Federation accounted for only 9%.

Figure 3.1. Evolution of exports by destination, 2014-2019



Note: *Data related to the area under the effective control of the Republic of Cyprus is not included in the selected EU list of countries as data are not available. Data related to the United Kingdom are also not included.
Source: Author's elaboration with data from (Datawheel, 2021[20]).

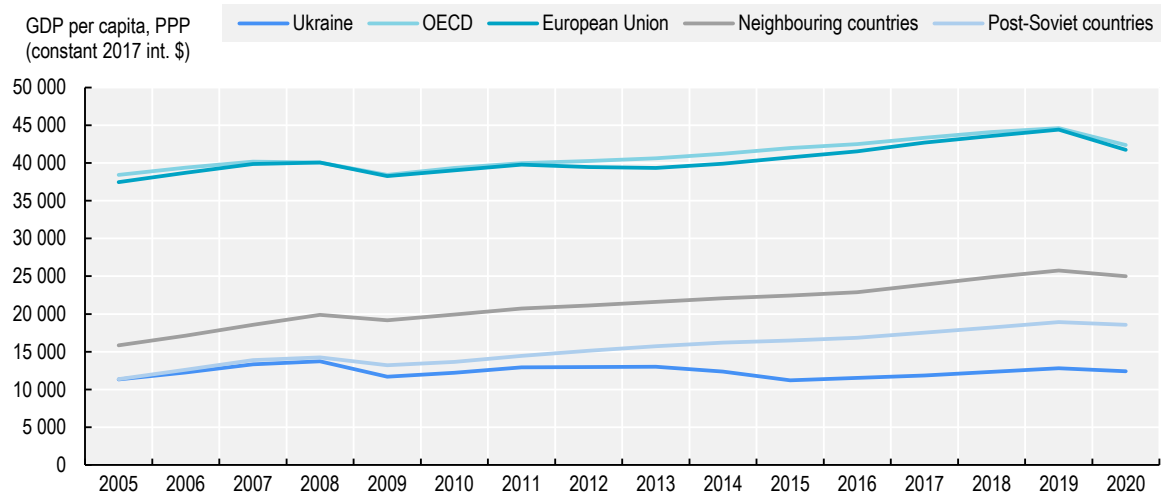
Ukraine has also sought to bolster its competitiveness through measures such as investment and export promotion and simplifying tax administration. Regarding investment promotion, in December 2021, Ukraine adopted a law on the State Support of Investment Projects (also known as the Law on "Investment Nannies"), which provides significant investment incentives to businesses operating in priority sectors of the economy, including exemptions from certain taxes and import duties (OECD, 2021[21]). However, there are concerns that this law undermines the position of small and medium-sized enterprises (SMEs) as it only supports investments over USD 20 million (OECD, 2021[22]; Verkhovna Rada, 2020[23]).

Regarding tax administration, Ukraine has improved value-added tax (VAT) refunds for SMEs through an automatic refund mechanism, and sought to protect them from late payments through an e-procurement system. Regarding export promotion, Ukraine has supported SME internationalisation by improving its legal framework and complying with EU standards, and providing training, seminars and consulting services via the Export Promotion Office for all businesses wishing to start exporting or enhance their existing export business. (OECD, 2020[24])

Successive crises strained Ukraine's growth compared to international benchmarks

Ukraine has suffered major political and economic shocks over the past two decades. This includes the 2008 Global Financial Crisis, the 2014 Euromaidan revolution, the Russian Federation's annexation of Crimea, the conflict in the Donbas region, the COVID-19 pandemic and, most recently, the full-scale Russian invasion beginning in February 2022. Overall, the successive political and economic crises have negatively affected the convergence of Ukraine's economy with post-Soviet and neighbouring countries (Figure 3.2).

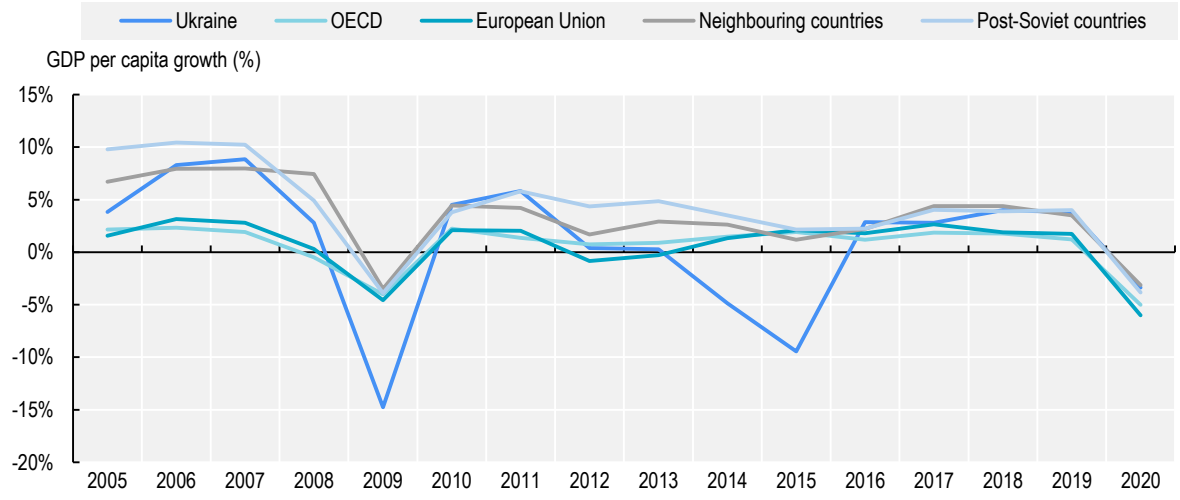
Figure 3.2. GDP per capita (PPP) in Ukraine and benchmark countries, 2005-2021



Note: GDP per capita based on purchasing power parity (PPP). Data are in constant 2017 international dollars. PPP GDP is gross domestic product converted to international dollars using PPP rates. An international dollar has the same purchasing power over GDP as the U.S. Dollar has in the United States.
Source: Author's elaboration with data from (World Bank, 2022[25]).

The Global Financial Crisis caused GDP per capita in Ukraine to shrink by 15% in 2009, compared with an average contraction of 4% among OECD member countries and 4.6% in the EU (World Bank, 2022[26]). Conversely, Ukraine also experienced a faster-than-expected recovery due, in large part, to increased external demand for natural resources, and a lower price for imported natural gas. By 2012-2013, however, the economy had stagnated and GDP per capita growth was close to 0%, unlike in post-Soviet countries and neighbouring countries, where GDP per capita continued to increase (Figure 3.3).

Figure 3.3. GDP per capita growth (annual %) in Ukraine and benchmark countries, 2005-2020



Source: Author's elaboration with data from (World Bank, 2022[26]).

The subsequent 2013-14 Euromaidan revolution also had significant economic ramifications for Ukraine. The government's refusal to sign an Association Agreement with the European Union (EU) led to weeks of mass protests. The protests ultimately led to a change of government, sparking the Russian Federation's annexation of Crimea in early 2014 and the Donbas war in 2014-15. During the latter, Russia-backed separatists, supported by Russian forces, seized large portions of Ukrainian territory in the Donetsk and Luhansk *Oblast*s. In total, Ukraine lost effective control of 7% of its territory as a result of the two events, including the city of Donetsk, which is one of the country's largest cities and an important heavy industry hub (UN, 2019[27]).

These events generated significant economic volatility, leading to a fall in GDP per capita of 4.9% in 2014 and 9.4% in 2015. However, key structural reforms initiated by the new government, such as introducing a floating exchange rate and inflation targeting, as well as a reduction in the budget deficit, helped reform the economy and unlock a four-year recovery loan programme (USD 17.5 billion) from the International Monetary Fund (IMF) (IMF, 2021[28]). This set the scene for a return to growth—from 2.9% in 2016 to 3.8% in 2019. Growth was also bolstered by the new government's signing of the EU-Ukraine Association Agreement in 2014, which opened up new and valuable trade and investment opportunities for Ukrainian exporters.

The global COVID-19 pandemic, which resulted in 100 000 deaths in Ukraine up to February 2022 (WHO, 2021[29]), saw GDP per capita contract by 3.4% in 2020, less than the fall of 6% in the EU. By the end of 2021, however, prospects of a substantial economic recovery had dimmed, as the country was confronted with a fourth pandemic wave combined with an energy crisis. The latter was sparked by falling coal and gas deliveries from the Russian Federation, and subsequently by Russia's full-scale invasion in February 2022.

Ukraine's governance performance has improved since 2014, but remains strained

Ukraine's overarching reform programme, which has been implemented since 2014, conceptualises economic development as being intrinsically linked to the development of strong public institutions. Creating solid foundations for sustainable economic growth and investment is dependent on issues such as the protection of property rights and a level playing field for businesses. To strengthen the ability of government institutions to combat corruption and promote the rule of law, Ukraine has received technical and financial support and encouragement from international partners including the IMF, the United States and the EU.

Since the 2014 Euromaidan revolution, Ukraine has made progress in a number of areas, including strengthening the judiciary, the implementation of an anti-corruption programme, as well as promoting fairer competition and improved governance, among other areas. However, there is still work to be done in terms of governance. In addition to the requirements set by the IMF as part of its borrowing programme (IMF, 2021[28]), the government recognises the need to further strengthen its institutions and improve the well-being of its citizens. To this end, it has undertaken a number of major reforms (Box 3.2).

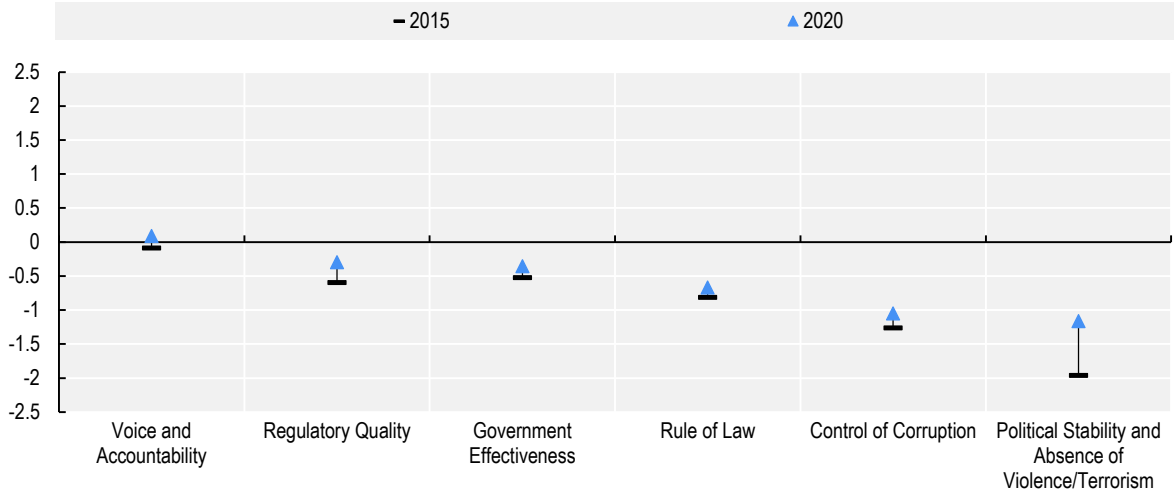
Box 3.2. Examples of recent initiatives to improve governance

- Passing the **Law on Illicit Enrichment** (2019), which re-criminalises illicit enrichment and requires the forfeiture of public officials' assets that cannot be justified by their legitimate income.
- Passing legal **amendments to banking regulation mechanisms** (2020), which close regulatory loopholes and ring-fence decisions taken by the regulator.
- Passing the **Law on Amendments to Certain Legislative Acts of Ukraine on Turnover of Farmland** (2020), which lifts the 18-year moratorium on the sale of farmland.
- Relaunching the **High Qualification Commission of Judges** and the **High Council of Justice** (both 2021), which foresee a decisive role for international experts in the selection of judicial candidates.

Source: Author's elaboration, based on (Reuters, 2019[30]; NBU, 2020[31]; Baker McKenzie, 2020[32]; Atlantic Council, 2021[33]).

The positive impact of the governance reforms is illustrated by Ukraine's improved performance on the World Bank's Worldwide Governance Indicators (Figure 3.4), which evaluate progress across six governance categories in over 200 countries. These show that Ukraine improved in all areas between 2015 and 2020. However, it is important to stress that in 2020, Ukraine still ranked low on almost all indicators, including those related to the rule of law and control of corruption, indicating ample room for further improvement.

Figure 3.4. Worldwide Governance Indicators in Ukraine, 2015 and 2020



Note: The measures of governance are provided in units of a standard normal distribution, with zero representing the mean value. The values run from approximately -2.5 to 2.5, with higher values corresponding to better governance. A full explanation of the methodology can be found here (Worldwide Governance Indicators, 2021[34]).
Source: Author's elaboration with data from (Worldwide Governance Indicators, 2021[34]).

Some of Ukraine's most ambitious governance reforms have focused on the subnational level. With the aim of improving public service delivery and living conditions in municipalities, as well as strengthening local democracy, the country launched its decentralisation reform in 2014. Key elements of the reform

included the territorial consolidation of over 10 000 local elected councils into 1 469 amalgamated municipalities over a six-year period, with a significant expansion of their administrative and service delivery mandates. This was coupled with an increase in local budgets. Table 3.1 outlines how Ukraine's administrative-territorial setup has changed over the past few years.

Table 3.1. Administrative units at the subnational level, 2017 and 2021

Tier/level of subnational government		Administrative unit	Number of units	
			2017	2021
First tier	Regional	*Oblast*s	24	24
		Autonomous Republic of Crimea	1	1
		Cities (Kyiv & Sevastopol)	2	2
Second tier	Intermediate	*Rayons* (districts)	490	136
		Cities of *oblast* significance	186	-
Third tier	Self-governments	Unified territorial communities	665	1 469
		Other cities (of *rayon* significance)	235	-
		Other (rural, urban and district councils)	10 000+	-

Source: Author's elaboration with data from (CabMin, 2021[35]).

Economic development and well-being in Ukraine: trends at the subnational level

As the government's decentralisation and regional development reform process entered its eighth year (2022), economic and well-being trends at the subnational level revealed significant regional inequities. The COVID-19 pandemic exacerbated territorial disparities, and although some regions coped relatively well with Covid's twin public health and economic shocks, others have lagged behind, with significantly negative effects on the well-being of their populations. Territorial disparities will also have been significantly affected by Russia's aggression.

As Ukraine's government looks to rebuild from the impact of COVID-19 and from Russia's war, it is essential that economic recovery policies take account of regional and local needs and assets. This section explores subnational variations in economic and well-being indicators, as well as changes in regional performance over time. It should be noted that the lack of available data at the territorial level, particularly in the field of well-being, limits this analysis, and will similarly limit the line of sight that domestic policy makers have over Ukraine's regional performance.

The well-being analysis draws on the OECD Regional Well-Being Indicators (Box 3.3), which can help policy makers assess regional strengths and challenges, monitor trends and compare results with other regions, both domestically and internationally. Due to a lack of reliable territorial data in Ukraine, not all of the OECD indicators are covered in this chapter (e.g. community or life satisfaction), and other indicators are adapted to better reflect Ukraine's specific regional economic and well-being context. Decision making to support regional development could be improved with more readily available, territorially-disaggregated data on a wide range of economic, environmental, governance and social indicators. This is discussed in greater detail in Chapter 4.

Box 3.3. OECD regional well-being indicators

Building comparable well-being indicators at the regional level

The OECD framework on measuring regional well-being builds on the OECD Better Life Initiative. It measures well-being in regions with the idea that well-being data are more meaningful if measured at the territorial level, as this enables the capture of local variations. Besides place-based outcomes, the framework also focuses on individuals, since both dimensions influence people's well-being and future opportunities.

Regional well-being indicators concentrate on providing information about people's lived experience rather than on means (inputs) or ends (outputs). In this way, they can inform the development of policies that move beyond merely improving certain economic or social indicators, focusing on improved citizen well-being. Such indicators also serve as a tool to monitor how well-being differs across regions.

The regional well-being framework allows for comparisons and interactions across multiple dimensions to account for complementarities and trade-offs faced by policy makers. At the same time, the comparison of regional well-being indicators over time allows actors to assess the direction, sustainability and resilience of regional development.

Ukraine's efforts to develop useful and comparable data could capture several well-being dimensions: income, jobs, housing, health, access to services, education, civic engagement, environment and safety—for which the OECD manages comparable statistics at the regional level—and the three additional dimensions of work-life balance, community (social connections), and life satisfaction.

Source: Author's elaboration, based on (OECD, n.d.[36]), *OECD Regional Well-Being (database)*, www.oecdregionalwellbeing.org.

Ukraine's demographic decline continues

Ukraine's last census was conducted over two decades ago. National censuses can provide a reliable basis for official population estimates and statistic. Even before Russia's war and the massive migration and displacement it caused, the absence of a recent census meant there was a lack of certainty regarding the spatial distribution of Ukraine's population. In the context of regional development, unreliable population data may lead to an inefficient allocation of public funds as transfers to local budgets (as well as the fiscal equalisation mechanism) are often tied to official population numbers (OECD, 2018[9]).

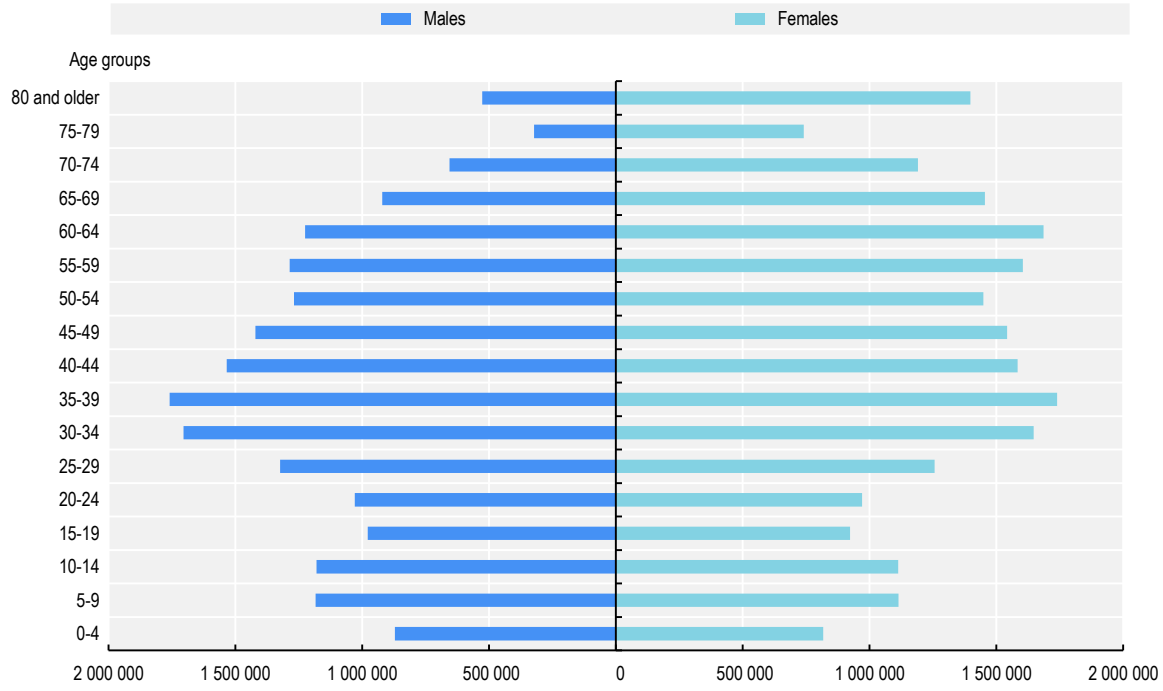
Ukraine's life expectancy was 72 years in 2019, which was well below the OECD average (80 years). This is partly due to harmful health behaviours such as alcohol abuse and smoking (particularly among men), political instability (e.g. territorial conflict), and a lack of access to healthcare. Alongside other Eastern European countries, it also has one of the most rapidly shrinking populations in the world.

The available data indicate that Ukraine has suffered from substantial population decline over the past two decades. Between 1990 and 2021, the population had decreased by more than eight million people. Low birth rates, high mortality rates and large-scale outward migration have contributed to this trend. By contrast, the average population in OECD countries has grown by 11.2% during the same period. Before the war, the United Nations (UN) projected that Ukraine's population would decrease by another 18% by 2050, from 44.2 million in 2017 to 36.4 million (WENR, 2019[37]).

Key shifts in the dynamics of Ukraine's population pyramid over the past decade include a marked decline in new-borns and working-age people (Figure 3.5). Strikingly, the 15-19 year-old cohort that is currently entering the labour force is about 50% smaller than the 35-39 year-old cohort, which could be a major

impediment to future economic growth. Another important challenge for the long term is the fact that the population under 5 years of age is even smaller than that of the 15-19 year-old cohort.

Figure 3.5. Age pyramid of Ukraine, 2021

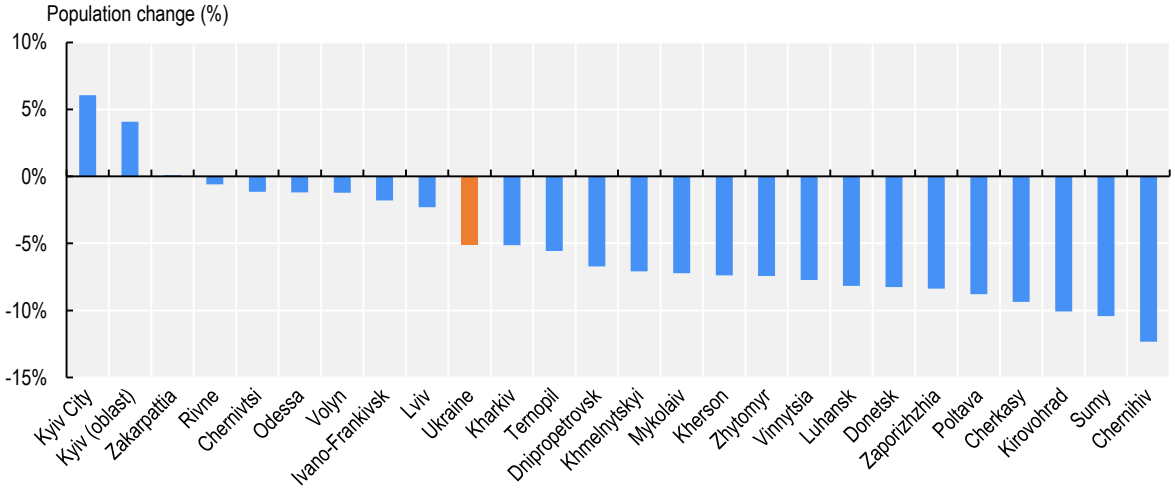


Source: Author's elaboration with data from (SSSU, 2021[10]).

Most regions face population decline and increasing elderly dependency

At the regional level, demographic decline has been observed in almost every *oblast*, although there are significant regional variations (Figure 3.6). In almost all regions, population growth was either flat (Zakarpattia *Oblast*) or declining. Only Kyiv City and, to a lesser extent, Kyiv *Oblast* reported substantial population growth between 2010 and 2021. The reported population decline in several rural regions—where agriculture is the dominant economic sector—has been particularly stark. Chernihiv *Oblast* suffered the largest drop in population, with a 12.3% decrease between 2010 and 2021, followed by Sumy, Kirovohrad and Cherkasy *Oblasts*.

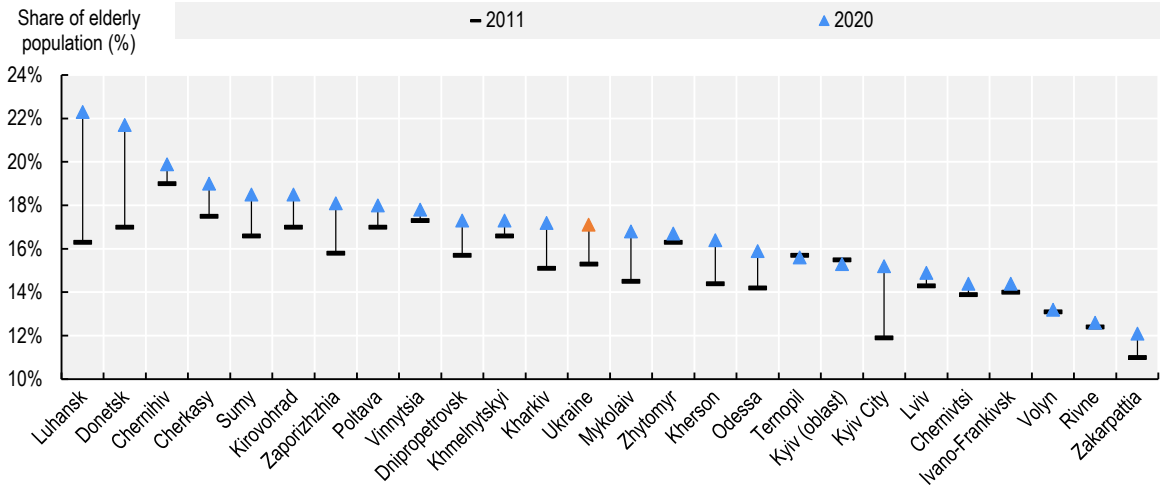
Figure 3.6. Population change (%) by *oblast* and Kyiv City, 2010 and 2021



Note: The chart excludes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol City as, after 2014, no data was available.
Source: Author's elaboration with data from (CabMin, 2021[35]).

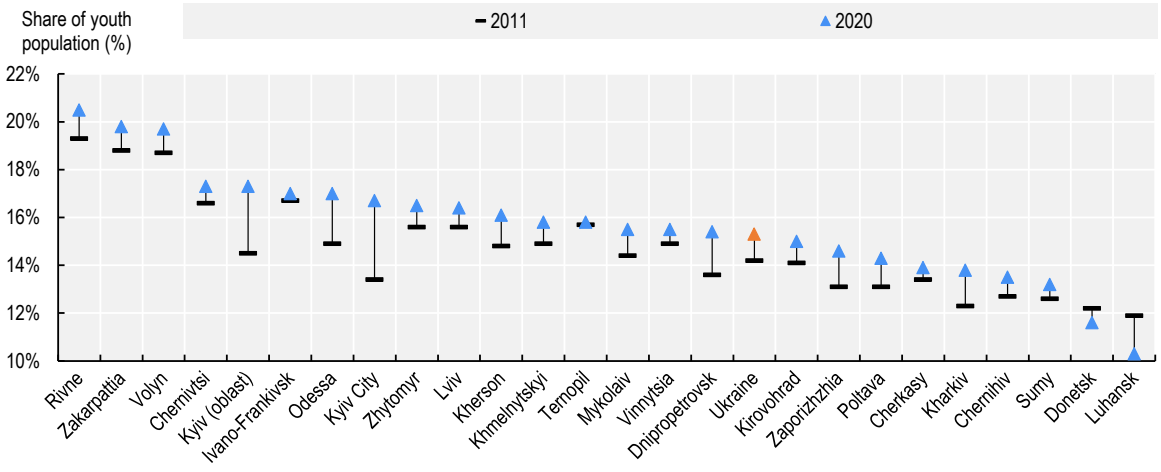
A key variable contributing to Ukraine's demographic decline is ageing. An ageing population typically includes a lower share of people who are economically active. The impact of ageing on Ukraine's population structure can be seen in Figure 3.7 and Figure 3.8, which look at the ratios between the number of people of working age and a) elderly people or b) young people at ages where they are generally economically inactive.

Figure 3.7. Share of elderly population (aged 65 and older) by *oblast* and Kyiv City, 2011 and 2020



Note: Share of elderly population (aged 65 and older) over total population. The chart excludes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol City as no data was available. For 2020, for Luhansk and Donetsk *Oblasts*, calculations (estimates) of the population are made on the basis of available administrative data on state registration of births and deaths and changes in registration of residence.
Source: Author's elaboration with data from (CabMin, 2021[35]).

Figure 3.8. Share of youth population (between the ages of 0 and 14) by *oblast* and Kyiv City, 2011 and 2020



Note: Share of youth population (between the ages of 0 and 14) over total population. The chart excludes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol City as no data was available. For 2020, for Luhansk and Donetsk *Oblasts*, calculations (estimates) of the population are made on the basis of available administrative data on state registration of births and deaths and changes in registration of residence.
Source: Author's elaboration with data from (CabMin, 2021[35]).

Between 2011 and 2020, Ukraine's elderly dependency ratio increased by 1.8 percentage points to 17.1%, which was lower than the OECD average (26.8%). During this period, in all regions, except for Kyiv and Ternopil *Oblasts*, the elderly dependency ratio increased, which can have important implications for the demand for elderly care. The most significant increases were observed in Donetsk and Luhansk *Oblasts* where the share of elderly population as part of the total population increased by 4.7 and 6.0 percentage points, respectively. This might be explained by increased outward migration of the working age population in both regions as of 2014-2015 (when the Donbas war started).

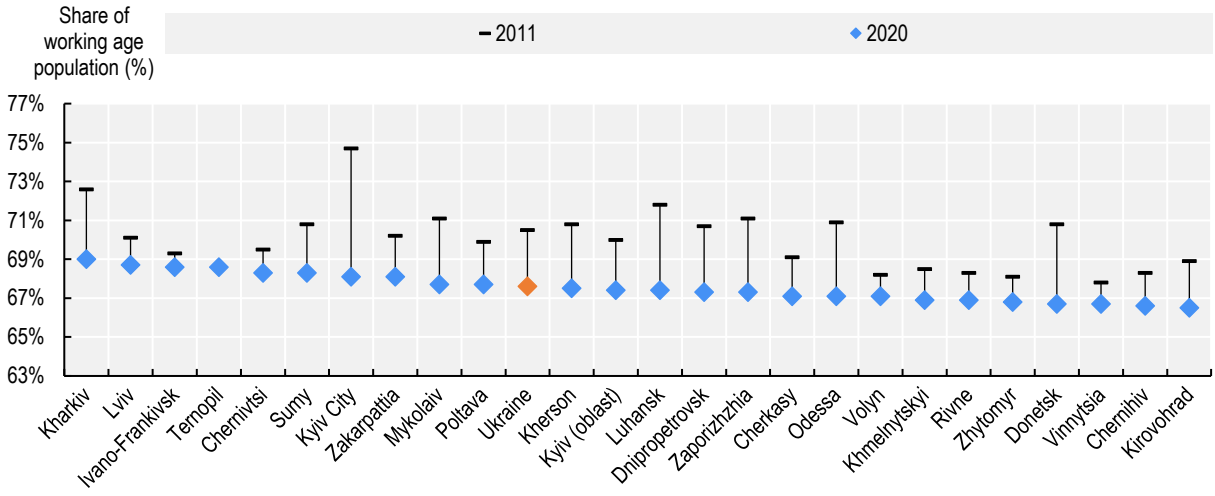
During the same ten-year period, Ukraine's youth dependency ratio increased slightly, from 14.2% in 2011 to 15% in 2020, which was below the OECD average (27.4%). Between 2011 and 2020, in 23 regions and Kyiv City the youth dependency ratio either remained stable or increased. It only declined in Luhansk and Donetsk. Moreover, while in 2020, Rivne, Zakarpattia and Volyn *Oblasts* reported a youth dependency ratio of about 20%, in Luhansk *Oblast* the share of youth population as part of the total population was only 10%, denoting important cross-regional variation. An increasing youth dependency ratio could imply that more investment is needed in areas such as schooling and childcare. The simultaneous increase in youth and elderly dependency in 21 regions and Kyiv City over the past decade implies that their share of working age population as part of their total population decreased.

The regional variations in economically active populations have important ramifications for the design of regional and municipal development policies. These need to take into account the territorially-differentiated effects that population decline and ageing have on productivity and economic development, as well as the current and future demand for public services. Furthermore, declining populations tend to negatively affect tax collection, putting an additional strain on the national and subnational governments' capacity to meet their administrative and service delivery tasks and responsibilities. Given the projections for continued population decline in the coming years, national and subnational development strategies need to contemplate interventions for both depopulation adaptation and mitigation.

Several regions have experienced demographic outflows affecting the labour market

In almost all regions, Ukraine's labour force has been declining. Over the past decade, the working age population (people aged 15-64) as a share of the total population has fallen from 70.5% in 2011 to 67.6% due to demographic decline (Figure 3.9). These values are similar to the OECD average, which also experienced a drop of 1.75 percentage points. However, while in OECD countries this phenomenon is largely due to the ageing of their populations, in the case of Ukraine, the exodus of working age people to other countries, mainly in the EU, accounts for the largest drop.

Figure 3.9. Share of working age population (15-64) by *oblast* and Kyiv City, 2011 and 2020



Note: Share of working age population (15-64) as part of the total population. The working age population comprises the 15-64 age group. The chart excludes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol City as, after 2014, no data was available. For the average of Ukraine in 2010, the chart includes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol City. For Luhansk and Donetsk *Oblasts*, calculations (estimates) of the population are made on the basis of available administrative data on state registration of births and deaths and changes in registration of residence.
Source: Author's elaboration with data from (OECD, 2021[38]) and (CabMin, 2021[35]).

All *oblasts,* except Ternopil (0 percentage points), experienced a reduction in the share of the working age population (15-64) as part of the total population. Particularly significant is the case of Kyiv City—which accounts for a very large share of regional GDP and employment—where the decrease in the working age population was 6.6 percentage points. Luhansk (4.4 percentage points) and Zaporizhzhia (3.8 percentage points) also witnessed significant decreases. In the other *oblasts*, the reported decline was between 1 and 3.5 percentage points, which might be explained by an increased migration of working age population to other parts of Ukraine and/or abroad.

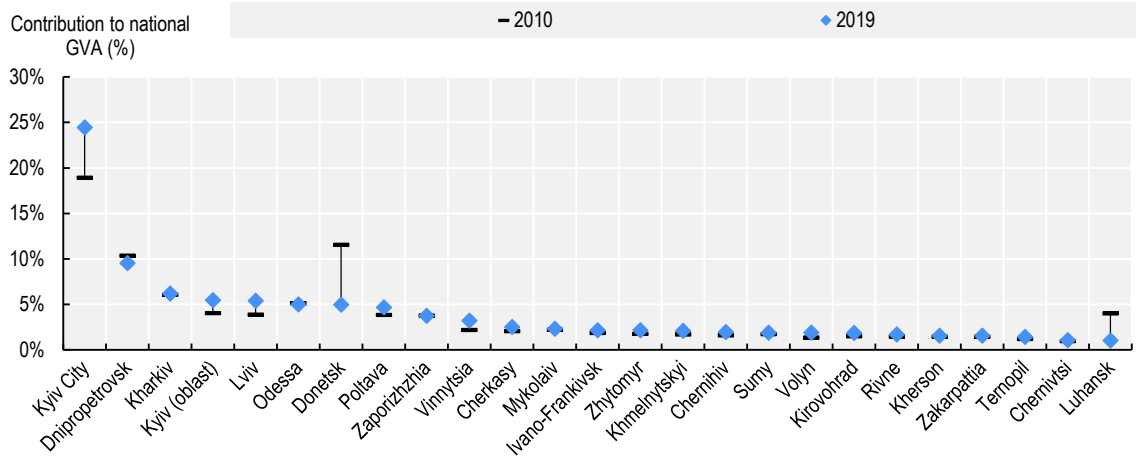
Regional development policies should take into account the effects that the shrinking labour force has on current and future economic development. To stem the flow of migration abroad, the government should also adopt regional development policies that build on local assets to stimulate local economic development, as well as aiming to improve the quality of labour market opportunities in Ukraine compared with other countries.

Regional economic trends point to rising territorial inequality in Ukraine

Ukraine's economic growth has fluctuated heavily over the past decade due to the different shocks mentioned earlier. To rebound from the COVID-19 crisis and set Ukraine's economy on a more solid footing, the country should build on the comparative advantages it possesses and ensure that growth is broad-based, across all sectors and territories.

As Figure 3.10 shows, the contribution to the national Gross Value Added (GVA) of most *oblasts* has not changed much over the last decade. Between 2010 and 2019, the contribution of 20 *oblast*s to the national GVA did not increase or decrease by more than 1 percentage point. Major fluctuations can be identified, however, when looking at Donetsk *Oblast*, Luhansk *Oblast* and Kyiv City. Between 2010 and 2019, the contribution of Donetsk *Oblast* and Luhansk *Oblast* to the national GVA decreased by 7 and 3 percentage points respectively. This change primarily occurred between 2013 and 2015 and is a consequence of the Donbas conflict. Conversely, between 2010 and 2019, the contribution of Kyiv City to the national GVA increased by 6 percentage points. In 2019, Kyiv City alone contributed 24% to national GVA, up from 22% in 2010. Together, Kyiv City and Kyiv *Oblast* contributed 30% to the national GVA in 2019. This means that Ukraine's economy is increasingly dependent on the Kyiv agglomeration, with other regions lagging behind. When excluding the Donetsk and Luhansk *Oblasts* from the equation, the change in the contribution of Kyiv City to the national GVA between 2010 and 2019 is more moderate (3 percentage points), while the drop in the contribution of Dnipropetrovsk *Oblast* is more pronounced (3 percentage points).

Figure 3.10. Contribution of *oblasts* and Kyiv City to the national GVA (%), 2010 and 2019



Note: The chart excludes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol City as, since 2014, no data was available. For 2010, data on these territories was included in the calculation of the contribution to the national GVA of the 24 *oblasts* and Kyiv City.
Source: Own elaboration, based on (CabMin, 2021[35]).

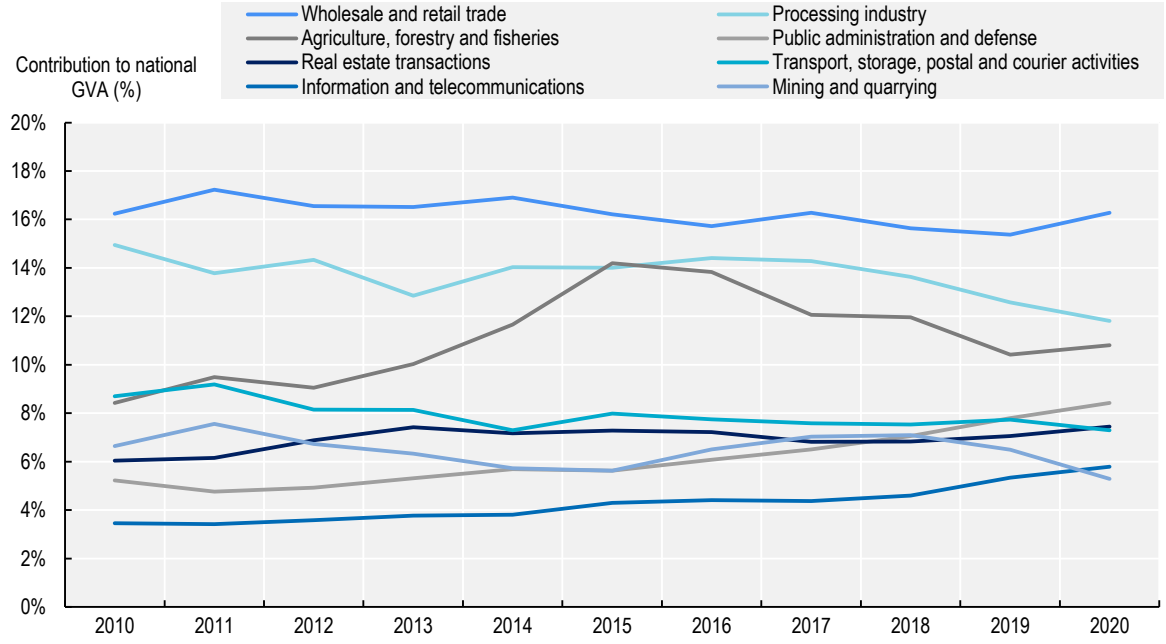
The increasing reliance of Ukraine's economy on Kyiv City could aggravate existing economic disparities in the country, with the capital surging ahead while other regions fall further behind. The gap is widening despite the government's efforts to increase regional competitiveness and cohesion (see Chapter 4). While on the one hand, increasing regional economic divergence may threaten well-being, economic development and social cohesion, on the other, a concentration of people and business (a contributor to economic divergence) could also facilitate faster economic growth. In fact, governments all over the world grapple with the trade-offs between the benefits from agglomeration economies and territorial equity. A

key question for policy makers to answer is how to tackle the challenge of lagging regions without compromising a country's aggregate economic growth (OECD, 2020[39]).

Ukraine's economic structure has changed significantly in recent years

The structure of Ukraine's economy has borne witness to significant volatility over the past decade (Figure 3.11). Between and 2015, and 2020 the biggest change occurred in the public sector, which has reported a growth of almost 50%, followed by information and telecommunications (34.8%). Conversely, the contribution of the agriculture sector fell by 23.9%, followed by the processing industry (15.7%), transport (8.7%) and mining (6%). These changes have important repercussions for productivity levels, the demand for business support services by the private sector, as well as the economic basis of regions and local communities.

Figure 3.11. Contribution of economic sectors to national GVA (%), 2010-2020



Note: 2020 values are preliminary and data are given without taking into account the temporarily occupied territory of the Autonomous Republic of Crimea, Sevastopol City, and since 2014 also without part of the temporarily occupied territories in Donetsk and Luhansk regions.
Source: Author's elaboration with data from (CabMin, 2021[35]).

In 2019, at the regional level, in terms of GVA, agriculture, forestry and fisheries predominated in 14 *oblast*s. This was followed by wholesale and retail trade, which was dominant in Kyiv *Oblast*, Lviv *Oblast*, Volyn *Oblast* and Kyiv City, and the processing industry (dominant in Donetsk *Oblast*, Ivano-Frankivsk *Oblast*, Kharkiv *Oblast* and Zaphorizhzhia *Oblast*). Mining and quarrying was the predominant sector in Poltava *Oblast* and Dnipropetrovsk *Oblast,* while in Odessa *Oblast*, transport, storage, postal and courier services was the dominant sector. It is notable that between 2015 and 2019, only three *oblast*s experienced a change in their dominant industry, denoting relative regional stability in key economic sectors:

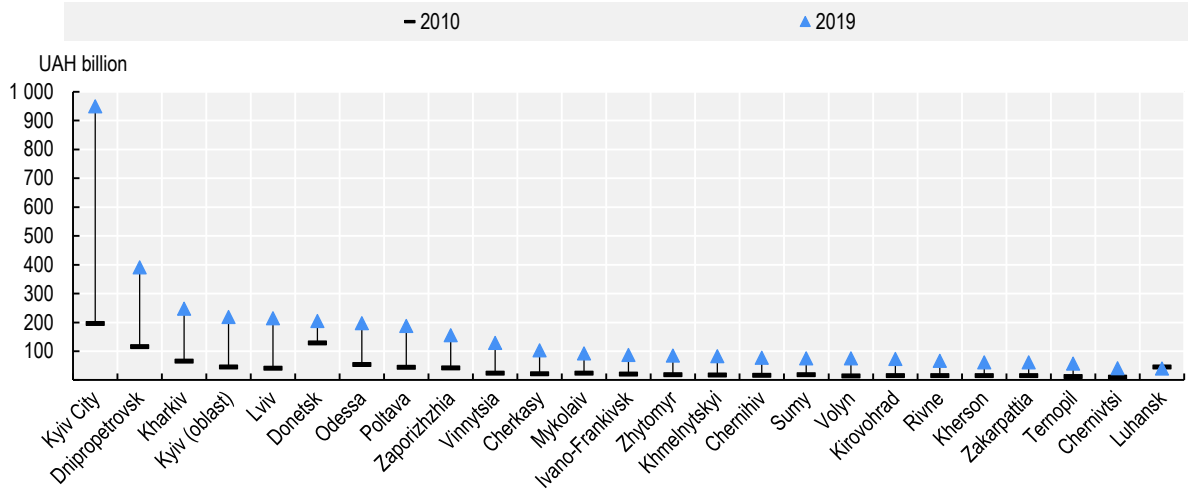
- Ivano-Frankivsk *Oblast*: from agriculture, forestry and fisheries to processing industry;
- Volyn *Oblast*: from agriculture, forestry and fisheries to wholesale and retail trade;
- Dnipropetrovsk *Oblast*: from processing industry to mining and quarrying.

Ukraine's productivity must continue to grow in all regions to improve competitiveness

Low productivity is a critical challenge for Ukraine's development. In 2019, GDP per employed person in terms of purchasing power parity stood at USD 29 245, which is similar to its level in 2012 (USD 28 845). The stagnant productivity of the economy and its uneven territorial distribution contribute to increased inter-regional asymmetries.

At the end of 2019, Kyiv City had the highest volume of Gross Regional Product (GRP) and Luhansk *Oblast* the lowest (Figure 3.12). It is notable that Kyiv City recorded an almost five-fold increase in GRP per capita between 2010 and 2019. Conversely, many *oblasts* saw only a slight rise in GRP over the ten-year period, or a drop in the case of Luhansk *Oblast*. This further highlights how growth in the Ukrainian economy was being increasingly driven by the capital city. The vast differences in GRP growth highlight the need for tailored public investment that builds on local assets, allowing those regions that are marked by limited economic growth to catch up with their peers.

Figure 3.12. Change in the Gross Regional Product (GRP) by *oblast* and Kyiv City, 2010 and 2019

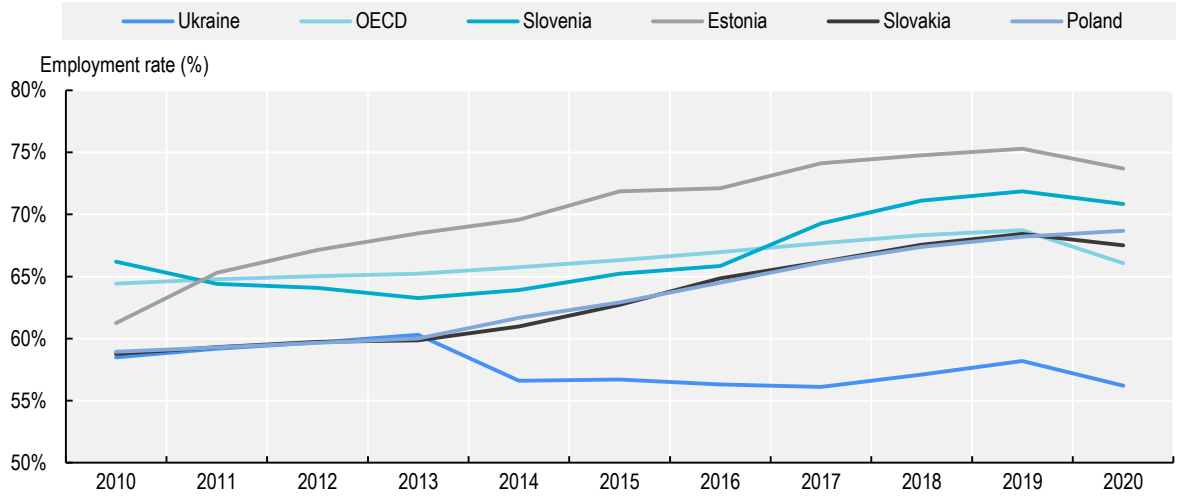


Note: The chart excludes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol City as, since 2014, no data was available
Source: Author's elaboration with data from (CabMin, 2021[35]).

Ukraine is falling further behind its peers in terms of employment rate

In 2020, Ukraine's official employment rate was 56.2%, well below the OECD average (66.1%), and also below that of other Central, East European and Baltic countries, such as Estonia, Poland, the Slovak Republic and Slovenia (Figure 3.13). Over the past decade, employment rates in all comparator countries increased by between 1.7 and 12.5 percentage points, while in Ukraine they fell by 2.3 percentage points. Besides demographic decline, key labour market challenges include the relatively low share of female participation in the labour force, as well as high rates of labour informality (20.3%). However, these effects are not uniform across Ukraine's territories.

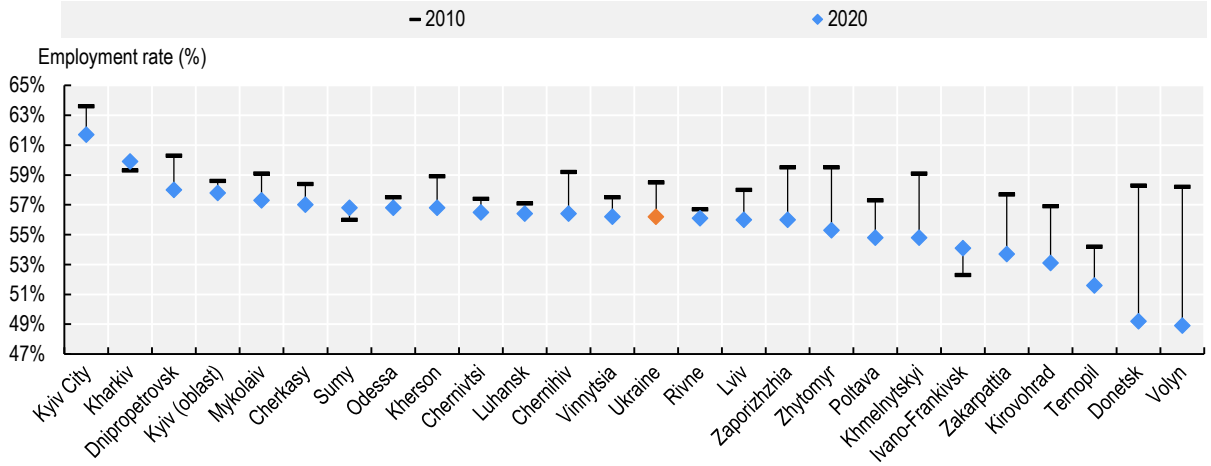
Figure 3.13. Employment rate in Ukraine compared to selected countries, 2010-2020



Source: Author's elaboration with data from (OECD, 2021[38]) and (CabMin, 2021[35]).

Employment rates vary significantly by *oblast*. In 2020, Kyiv City had the highest rate of official employment (61.7%), followed by Kharkiv *Oblast* (59.9%) (Figure 3.14). By contrast, Volyn *Oblast* and Donetsk *Oblast* had the lowest rates of official employment (48.9% and 49.2%) respectively. It should also be noted that the rates of employment growth varied significantly across regions. Between 2010 and 2020, only Ivano-Frankivsk, Sumy and Kharkiv *Oblasts* reported positive growth in their official employment rates (3.4%, 1.4% and 1%, respectively), while all other *oblast*s and Kyiv City reported declines.

Figure 3.14. Employment rate by *oblast* and Kyiv City, 2010 and 2020



Note: The chart excludes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol City as, since 2014, no data was available. For the calculation of the national employment rate in 2010, data on both territories was included.
Source: Author's elaboration with data from (CabMin, 2021[35]).

The variation in regional performance in terms of employment rates illustrates the need to design regional development strategies that provide tailored policy solutions to local employment barriers and conditions.

These can include weak employability of the local labour force due to limited work readiness (low work-related skills, education or a lack of work experience), work availability (e.g. due to care responsibilities or health-related limitations) or scarce opportunities due to insufficient job creation. A place-based approach could involve triple helix actors (local firms, education institutions and government) collaborating to develop initiatives that effectively address regional skills imbalances.

Low female labour force participation is holding back regional development

An additional challenge facing Ukraine's economy is its male-dominated labour market (Table 3.2). In 2020, on average, the labour market participation rate of men was 9 percentage points higher than that of women. However, there were significant regional variations of this phenomenon. In some *oblasts*, this difference was much higher, reaching 40 percentage points in Zakarpattia and around 25 percentage points in Odessa, Ivano-Frankivsk and Kherson. Only Chernihiv reported balanced labour participation rates, while Kyiv City and Rivne *Oblast* were the only regional-level administrative units in the country where the labour market participation of women was higher than that of men, by 2 percentage points.

Table 3.2. Subnational employment indicators of Ukraine, 2010, 2019 and 2020

	Employees aged 15-64			Ratio men-women	Key employment sector in the region (share of employment)	
Region	2011	2020	Change	2020	2019	
Cherkasy	69%	67%	2%	1.03	Agriculture, forestry and fisheries	28.20%
Chernihiv	68%	67%	2%	1	Agriculture, forestry and fisheries	25.40%
Chernivtsi	70%	68%	1%	1.1	Agriculture, forestry and fisheries	28.30%
Dnipropetrovsk	71%	67%	3%	1.04	Wholesale and retail trade	26.40%
Donetsk	71%	67%	4%	1.08	Industry	25.60%
Ivano-Frankivsk	69%	69%	1%	1.23	Agriculture, forestry and fisheries	29.50%
Kharkiv	73%	69%	4%	1.07	Wholesale and retail trade	24.50%
Kherson	71%	68%	3%	1.21	Agriculture, forestry and fisheries	30.30%
Khmelnytskyi	69%	67%	2%	1.1	Agriculture, forestry and fisheries	28.40%
Kirovohrad	69%	67%	2%	1.05	Agriculture, forestry and fisheries	29.80%
Kyiv (*oblast*)	70%	67%	3%	0.98	Wholesale and retail trade	27.20%
Kyiv City	75%	68%	7%	1.1	Wholesale and retail trade	23.10%
Luhansk	72%	67%	4%	1.07	Wholesale and retail trade	28.20%
Lviv	70%	69%	1%	1.08	Wholesale and retail trade	20.10%
Mykolaiv	71%	68%	3%	1.11	Agriculture, forestry and fisheries	29.10%
Odessa	71%	67%	4%	1.25	Wholesale and retail trade	24.60%
Poltava	70%	68%	2%	1.12	Wholesale and retail trade	22.40%
Rivne	68%	67%	1%	0.92	Wholesale and retail trade	27.10%
Sumy	71%	68%	3%	1.04	Agriculture, forestry and fisheries	24.20%
Ternopil	69%	69%	0%	1.11	Agriculture, forestry and fisheries	32.80%
Vinnytsia	68%	67%	1%	1.13	Agriculture, forestry and fisheries	34.10%
Volyn	68%	67%	1%	1.13	Wholesale and retail trade	23.20%
Zakarpattia	70%	68%	2%	1.4	Agriculture, forestry and fisheries	26.30%
Zaporizhzhia	71%	67%	4%	1.09	Wholesale and retail trade	22.20%
Zhytomyr	68%	67%	1%	1.09	Wholesale and retail trade	25.40%
Ukraine	**71%**	**68%**	**3%**	**1.09**	**Wholesale and retail trade**	**22.9%**

Note: The dataset from the SSSU excluded data on the temporarily occupied territories of the Autonomous Republic of Crimea, Sevastopol City and a part of temporarily occupied territories in the Donetsk and Luhansk regions.
Source: Author's elaboration with data from (CabMin, 2021[35]).

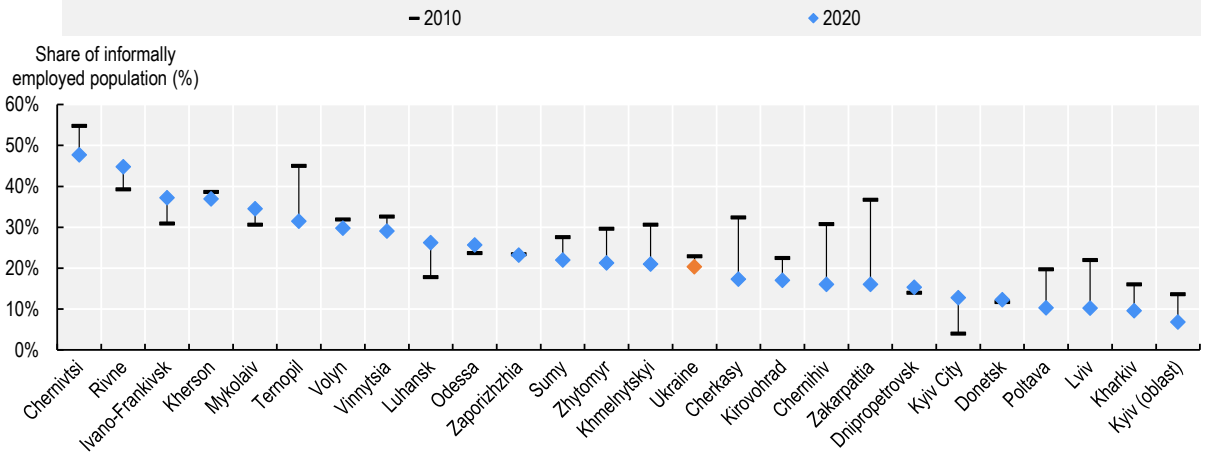
In 2019, at the national level, the dominant employment sector was wholesale and retail trade. Agriculture, by contrast, was the dominant employment specialisation of half of the 24 *oblasts*. Eleven *oblasts* relied on the wholesale and retail trade sector for their largest share of economic activity. Only in Donetsk was industry the main economic sector, in terms of employment.

High levels of informality constrain Ukraine's economic outlook

Ukraine's labour market is characterised by a high level of labour market informality. A 2017 survey of workers across the country showed that 46% of respondents knew someone who worked informally (ILO, 2019[40]). While informal work can provide an important entry point to work and entrepreneurship, a large share of informality in the economy has detrimental effects on a wide range of issues, including worker well-being, public revenues, labour productivity, and fair competition. Furthermore, it can limit well-being by leaving a sizeable cross-section of the population with less access to key public services, such as social protection and healthcare. Moreover, people employed in the informal labour force tend to face high occupational risks. Without adequate policies to manage these risks, such workers will remain particularly vulnerable and may pass this vulnerability on to children and the elderly (OECD/ILO, 2019[41]).Given the pervasiveness of this problem in several regions, the government should make tackling labour informality a key regional development priority.

As with other indicators, it is important to highlight the significant regional differences in informal employment (Figure 3.15). Whereas in 2020 almost half of the total workforce of Chernivtsi *Oblast* and Rivne *Oblast* was informally employed, in other *oblasts*, notably Lviv, Kharkiv, Kyiv and Poltava, this percentage was barely 10%. Similarly, the change in informal employment between 2010 and 2020 varied significantly between regions. For example, Kyiv City saw the biggest increase in informal employment (320%), followed by Luhansk *Oblast* (147%). A key element explaining the increase in informal employment in Kyiv *Oblast* is the influx of internally displaced people from the Donbas. During the same period, however, informal employment actually declined in 17 *oblasts*. For example, in Zakarpattia *Oblast* and Lviv *Oblast*, informal employment decreased by over 50%.

Figure 3.15. Share of informally employed population aged 15-70 by *oblast* and Kyiv City, 2010 and 2020



Note: The chart excludes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol City as, since 2014, no data was available. For the calculation of the national share of informally employed people (age 15-70) in 2010, data on both territories was included.
Source: Author's elaboration with data from (CabMin, 2021[35]).

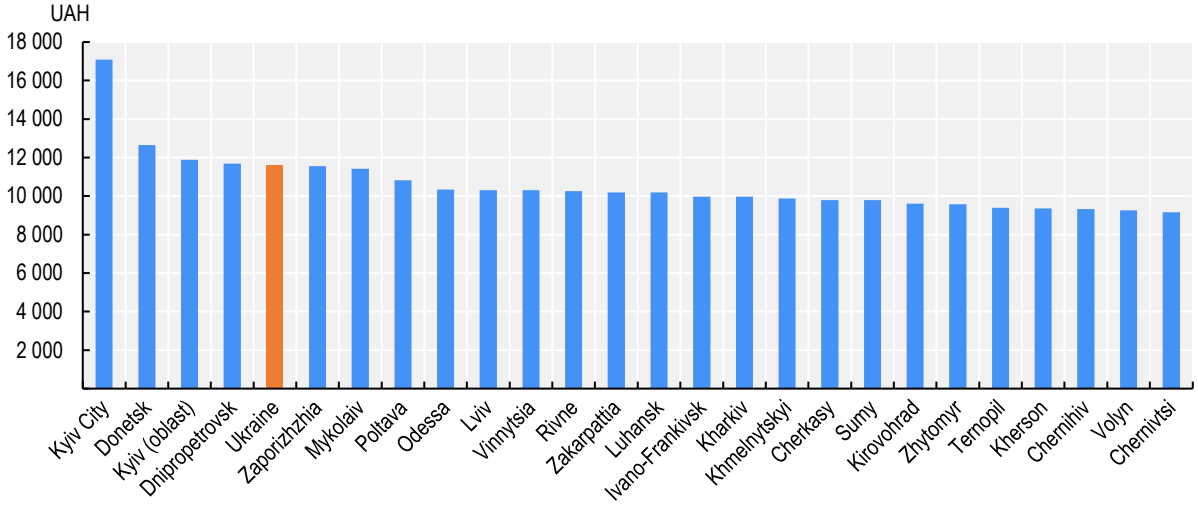
Informality is generally associated with poverty, lack of access to financial systems, and deficient public health and medical resources. Informal workers are more prone to have few savings and tend to lack access to formal social benefits, which makes them particularly vulnerable to economic shocks (World Bank Group, 2021[42]).

The regional variations in informality highlight the need to develop and implement territorially-differentiated policies that build on local employment and business dynamics, and to match these with measures aimed at increasing formal employment. Depending on local characteristics, such measures could include simplifying regulations, enhancing access to finance and investing in human capital. Measures could also include investment in the digitalisation of services and the creation of one-stop-shops to increase informal workers' access to public resources (OECD, 2021[43]). Several OECD member countries (e.g. France, Italy and Mexico) use social vouchers as a tool to formalise work by enabling access to particular goods and services. An assessment of French food and meal vouchers, created in 1962, found that they benefited almost 4.5 million workers and 140 000 companies (80% of which are SMEs). The study estimated that for every EUR 1 of contribution from the employer for the vouchers, EUR 2.55 were reinjected into the local economy, resulting in the creation of 164 000 jobs (OECD, 2021[44])

Low wages in Ukraine's regions are a key driver of emigration

While wages in Ukraine are low when compared to almost all its neighbouring countries, the country also has a large wage differential at the regional level (Figure 3.16). In 2020, the average monthly wage per capita of workers in Kyiv City was UAH 17 086 (USD 633) and that of Kyiv *Oblast* reached UAH 11 887 (approximately USD 441). This reflects the high concentration of economic and value-added activities in and around the capital. Other *oblasts* that performed relatively well were Mykolayiv, Zaporizhzhia and Dnipropetrovsk in the central and eastern parts of the country, with average monthly per capita wages of workers between UAH 11 000 and 12 000. Twelve regions had average wages below UAH 10 000, with Chernivtsi ranking the lowest (UAH 9 166, about USD 340), almost half that of Kyiv City.

Figure 3.16. Average monthly wages of regular employees by *oblast* and Kyiv City, 2020



Note: Wage accruals per pay-roll, in UAH. The chart excludes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol City as no data was available. It also excludes the temporarily occupied territories in Donetsk and Luhansk.
Source: Author's elaboration with data from (CabMin, 2021[35]).

Low wages are a key driver of outward migration, which has important ramifications for subnational economic development. To address the issue of low wages, policy makers should look to build on the territorial strengths and assets of individual regions, including location, physical infrastructure, and natural and human resources. They could also include the quality of public services, such as education and healthcare.

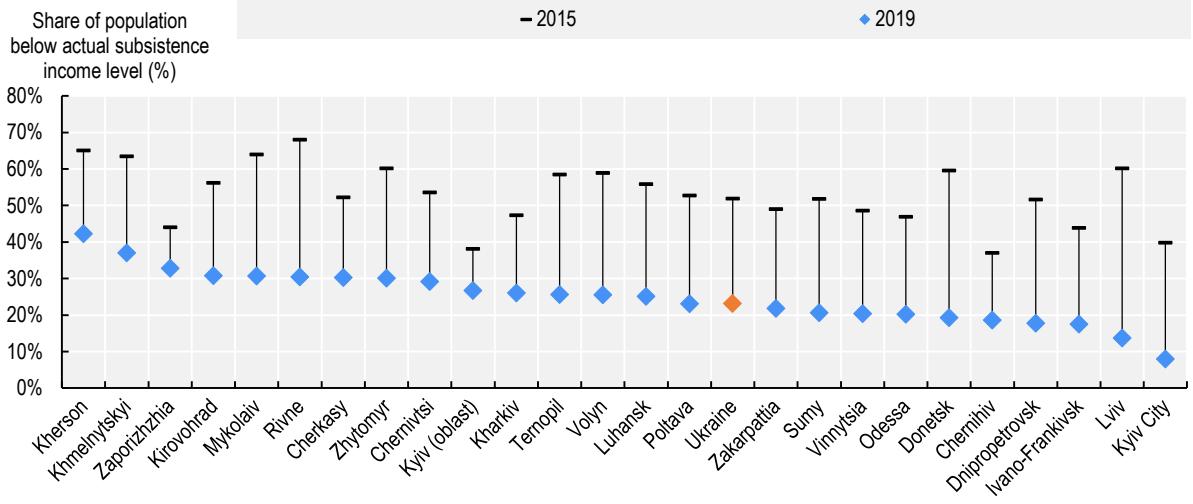
Indicators of regional well-being in Ukraine

While macroeconomic indicators, such as GDP, provide a good measure of financial or material well-being, they only provide a partial picture of well-being in its fullest sense, including for example the living conditions of citizens. The following sections look at issues such as access to healthcare, education and the prevalence of poverty and crime. They also address how the performance of regions in these areas differs.

Poverty indicators are moving in the right direction across Ukraine

Between 2015 and 2019, there was a significant improvement in the levels of regional poverty in Ukraine. Indeed, the national share of the population living below the actual subsistence income level fell by over half, from 52% to 23%. This decline was driven, at least in part, by real wage growth (World Bank, 2019[45]). Despite regional variations in the extent of the drop, all 24 *oblasts* experienced a decline (Figure 3.17). The fall was steepest in Lviv *Oblast,* which went from having one of the highest regional rates of population living below the actual subsistence income (60% in 2015) to one of the lowest (14% in 2019). By contrast, Zaporizhzhia *Oblast* recorded a decline of only 11 percentage points over the same period. This positive trend has important implications for regional and local development as it may affect the demand for and cost of social service delivery, for example. At the same time, all levels of government are encouraged to gather in-depth data to identify which particular groups and communities are still living in poverty, in order to better design policies and services that address their needs.

Figure 3.17. Population below the actual subsistence income level by *oblast* and Kyiv City, 2015 and 2019

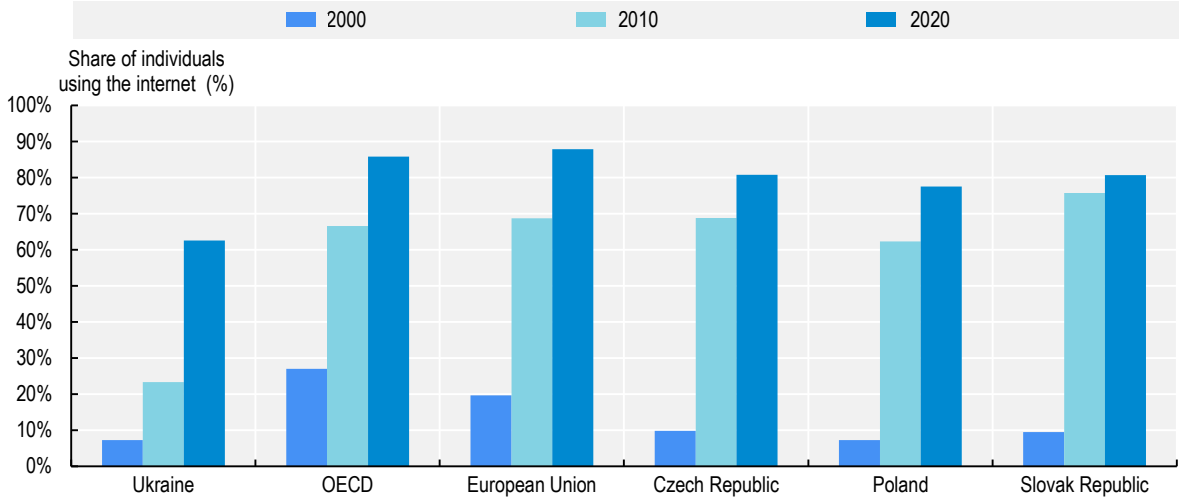


Note: The average monthly actual subsistence minimum in 2015 was UAH 2 257.0, in 2016 UAH 2 642.38, in 2017 UAH 2 941.46, in 2018 UAH 3 262.67 and in 2019 UAH 3 660.94 per person per month. The chart excludes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol City as no data was available. It also excludes part of the temporarily occupied territories in Donetsk and Luhansk *Oblasts*.
Source: Author's elaboration with data from (CabMin, 2021[35]).

Internet access in Ukraine has surged over the past two decades

Internet access in Ukraine has improved significantly over the past two decades, rising from 23% in 2000 to 63% in 2020 (Figure 3.18). However, progress has been much more pronounced in urban centres than in rural areas. Internet access in Ukraine also remains lower than in comparator countries such as Poland (78%), Slovak Republic (81%) or the Czech Republic (81%), and well below the average for OECD countries (86%). The COVID-19 pandemic highlighted the importance of internet access for continued provision of key public services (e.g. education) and to facilitate remote working.

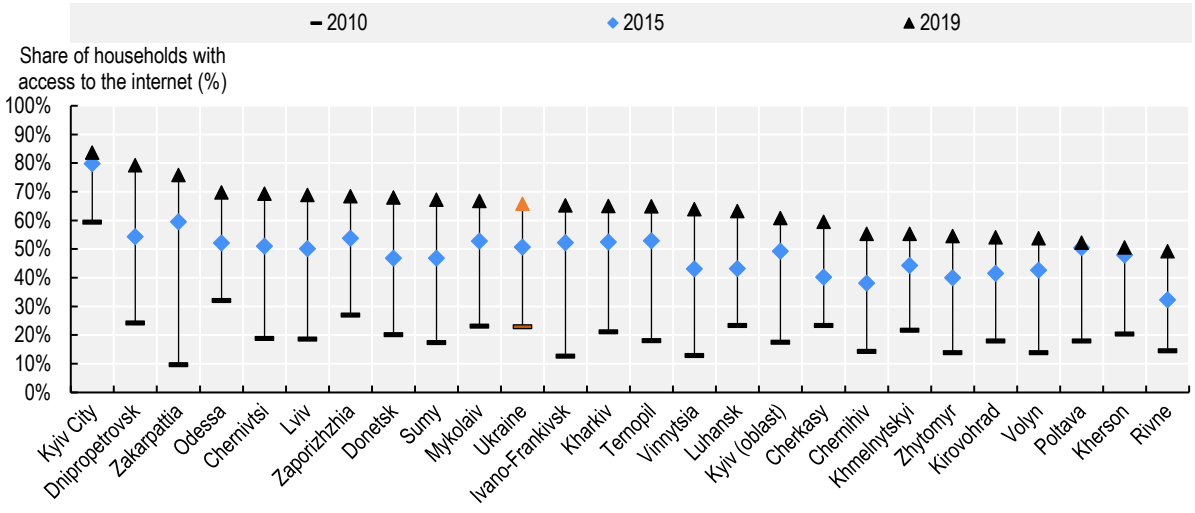
Figure 3.18. Share of individuals using internet in Ukraine and selected countries, 2000, 2010 and 2020



Source: Author's elaboration with data from (Synowiec, 2021[46]).

All *oblasts* have enjoyed increased internet access over the past decade (287% increase on average) and the difference between the best and worst performing regions decreased between 2010 and 2019. At the same time, progress has been uneven across territories (Figure 3.19). Kyiv City has the highest level of internet access in the country (84% of households), followed by Dnipropetrovsk *Oblast* and Zakarpattia *Oblast* (79% and 76% respectively). By contrast, the territory with the lowest level of internet access in Ukraine was Rivne *Oblast*, where only 49% of citizens had access to broadband services. The territorial digital divide illustrated by these data points shows that there is still room for improvement in the rollout of internet networks across Ukraine, particularly in the south and southeast. This is vital not only in the context of the COVID-19 recovery phase, but also more generally to improve service delivery, economic development and the well-being of citizens.

Figure 3.19. Proportion of households that have access to internet services at home by *oblast* and Kyiv City, 2010, 2015 and 2019

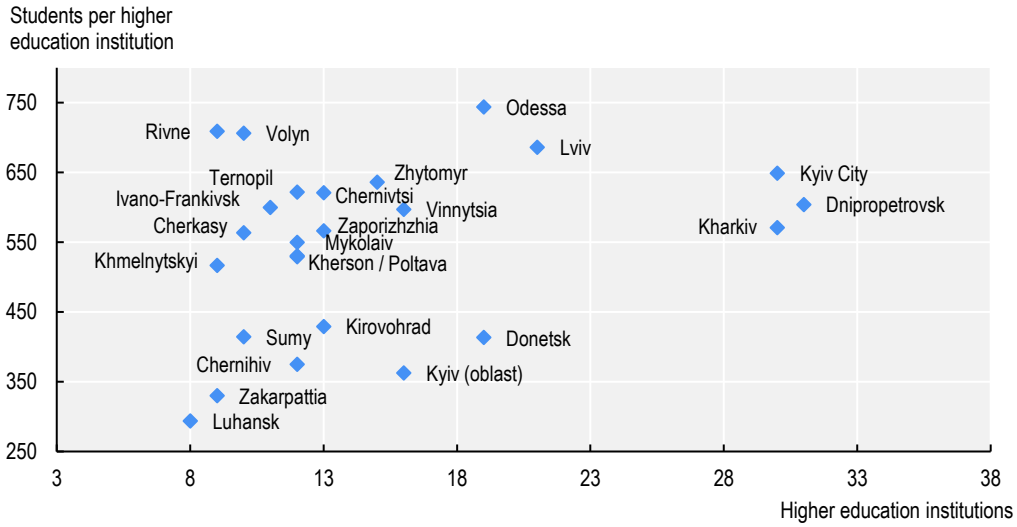


Note: The chart excludes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol City as no data was available for these territories.
Source: Author's elaboration with data from (CabMin, 2021[35]) and based on the results of a sample survey of living conditions of households.

Access to higher education institutions varies significantly across regions

Ukraine benefits from a high number of secondary education institutions, with regional variations in terms of the number of education institutions and the number of students per institution (Figure 3.20). In 2020, the number of students per higher education institution ranged from less than 300 in Luhansk to 744 in Odessa *Oblast*. Dnipropetrovsk and Kharkiv *Oblasts*, along with Kyiv City, had a relatively high number of higher education institutions, as well as a high concentration of students. This concentration of knowledge in specific territorial pockets can weaken access to knowledge in other territories, and affect innovation potential. In order to measure changes in access to education, ideally, data on additional indicators are assessed, such as enrolment rates. However, no such statistics were available.

Figure 3.20. Number of students and higher education institutions by *oblast* and Kyiv City, 2020



Note: The chart excludes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol City as no data was available for these territories.
Source: Author's elaboration with data from (CabMin, 2021[35]).

Improving education and skills is essential to ensuring that the supply of human capital matches local labour demand. This not only implies increasing university enrolment, but also improving skills at the lower end, for example by reducing school dropout rates. In fact, regional data from across the OECD show that the share of low-skilled workers appears to have a greater impact on growth than the proportion of workers with tertiary qualifications (OECD, 2012[47]). Policies that aim to upskill the labour force may thus be as important for growth as policies aimed at expanding access to higher education. In this regard, the territorial dimension is critical, as low- to medium-skilled workers tend to be less mobile than those that are highly skilled. This requires policies aimed at addressing skill gaps in order to better adapt to needs and assets (OECD, 2012[47]). To make informed decisions on how to improve access to education and the skills of the local labour force, it is essential for Ukraine to invest in improving the availability of sectoral data on the subnational level. For example, the country should consider gathering regional data on the school enrolment rate of different age groups, the population with upper secondary, post-secondary, non-tertiary and tertiary education, or even the rate of young people not in employment and not in any education and training (NEET).

The government could explore micro-credentials as a means of building expertise and skills of learners of all ages. Micro-credentials refer to a form of certification issued for a relatively small, short and highly targeted learning project. Policy makers have come to see micro-credentials as a way to provide learners with important opportunities for academic advancement, upskilling and reskilling, as well as to improve access to education opportunities overall. When developed together with (higher) education institutions and the private sector, micro-credentials can be a very useful tool to meet (changing) regional and local labour demands (OECD, 2021[48]; OECD, 2020[49]).

Efforts with respect to upskilling and reskilling the adult population are highly necessary. As shown in Figure 3.14, employment rates are low in Ukraine in comparison to the OECD average and especially female labour market participation lags significantly behind that of men. While this suggests a high unmet labour potential, people outside the labour force often have obsolete skills and their (re-)integration into the labour market will require supporting them with upskilling and reskilling to meet the employers' needs. While difficult to predict, economic restructuring in the post-war period driven by continued digitalisation

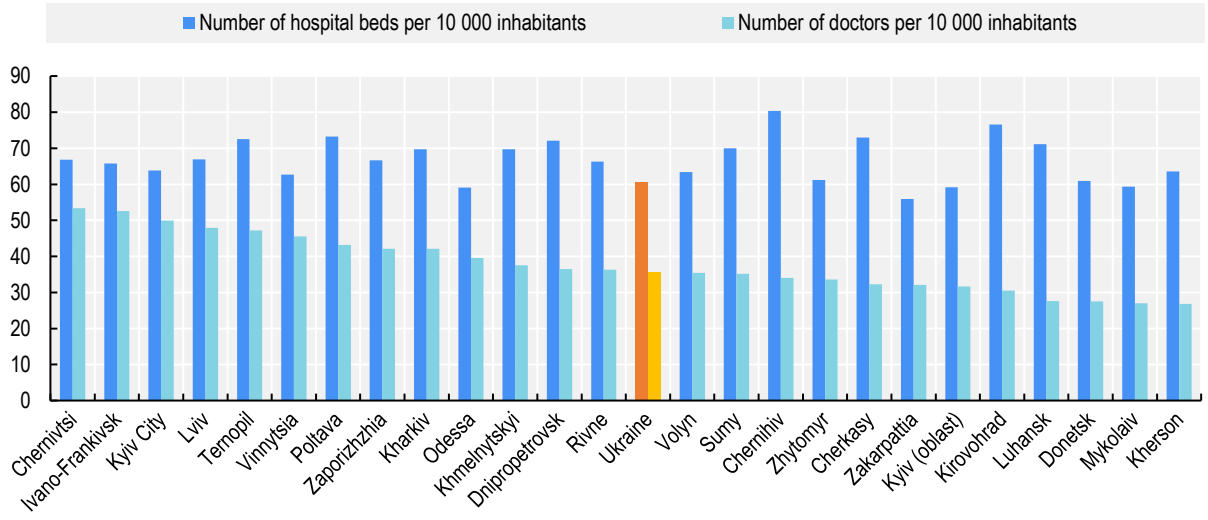
and the green transition may also imply demand for different and new skills. Hence, also people who actively participated in the workforce before the war may require further education and training to have the skills that meet changing regional and local labour demands.

Territorial disparities in healthcare undermine the capacity of regions to respond to crises

In 2020, the number of doctors per capita in Ukraine (36 per 10 000) was higher than the OECD average (33). However, there were also significant territorial variations with implications for the COVID-19 crisis, particularly given Ukraine's low vaccination rates, and more recently in dealing with victims of Russia's aggression. Of the 24 *oblasts*, 15 were above the OECD average in terms of doctors per capita. Chernivtsi and Ivano-Frankisvk had, on average, more than 50 doctors per 10 000 inhabitants (53.4 and 52.3 respectively). Nine *oblasts* had fewer doctors per capita than the OECD average: Donetsk, Kyiv, Kirovograd, Luhansk, Mykolaiv, Kherson, Cherkasy, Chernihiv, Zhytomyr and Zakarpattia (Ministry of Health, 2020[50]).

There are also disparities in the number of hospital beds per capita across Ukrainian regions (Figure 3.21). While the number of hospital beds per 10 000 inhabitants in Ukraine stood at 60.5 in 2020, it reached 80.4 in Chernihiv *Oblast* and 76.6 in Kirovohrad *Oblast*. On the other side of the ledger, Zakarpattia *Oblast* had 55.4 beds per 10 000 inhabitants, which was more than the majority of OECD member countries in the same year (OECD, 2022[51]).

Figure 3.21. Provision of doctors and hospital beds per 10 000 inhabitants by *oblast* and Kyiv City, 2020



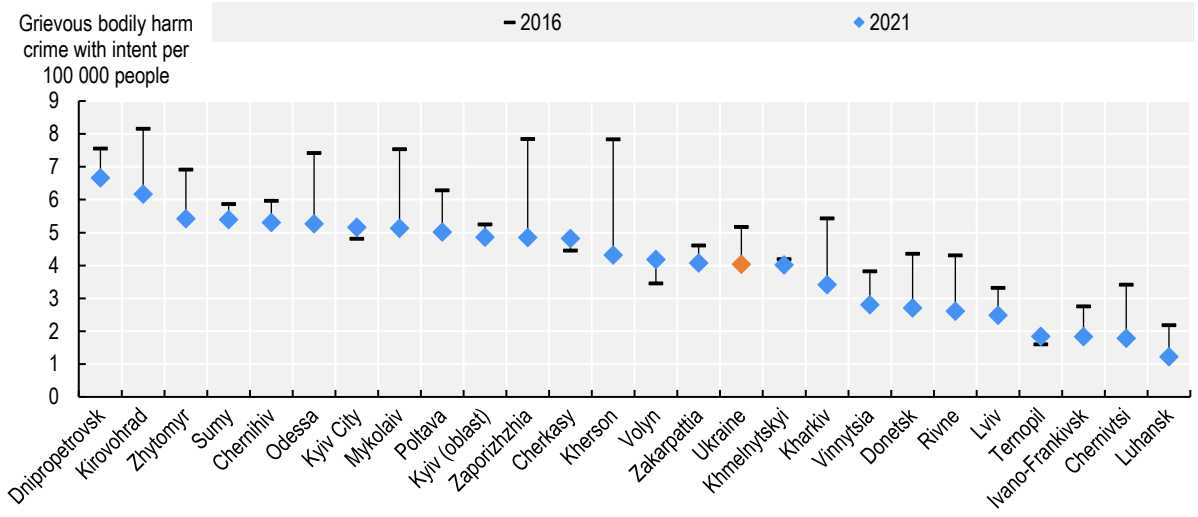
Note: The chart excludes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol City as, after 2014, no data was available.
Source: Author's elaboration with data from (Ministry of Health, 2020[50]).

While territorial variation in access to healthcare is common in OECD countries, it can have important implications for a region's preparedness to deal with health or other crises requiring medical attention. Improving access to healthcare requires active collaboration among and across levels of governments. For example, inter-municipal co-operation agreements can be developed to improve access to healthcare institutions. Likewise, it may require investment in infrastructure and human resources that respond to local demands. These tend to vary as, for example, the share of the elderly population differs across regions.

Violent crime in post-Maidan Ukraine declined sharply overall, although regional variations exist

Ukraine saw improvements in the physical safety of its population between 2016 and 2020 across a number of indicators. For example, in this period Ukraine saw a drop in the number of grievous bodily harm with intent crimes that were committed on its territory (from 5.2 to 4.0 per 100 000) (Figure 3.22). The level of this type of crime was generally lowest in the western part of the country. Of the five *oblasts* that reported the highest rates of this type of crimes per 100 000 people—Dnipropetrovsk, Kirovohrad, Zhytomyr, Sumy and Chernihiv—four were located in the east or southeast of Ukraine.

Figure 3.22. Grievous bodily harm with intent per 100 000 people by *oblast* and Kyiv City, 2016 and 2020



Note: Grievous bodily harm with intent (Article 121 of the Criminal Code of Ukraine). The chart excludes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol City as no data was available for these territories.
Source: Author's elaboration with data from (CabMin, 2021[35]).

Crime and violence can have a major impact on the social and economic well-being of communities and citizens. The dynamics of crime and insecurity can severely affect the attractiveness of a region for citizens and companies. This makes public safety an important issue for national and subnational governments to address through place-based regional development policy. Policies should be based on the relationships between violent crime and subnational well-being dimensions to identify complementarities in different policy domains, increasing the effectiveness of policy interventions (OECD, 2014[52]).

Pursuing regional development in a complex environment

The analysis of quantitative data of Ukraine's performance on a series of socio-demographic, economic, labour, governance and well-being indicators at the national and regional levels point to a mixed performance.

On the one hand, Ukraine progressed significantly in a number of areas. For example, as a consequence of ambitious judicial and governance reforms that the government has been pursuing since 2014, performance on the different Worldwide Governance Indicators improved between 2015 and 2020. Most progress was made in the field of political stability. At the same time, Ukraine still ranked relatively low on

most indicators in 2020, particularly those related to the rule of law and corruption, signalling ample room for improvement. Ukraine also witnessed an impressive drop in poverty (primarily a result of increases in real wages) and internet access increased significantly across the country. In both fields, regional disparities decreased over the last decade. Further expanding broadband coverage, especially in rural areas, will be essential to allow lagging regions to fully capitalise on the economic and social benefits of digitalisation.

On the other hand, Ukraine's performance on a number of demographic, economic and well-being indicators has remained poor or worsened since 2011. For instance, the successive political and economic crises (e.g. the Global Financial Crisis, Donbas war, COVID-19 pandemic and now Russia's war against Ukraine) have negatively affected the convergence of Ukraine's economy with post-Soviet and neighbouring countries. Moreover, the national economy has become increasingly dependent on the Kyiv agglomeration, with other regions struggling to catch up. This was caused, among other reasons, by the Donbas war that sparked a drop in the gross value added of Donetsk and Luhansk, which historically were major centres of industrial production. Moreover, by the end of 2021, almost all of Ukraine's regions suffered from decreasing population and a shrinking labour force, with significant implications for the cost of and demand for public services, as well as productivity and economic development. Outward migration—primarily driven by low wages compared to Ukraine's neighbours—was a key contributor to the population decline. Economic growth also appears to be strained by limited participation of women in the labour force. In all regions, except three, labour market participation of men was higher than that of women in 2020. To address this issue, tailored labour market policies need to be designed and implemented in a way that takes into account local roadblocks to female participation in the labour force and builds on territorial assets. Ukraine also reported stark regional discrepancies in terms of access to key public services such as education. Improving the quality of and access to education for learners of all ages across the country is essential to ensure that the supply of human capital meets local labour demands. New learning opportunities could be created—including for the adult population—through micro-credentials that respond to regional labour needs.

These trends provide the backdrop against which Ukraine has designed and implemented its regional and local development policies. Moreover, the data presented above can support evidence-based decision making by national and subnational policy makers as they advance with the creation and implementation of a framework for subnational reconstruction and recovery.

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Annex 3.A. Benchmark countries

Annex Table 3.A.1. Benchmark country selection OECD, EU, post-Soviet countries and neighbouring countries

OECD countries	EU countries	Post-Soviet countries	Neighbouring countries
Australia	Austria	Armenia	Belarus
Austria	Belgium	Azerbaijan	Moldova
Belgium	Bulgaria	Estonia	Poland
Canada	Croatia	Georgia	Romania
Chile	Cyprus	Kazakhstan	Russian Federation
Colombia	Czech Republic	Kyrgyz Republic	Slovak Republic
Costa Rica	Denmark	Latvia	
Czech Republic	Estonia	Lithuania	
Denmark	Finland	Moldova	
Estonia	France	Russian Federation	
Finland	Germany	Tajikistan	
France	Greece	Turkmenistan	
Germany	Hungary	Uzbekistan	
Greece	Ireland		
Hungary	Italy		
Iceland	Latvia		
Ireland	Lithuania		
Israel	Luxembourg		
Italy	Malta		
Japan	Netherlands		
Korea	Poland		
Latvia	Portugal		
Lithuania	Romania		
Luxembourg	Slovak Republic		
Mexico	Slovenia		
Netherlands	Spain		
New Zealand	Sweden		
Norway			
Poland			
Portugal			
Republic of Türkiye			
Slovak Republic			
Slovenia			
Spain			
Sweden			
Switzerland			
United Kingdom			
United States			

Annex 3.B. Implementation status of 2018 OECD recommendations on regional development

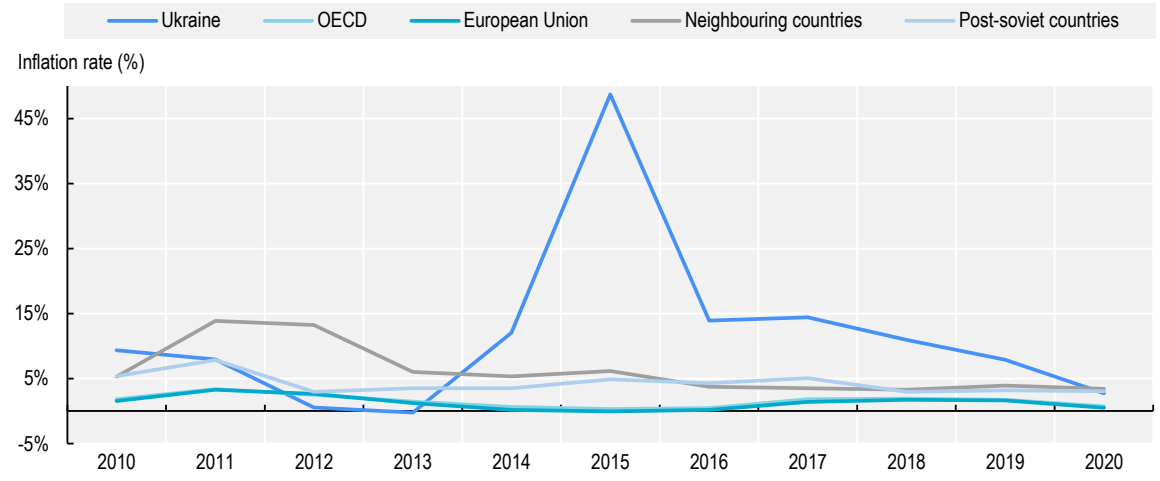
Annex Table 3.B.1. State of implementation of selected recommendations from the OECD *Maintaining the Momentum of Decentralisation in Ukraine* report

2018 recommendation	Comment
Strengthen co-ordination mechanisms by reinforcing the capacities of the Secretariat for the Cabinet of Ministers.	**Limited progress** - Since 2018, the co-ordination capacities of the Secretariat for the Cabinet of Ministers have not increased substantially. - Several central executive agencies and other public institutions contributed to the development of the State Strategy for Regional Development 2021-2027 and Economic Strategy 2030. - The existing co-ordination bodies for the development, implementation, financing and monitoring of Ukraine's regional development policy leave ample room for improvement. - The Inter-Departmental Co-ordination Committee for Regional Development has only occasionally convened. - Ukraine created the Congress of Local Authorities and Regions, which has the potential to improve vertical co-ordination on regional development and decentralisation.
Strike a balance in the types of projects ("hard and "soft" infrastructure) being funded through regional development funds.	**Limited progress** - Most intergovernmental financing mechanisms for regional development continue to prioritise investment in "hard" infrastructure. - The State Strategy for Regional Development 2021-2027 addresses the need for "soft" investment.
Reintroduce stability into the SFRD's own financing mechanism.	**No progress** - Following changes to the Budget Code, beginning in 2022, the SFRD should be composed of at least 1.5% of the revenues from the General Fund of the State Budget. Previously this was 1%.
Eliminate political representation on the project approval committee of the SFRD.	**No progress** - Members of the Verkhovna Rada continue to play a decisive role in the project selection procedure of several subventions for regional development.
Set up a permanent sub commission dedicated to fiscal issues.	**No progress** - No permanent sub commission dedicated to fiscal issues or similar body has been established.
Increase own sources revenues of subnational governments.	**No progress** - No substantive changes have been made to the mandate of subnational government to adjust the rate or base of local taxes. No new local taxes have been created. - The percentage of Personal Income Tax that municipalities can keep has increased.
Design and implement new allocation mechanisms of sectoral grants according to a demand-driven approach, based on output indicators and quality standards.	**Limited progress** - *Oblasts* and municipalities have access to several competitive subventions to support regional development, such as the SFRD for which project proposals are reviewed and selected based on different criteria. - Subventions tend to lack needs-based criteria, as well as outcomes indicators.
Change the system of personal income tax collection to the place of residence instead of the place of work.	**No progress** - In 2021, the Office of the President issued a decree giving the Cabinet of Ministers three months to submit draft legislation that would credit part of the personal income tax to local budgets according to the registered place of residence of taxpayers. In response, over a dozen different amendments have been presented which are currently being reviewed.
Develop state-region contracts for regional development.	**No progress** - No State-Region contracts have been developed. - All *oblasts* have regional development strategies that are aligned to the State Strategy for Regional Development 2021-2027.
Develop subnational public-private partnerships for regions and large cities with adequate capacities.	**Limited progress** - There continue to be relatively few municipalities that have set up a public-private partnership. - The State Agency on Support Public-Private Partnership was established that provides training to national and local authorities in the field of public-private partnerships.

Source: Author's elaboration.

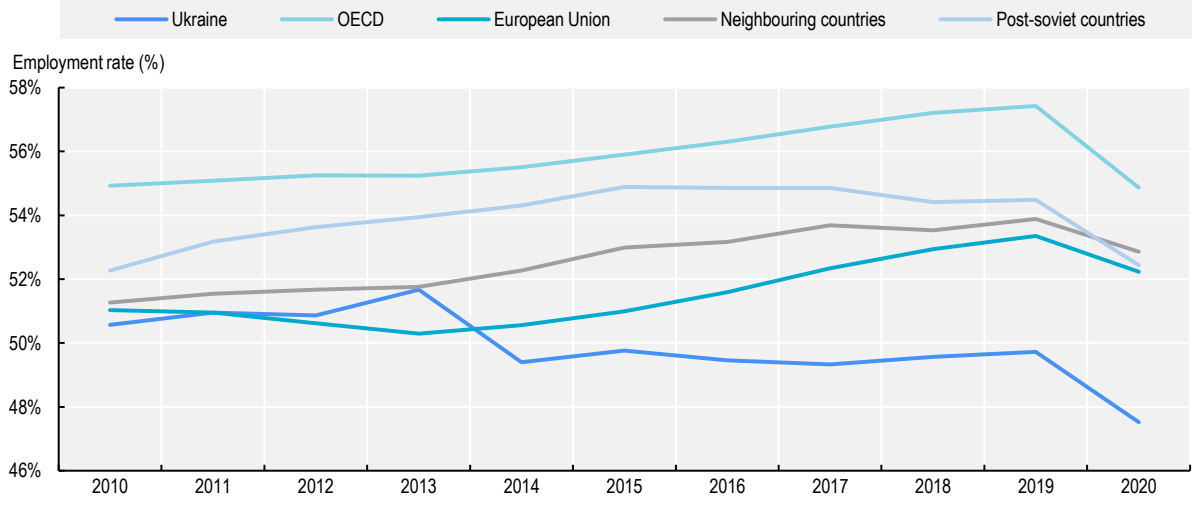
Annex 3.C. Macro-economic indicators

Annex Figure 3.C.1. Inflation, consumer prices (%), 2010-2020



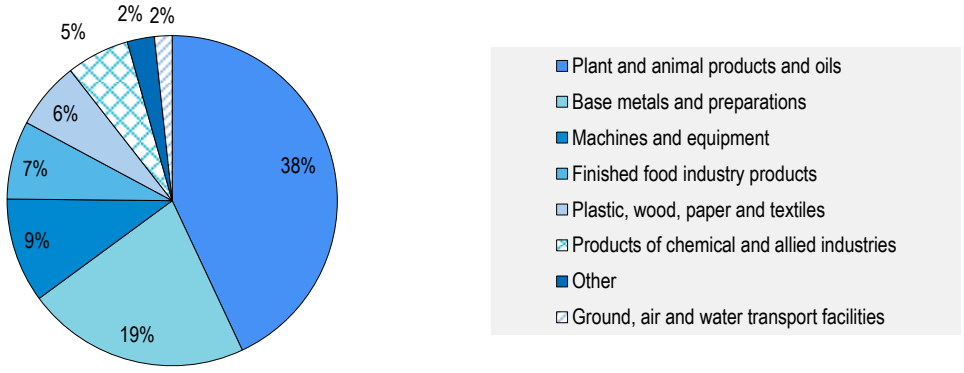
Source: Author's elaboration with data from (World Bank, 2022[53]).

Annex Figure 3.C.2. Employment rate (%), 2010-2020



Source: Author's elaboration with data from (World Bank, 2021[54]).

Annex Figure 3.C.3. Composition of exports, 2020



Source: Author's elaboration with data from (SSSU, 2021[55]).

4 Ukraine's regional and municipal development policy frameworks

This chapter examines recent advances in Ukraine's territorial development policy, and how it could be strengthened post-2022. First, it looks at how Ukraine has overhauled its legislative framework for regional development since 2014. Second, the chapter takes stock of how recent changes to the country's multi-level governance system have affected the state's capacity to design and implement regional development policy. In particular, it evaluates the effectiveness of existing co-ordination mechanisms to ensure vertical and horizontal policy coherence. Third, the chapter explores advances in and challenges to the design of Ukraine's multi-level regional development planning instruments. Finally, the chapter assesses how constraints related to the production, analysis and dissemination of territorially-disaggregated data hamper evidence-based decision making.

Preface: Building on Ukraine's regional development policy framework to support post-war reconstruction

This chapter analyses Ukraine's progress in strengthening its legislative, regulatory and planning frameworks for regional development between 2018 and 2021. It also explores the tasks, responsibilities and capacity challenges of the main actors involved in the design and implementation of various regional and local development strategies, projects and action plans.

Considerations for Ukraine's post-war recovery at the subnational level

The data and analysis presented in this chapter are particularly relevant for the development and implementation a national recovery plan at the subnational level. For example, the assessment of the strengths and challenges of municipalities in implementing the State Regional Policy can provide insights into how they can support the delivery of local recovery projects.

The following paragraphs discuss the relevance and implications of some of the chapter's main findings for Ukraine's recovery and reconstruction. They include links to boxes, tables and charts included in the chapter.

Ukraine's recovery and reconstruction efforts should build on local needs and assets

Ukraine's post-2014 regional development and decentralisation reforms are widely considered to be highly successful. By giving municipalities a vast array of new administrative and service delivery responsibilities, providing them with additional financial resources to execute their mandate, and making them the locus of local development efforts, the reforms, which received broad public support, have led to improvements in service delivery.

As it advances in the development and implementation of a national recovery plan, the government should be careful not to adopt a centralised approach to post-war recovery and reconstruction, which would ignore the important potential that the local level now has to rebuild economies and communities. Instead, the government should adopt a recovery approach that builds on local needs and capacities as a basis to return to integrated regional development.

To ensure that the recovery and reconstruction efforts meet both national priorities and local needs, Ukraine should closely involve all levels of subnational government as it advances in the design and implementation of a national recovery plan. In doing so, it can build on and further strengthen the multi-level governance arrangements that were modified as part of the post-2014 decentralisation and regional development reforms. This includes the merger of over 10 000 communities into 1 469 municipalities, the gradual devolution of administrative and service delivery tasks to the municipal level, as well as steps to promote greater fiscal decentralisation. It also includes the creation of regional development agencies, and different vertical and horizontal co-ordination bodies that support the coherent implementation of Ukraine's State Regional Development Policy at all levels of government. These achievements provide important stepping stones for rebuilding Ukraine's local economies and communities.

Involving subnational governments in the delivery of a national recovery plan would also serve as an important signal of the government's continued support for decentralisation and place-based regional development. In particular, supporting municipalities during the post-war recovery and reconstruction period and beyond is essential to ensuring that territories recover quickly and in a sustainable manner, while increasing their resilience to possible future shocks.

Municipalities can support local reconstruction projects

As part of the post-2014 decentralisation reforms, amalgamated municipalities progressively received new administrative and service delivery tasks. This provided them with the opportunity to build important skills and acquire experience in development planning, budgeting and investment management (Figure 4.7). For local recovery efforts to be effective, the government should build on these important assets. The expertise and experience in local administration that municipalities gained since 2014 could allow them to take stock of territorial needs, design and deliver local reconstruction projects, manage recovery financing and track progress in meeting local needs.

Despite these advances, many municipalities, particularly those categorised as rural and settlement municipalities, may need further support to improve their strategic planning and project management skills, for example to adequately assess the economic, social and environmental impact of possible recovery projects and ensure that they align with national and regional priorities. Many municipalities may also benefit from support to strengthen their ability to link recovery project financing to their local budgets and revenue streams.

The cost of the post-conflict reconstruction requires the involvement of non-governmental actors

The current legislative and planning framework for regional development provides very little room for non-governmental actors to contribute to the design and implementation of territorial development initiatives. In the past, this has limited the ability of subnational governments to leverage the support of businesses, the social economy, academia and citizens to meet territorial development objectives.

Meeting the immense challenge of the post-war recovery will require the mobilisation of non-governmental actors in Ukraine. They can contribute by identifying immediate needs and providing support to vulnerable populations, particularly in remote areas, as well as by contributing to the design, delivery and monitoring of recovery initiatives. Municipalities, in particular, can provide a platform to facilitate and promote broad-based stakeholder involvement in recovery efforts. In addition, citizens can also be involved in quality assurance and in setting service delivery standards. However, the capacity of municipalities to effectively engage with non-governmental actors must be bolstered. The 2021 OECD survey undertaken for this study indicates that about 40% of the 741 responding municipalities considered they lacked the expertise to adequately involve the private sector and individual citizens in the design and implementation of development plans (Figure 4.6).

Existing co-ordination bodies can be used to ensure policy coherence

The Congress of Local and Regional Authorities (Box 4.13), which was created to support the implementation of Ukraine's regional development and decentralisation reforms, can be used as a platform to facilitate dialogue among levels of government regarding subnational recovery efforts. An important task for this Congress could be ensuring that recovery initiatives meet local demands, while avoiding a fragmented approach that would undercut the adequate use of funding. However, the pre-existing challenges that have hampered its effectiveness so far must first be addressed. This means ensuring that both upward and downward communication between the national government – in particular with the National Council for Recovery – and subnational authorities takes place.

Ukraine's regional development planning framework should be updated to include recovery objectives

Over the past few years, Ukraine has established a more robust multi-level regional development planning system. This resulted in the creation of a new State Strategy for Regional Development, regional development strategies in each *oblast*, and several hundred municipal development plans. These provided

relative clarity regarding the government's territorial development aims and an ability to track regional development outcomes.

As it advances in the development and implementation of a national recovery plan, Ukraine should take the opportunity to learn from the challenges faced by national and subnational governments in implementing their regional and local development strategies and plans. These include the lack of clarity regarding the implementation tools that regional and municipal governments can use, as well as uncertainty about the sources of funding that are available to finance projects.

Ukraine should also ensure that regional and local development strategies and plans are redesigned or updated and effectively linked to a national recovery plan. In the light of the destruction that has been wrought by the war, policy makers will also have to critically reflect on whether it is necessary to modify the overall aim of Ukraine's State Regional Policy going forward. For instance, more emphasis might need to be placed on boosting territorial resilience. In addition, the government is advised to mandate subnational governments to include a spatial dimension in their regional and local recovery development strategies to ensure that they effectively respond to territorially-differentiated needs and assets. So far, this has been missing from the regional development strategies prepared by *oblasts* and municipalities (U-LEAD, 2022[1]).

Streamlining planning requirements for subnational governments can support recovery efforts

With the gradual rollout of the regional development reforms and decentralisation, the number of territorial development strategies and plans that subnational governments are required to develop proliferated. This creates a risk of overlap among planning documents, potentially resulting in a duplication of efforts. It can also create confusion over the hierarchal relationship between the different strategies and plans and lead to a fragmented use of resources, particularly when the objectives of different strategies and plans are not aligned. In addition, the responsibility to develop a wide array of strategies, plans and programmes might limit the human and financial resources that are available to support implementation. To ensure the effective delivery of a national recovery plan at the subnational level, Ukraine is advised to streamline the overall planning requirements for subnational governments. In doing so, it should strike a balance between planning and implementation, while ensuring the high quality of a limited number of highly complementary national- and subnational-level strategies and plans.

Subnational governments need support to facilitate territorial economic development

Enhancing the capacity of subnational governments to foster economic development was not a particular priority of the post-2014 decentralisation and regional development reforms. According to interviews with local stakeholders conducted in 2021, municipalities generally did not consider creating an environment that was favourable to economic development to be among their main responsibilities. Furthermore, the 2021 OECD project survey results indicate that supporting small and medium-sized enterprises is an area that many municipalities highlighted as lacking clarity with respect to the division of responsibilities among levels of government (Figure 4.2).

By May 2022, the International Monetary Fund expected that in 2022 Ukraine's GDP would shrink by 35% (IMF, 2022[2]). Moreover, by July 2022, it was estimated that the war would have resulted in over 5.8 million people fleeing the country and in the internal displacement of millions more (UNHRC, 2022[3]). In this context, the regional recovery efforts need to emphasise rebuilding competitive local economies, which requires municipalities to effectively engage with the local private sector to support job creation. This should be coupled with, for example, increased public investment in research, development and innovation at the local level, particularly in rural areas.

Addressing the lack of data at the local level is fundamental to ensuring an effective recovery

Prior to the invasion, Ukraine faced multiple challenges in terms of the availability of data on regional and local development. The government, aided by international partners, will need to support the capacity of subnational governments and local non-governmental actors alike to provide up-to-date information on immediate and longer-term development needs. It should also ensure that the territorially-disaggregated data needed for recovery is collected centrally and is presented on an easily accessible platform. This is essential for supporting evidence-based decision making on recovery and reconstruction, and tracking progress on meeting local needs.

Introduction

Designing and implementing a regional development policy that fosters economic development and well-being rests on the ability to design an integrated strategy that is tailored to the needs, strengths and capacities of different places. This requires policy makers to articulate a strategic vision with clear objectives, defining the policy to support it, and to engage in regional development planning that is "place-tailored", results-oriented, forward-looking and aligned with national objectives and local realities. Moreover, different policy sectors and actors should come together to identify and implement regional development and investment initiatives in a coherent manner that optimises resources. Success further depends on activities taking place at the proper territorial scale, as well as adopting a learning-based approach to building capacity.

Over the past decade, Ukraine has taken significant steps in setting up an elaborate legislative and policy framework for local and regional development, and building implementation capacity at all levels. This includes the 2014 reform of local self-government and territorial organisation of power, the approval of a legislative framework for the country's State Regional Policy, and the design and implementation of successive State Strategies for Regional Development (SSRD). Other progress also includes the creation of regional development agencies (RDAs), and the establishment of several financing mechanisms targeting regional development. By 2021, the government was in a position to further consolidate this framework and support a stronger place-based approach to better meet its growth aims and generate greater well-being throughout the country. To capitalise on the results of the regional development reforms, however, Ukraine needs to overcome several key challenges.

First, the number of planning documents that national and subnational governments are expected to develop has proliferated. This comes on top of the multiple, and at times competing, strategic frameworks for regional development currently in place. This may create uncertainty regarding the aims of Ukraine's State Regional Policy, risking a fragmented implementation process and sub-optimal use of public resources. It could also complicate monitoring and evaluation efforts. Second, centre-of-government co-ordination in the field of regional development has remained relatively weak, hampering efforts to ensure the effective implementation of the country's State Regional Policy across sectors and among levels of government. This is compounded by the absence of functioning horizontal and vertical co-ordination mechanisms that are necessary to increase policy coherence and effectiveness, and to generate trust-based partnerships. Third, the mechanisms for implementing the country's regional development policy and corresponding strategies, particularly at the *oblast* level, are still embryonic. This applies especially to the work of RDAs in helping articulate and implement regional and local development strategies. Fourth, many of the 1 469 newly amalgamated municipalities are still building the necessary technical expertise to effectively contribute to the implementation of the country's State Regional Policy. This is compounded by the limited participation of non-governmental actors throughout the regional development planning cycle. Finally, to improve evidence-based decision making, Ukraine needs to boost the capacity of all levels of government to produce, analyse and disseminate information on local and regional development performance.

This chapter, which updates and adds to the 2018 OECD report *Maintaining the Momentum of Decentralisation in Ukraine*, focuses on the legislative and policy framework for regional development, as well as the multi-level governance structures that support regional development in Ukraine. It begins by analysing Ukraine's progress in overhauling its legal and regulatory framework for regional development. Subsequently, it explores the roles and responsibilities of the main actors involved in the development and implementation of the country's State Regional Policy. The chapter then explores recent advances in the design of Ukraine's multi-level regional development planning instruments. It concludes with a discussion of the advances in and challenges to the creation of an outcome-oriented performance measurement system for regional development.

Box 4.1. Recommendations to strengthen the design, implementation and monitoring of Ukraine's strategic planning framework for regional development

The following recommendations should be considered in a timeframe that is appropriate to the current context of war and post-war reconstruction and recovery.

To strengthen Ukraine's overall strategic planning framework for regional development, Ukraine is advised to:

- Ensure continued alignment between the State Strategy for Regional Development (SSRD) and subnational development strategies. This can be done by:
  - Modifying the legal framework to call on state, regional and municipal authorities to conduct a mandatory assessment of the strategies after the first three or four years of implementation and/or in light of any significant economic, social, environmental or political changes.
- Strike a balance between development planning and implementation, and promoting horizontal and vertical policy coherence. This can be done by:
  - Creating a national planning law that defines the long-, medium- and short-term planning documents needing to be developed (including the State Strategy for Regional Development, as well as regional and local development strategies), when and how the different documents should align, and who should be responsible for their design, implementation and monitoring.
- Strengthen the mandate and capacity of municipalities to create the conditions for increased subnational economic development. This could be done by:
  - Creating new or modifying existing regional development subventions[1] to facilitate the implementation of projects to support small and medium-sized enterprises (SMEs).
  - Raising municipalities' awareness of their economic development responsibilities and providing capacity building support to help them meet them.
  - Investing in outreach to municipalities to educate them on the benefits and, in particular, the multiple risks associated with local-level public-private partnerships (PPPs), as well as funding and financing alternatives to deliver services and infrastructure.

To support the coherent implementation of Ukraine's State Regional Policy at all levels, the government is recommended to:

- Strengthen regional development policy co-ordination. For example by:
  - Providing the Ministry for Communities and Territories Development (MinRegion) with more tools to ensure its contribution to policy development in sectors with a regional-/local-level incidence, for example by giving it a role in the review of draft policy proposals on issues such as transport and subnational economic development.
- Clarify the mandate and strengthen the capacity of regional development agencies (RDAs) to execute their tasks and responsibilities. This can be done by:
  - Adopting regulations requiring oblasts to provide RDAs with a minimum level of funding.
  - Setting up peer-to-peer learning trajectories to facilitate the exchange of good practices between Ukrainian RDAs and their peers from OECD member countries.
- Bolstering horizontal co-ordination mechanisms in the field of regional development by:

- Reinforcing the Inter-Departmental Co-ordination Commission for Regional Development (ICC) by:
  - Determining and holding a minimum number of sessions per year, with an established work plan.
  - Streamlining the ICC's broad set of responsibilities to ensure its meetings focus on key regional development issues.
  - Providing the ICC with a formal role in the design and/or mid-term revision of the SSRD.
  - Creating (technical) working groups within the ICC related to, for example, the monitoring and evaluation of the State Regional Policy and the SSRD, as well as regional development financing mechanisms.
- Strengthen vertical co-ordination mechanisms for regional development by:
  - Improving the effectiveness of the Congress for Local and Regional Authorities to facilitate debate and exchange among levels of government. This can include:
    - Establishing a transparent process for selecting which subnational representatives can take part in the meetings of the Congress.

To strengthen the effectiveness of the SSRD, Ukraine is advised to:

- Clarify how the government targets the special functional territories mentioned in the SSRD. For example by:
  - Defining how the state programmes for the socio-economic development of individual territories will be designed, implemented and financed.
  - Ensuring that the state programmes for the socio-economic development of individual territories include a clear description of the different special functional territories they target, their comparative development challenges and potential.
- Promote and facilitate the participation of a wide range of governmental and non-governmental actors in the full lifecycle of regional development strategies. For example by:
  - Involving representatives from the different associations of local governments, business chambers, think-tanks and leading civil society organisations in a mid-term review of the SSRD.
- Clarify the relationship between the SSRD and the National Economic Strategy 2030 and how both strategic planning frameworks seek to advance regional development.

To strengthen the impact of the *oblast* development strategies, Ukraine is advised to:

- Improve the quality of the regional development strategies, by:
  - Reviewing and updating the methodology that guides their design, monitoring and evaluation.
  - Adopting legislation proposed by MinRegion to reinforce the link between the *oblast* strategies, other regional development planning instruments and the State Fund for Regional Development.
- Increase clarity about the mechanisms to finance and implement the regional development strategies. For example by:
  - Mandating regional development strategies to include implementation and monitoring plans that indicate which actors will be involved, as well as their specific tasks and responsibilities.
  - Establishing multi-sector and multi-level regional co-ordination mechanisms to oversee the implementation of the regional development strategies.

To strengthen the ability of municipalities to foster territorial development and contribute to the implementation of the SSRD, Ukraine is advised to:

- Facilitate peer-to-peer learning among municipalities, building on the experience that some have already gained in designing local development strategies.
- Promote and facilitate municipalities' engagement with stakeholders by, for example:
  - Updating existing legislation to make public consultation an integral part of development and investment planning at the national and subnational levels.
  - Providing more systematic capacity building support to municipalities in the field of stakeholder consultation and setting up peer-to-peer learning processes.

To improve evidence-based decision making on regional development, Ukraine is advised to:

- Increase the availability of up-to-date territorially-disaggregated information on a wide range of topics. For example by consolidating the Hromada Performance Monitoring Platform by:
  - Ensuring that all data presented on the platform are also included on the SSSU's website and offering users the possibility to download the raw data, while protecting respondents' data.
  - Including metadata for each indicator to allow users to understand, for example, the units of measurement for the different indicators, how the data were gathered and by whom.
- Invest in the generation, analysis and dissemination of information on citizen and user experience with public services at the national, regional and local levels.
- Strengthen the role that the SSSU plays in gathering, analysing and disseminating data across ministries and among levels of government. For example by:
  - Investing in the ability of its staff to provide training to subnational governments so the latter can produce, analyse and disseminate development statistics, as well as to use evidence as a learning tool.
  - Expanding the available territorially-disaggregated data on the SSSU portal and integrating data presented on the portals of other state institutions.
  - Creating inter-agency commissions—for instance for regional development—that are charged with defining the sectoral data needs, establishing standards to generate and present statistics, as well as ensure current databases are up-to-date and new ones are developed.
- Establish a publicly accessible regional development performance monitoring platform that allows the government to track and communicate its development objectives and territorial performance with a wide audience.

Ukraine's strategic planning framework for regional development

Over the past decade, Ukraine has taken important steps in setting up a comprehensive framework for regional and local development, allowing governments at all levels to play a major role in designing and implementing regional and local development initiatives. Progress in this field is closely linked to the rollout of the country's decentralisation reforms that resulted in the creation of 1 469 amalgamated municipalities (from an original number of over 10 000 in 2015). These municipalities' remit includes a vast array of new administrative and service delivery responsibilities, making them the locus of regional development efforts. The effectiveness of the regional development reform process, however, is curtailed by a series of challenges such as the proliferation of planning instruments and the absence of a national planning law. Other constraints include the limited focus that the decentralisation and regional development reforms placed on subnational economic development, as well as the piecemeal implementation of the decentralisation reforms.

Strategic planning frameworks for regional development across the OECD

A regional development strategy sets out a vision-based, long-range plan to achieve national, regional or local aims for growth. In so doing, it draws together sectoral policy interventions for regional development and facilitates integrated action by helping different sectors understand and work towards realising long-term development objectives (Box 4.2). It differs from a regional economic development strategy both in its scope and the breadth of the policy instruments used.

Box 4.2. The scope of regional development

Regional development

Regional development is a broad term that refers to a general effort to reduce regional disparities and foster balanced and inclusive growth in a country, an individual region or a metropolitan, urban or rural area. Over time, the main objective of regional development has evolved from top-down interventions designed to reduce regional disparities through compensation of less developed areas into a much broader approach aimed at improving regional competitiveness, often by adopting a strategy that builds on territorially-differentiated development strengths and challenges. It emphasises co-operation among and across levels of government, as well as leveraging the contribution of non-governmental actors.

Regional development policies and strategies

A regional development policy refers to the set of goals and priorities reflected in laws, regulations, as well as planning and budgeting instruments that aim to reduce territorial disparities and foster inclusive and balanced social, economic and environmental development in a country or a specific territory.

A regional development strategy, by contrast, is a long-term planning instrument to achieve specified territorial objectives. It can bring together the strategies of diverse policy sectors to support their coherent implementation and contribution to a territory's productivity and attractiveness, as well as to the well-being of its citizens. It depends on several other elements, such as sectoral policies, the subnational governments with whom policy responsibilities are shared, and non-governmental actors.

Source: Author's elaboration, adapted from (OECD, 2020[4]).

Many countries (e.g. Brazil, Chile, Germany, Greece, Ireland, Malaysia, Mexico, the Netherlands, Portugal, Switzerland, the Republic of Türkiye and the United Kingdom) have a document outlining a strategic vision for their country. However, these often have a short time horizon (e.g. one to six years). Increasingly,

however, countries aim to develop strategies that span one to two decades or even longer (e.g. Costa Rica, the Czech Republic, Finland, Hungary, Israel, Lithuania, Norway, and Slovenia) (OECD, 2020[4]). In countries where changes in government generally imply a marked shift in priorities, the development of a long-term strategic plan can contribute to policy continuity and improved outcomes.

Implications of top-down versus bottom-up regional development planning

A country's approach to regional development can be top-down, bottom-up or a combination of the two. In the case of the former, the national government sets the development vision and takes a command and control approach to policy design and implementation. Conversely, a bottom-up approach implies that subnational governments or other subnational actors identify local needs, and establish and implement plans to meet them. On their own, neither approach will likely be effective or sustainable. Top-down approaches tend to meet strong implementation resistance from local stakeholders. Adopting an approach that focuses primarily on bottom-up development may limit policy coherence, lead to disconnected investments across territories, and face financing constraints. A key question policy makers need to answer is how to strike an appropriate balance between the two approaches (OECD, 2020[4]).

There is evidence that strategies that combine a bottom-up and top-down approach are among the most effective (Crescenzi and Giua, 2016[5]). The development and implementation of a long-term regional development strategy that is the result of extensive stakeholder consultation processes can promote policy coherence among sectors and across levels of government, while enhancing the efficient use of resources. It provides the framework for action that enables different actors to take responsibility for implementing the initiatives necessary to achieve a society's long-term development vision, and builds their understanding of the need for collaboration (Rojas, Cuadrado-Roura and Fernández Güell, 2008[6]).

The majority of OECD countries present their long-term regional development strategies within a regional policy framework, using different planning instruments to articulate their objectives and plans. For example, in European Union (EU) countries, seven years is a common timeframe that is in line with the EU policy cycle. Ukraine follows this practice. Moreover, in many instances, the national-level strategic documents are complemented by regional development strategies designed by subnational actors (OECD, 2016[7]; OECD, 2019[8]).

The legislative framework for regional development

Beginning in 2014, the government embarked on an ambitious overhaul of its multi-level and territorial governance structures, which included a series of decentralisation reforms. Crucial elements were the adoption of the Concept Framework of Reform of Local Self-Government and the Territorial Organisation of Power. This document outlined a strategy for boosting democratic governance at the subnational level through broad-based decentralisation, as well as the gradual merger of over 10 000 communities into 1 469 municipalities. This was combined with the creation of a new legal framework for regional development policy through the approval of the 2015 Law "On the Principles of State Regional Policy".

The combined objective of the decentralisation and regional development reforms initiated in 2014/2015 was four-fold. First, it sought to bolster territorial cohesion in economic and social terms. Second, it aimed to increase the well-being of all citizens, regardless of their place of residence. Third, it sought to enhance the competitiveness of regions and municipalities. Fourth, it intended to put municipalities at the centre of development efforts, while simultaneously increasing local democracy.

The 2015 Law "On the Principles of State Regional Policy" forms the basis of Ukraine's regional development system

The 2015 Law "On the Principles of State Regional Policy" sought to ensure the establishment of a comprehensive, consistent and implementable regional development policy (Box 4.3). The law put

Ukraine's legislative framework for regional development on a solid footing. Indeed, it clearly outlined its main policy instruments including the State Strategy for Regional Development (SSRD), as well as the key actors involved in its design and co-ordination. At the same time, the law is ambiguous regarding the design, implementation and monitoring of several planning instruments, thus undermining its effectiveness and creating uncertainty for actors at all levels of government.

Box 4.3. Ukraine's Law "On the Principles of State Regional Policy"

The 2015 law established key concepts for regional development, such as the State Regional Policy, regional development programmes and projects. It also introduced a set of regional development planning instruments: the State Strategy for Regional Development (SSRD), the regional development strategies (*oblast* level) and their respective action plans, as well as strategies for the development of cities, towns and villages. Moreover, it established which actors are responsible for developing and implementing the country's State Regional Policy and its main planning instruments.

In particular, the approval "On the Principles of State Regional Policy" established that the State Fund for Regional Development (SFRD), created in 2012, should provide financing for the implementation of state and regional development strategies. It also introduced basic concepts for monitoring the performance of the country's regional development strategies and action plans and provided for the possibility to set up regional development agencies (RDAs), as well as an Inter-Departmental Co-ordination Commission for Regional Development.

After the adoption of the law "On the Principles of State Regional Policy", the Cabinet of Ministers of Ukraine passed resolution 931, which establishes the procedure for the development and monitoring and evaluation of the SSRD.

Source: Author's elaboration, based on (Verkhovna Rada, 2015[9]; CabMin, 2018[10]).

Taken together, the Law "On Principles of State Regional Policy" and the 2015 Cabinet of Ministers (CabMin) Resolution no. 931 (CabMin, 2018[10]) provide relatively detailed information on the main planning instruments that constitute Ukraine's State Regional Policy (Table 4.1 and Figure 4.1). These are the SSRD and the regional development strategies that need to be developed by each *oblast*. Both are linked to the EU planning cycle. Each of these planning instruments needs to be supported by action plans. The action plans of the regional development strategies form the basis for the development of regional development and investment projects.

Table 4.1. Main planning instruments for regional development in Ukraine

	State Strategy for Regional Development	Regional development strategies
Scope	National	*Oblast*/regional
Creation	Mandatory	Mandatory
Timeframe	7 years	7 years
Development co-ordinated by	Ministry for Communities and Territories Development (MinRegion)	Council of Ministers of the Autonomous Republic of Crimea, *oblast*, Kyiv and Sevastopol city state administrations
Approval by	Cabinet of Ministers (CabMin)	Verkhovna Rada of the Autonomous Republic of Crimea, *oblast*, Kyiv and Sevastopol city councils
Consultation	With regional development entities	With regional development entities
Action plans	One for the first 3 years, a second for the last 4 years	
Updating	Possible after 3 years	Not specified

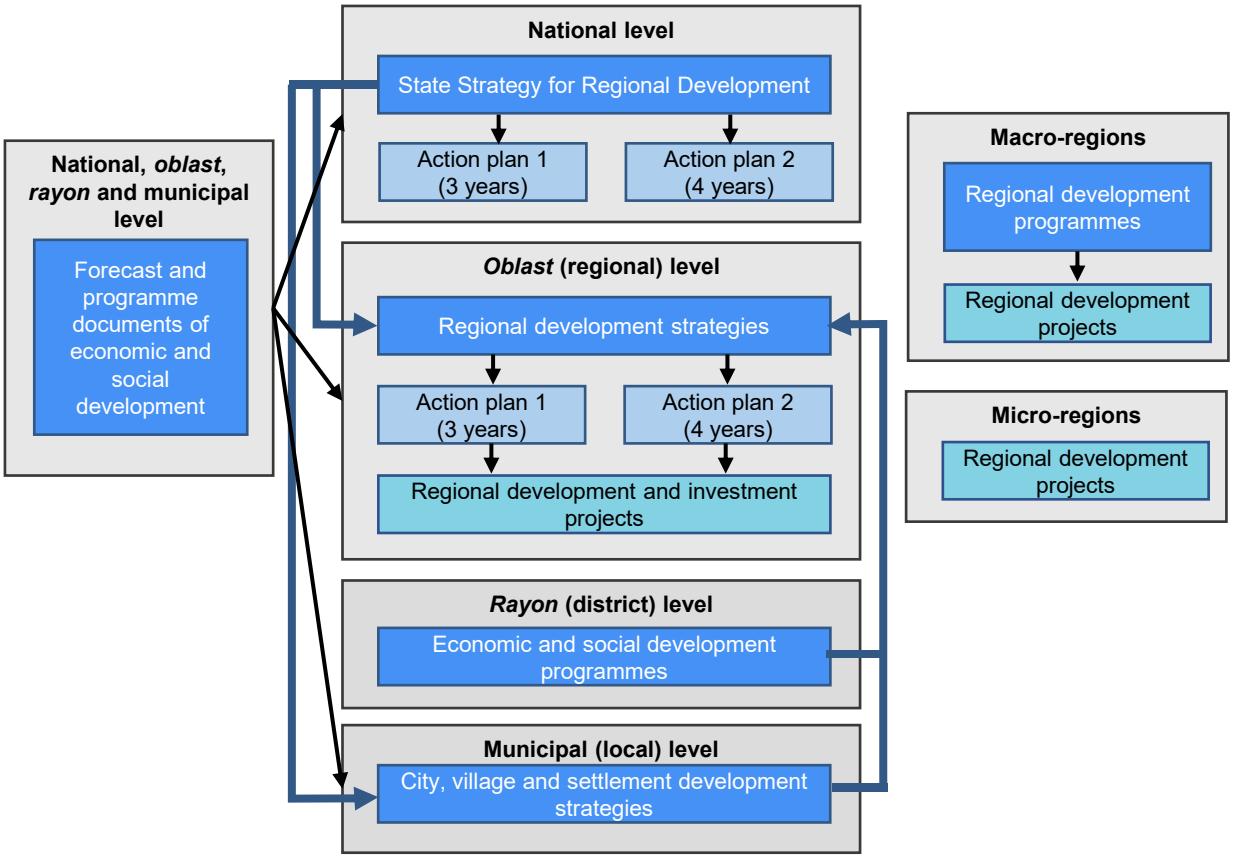
Contents	- Trends and main problems of socio-economic development of regions; - Priorities of the State Regional Policy; - Strategic goals and directions of regional development and interregional co-operation; - Operational goals; - The main tasks and implementation mechanisms; - Monitoring and evaluation system.	- Trends and main problems of socio-economic development of the Autonomous Republic of Crimea, regions, cities of Kyiv and Sevastopol; - Strategic goals and development priorities; - Operational goals; - The main tasks and implementation mechanisms; - Monitoring and evaluation system.
To be aligned to	Not applicable	SSRD
Sources of financing	- Funds of the State Budget of Ukraine, in particular the SFRD; - Funds from local budgets; - Charitable contributions; - Funds of international organisations.	

Source: Author's elaboration, based on (Verkhovna Rada, 2015[9]; CabMin, 2018[10]).

The Law "On Principles of State Regional Policy" and CabMin Resolution no. 931 also mention a series of complementary planning instruments. These include strategies for the development of cities, villages and settlements, the development of which is not mandatory. They also refer to regional development programmes for Ukraine's macro-regions. These are specially defined territories that can consist of several regions or their parts, which are united by common features, and are "characterized by common development problems" (Verkhovna Rada, 2015[9]). Likewise, according to the Law "On Principles of State Regional Policy", regional development projects can be implemented at the micro-regional level. However, the relevant legislation provides very limited information about the process through which each of these instruments needs to be developed, implemented or monitored. This creates uncertainty at all levels of government, and hampers the adequate implementation of the Law "On Principles of State Regional Policy".

On paper, the legislative framework envisions a combined bottom-up and top-down approach to regional development planning. In practice, however, a top-down approach predominates. Current legislation supposes a partial top-down approach as the development of the mandatory regional development strategies and the optional strategies of cities, villages and settlements must comply with the provisions of the SSRD and be aligned with the national government's strategic priorities. At the same time, however, the Law "On Principles of State Regional Policy" espouses a bottom-up approach as it specifies that actors such as municipalities can submit proposals for the development of the SSRD, the regional development strategies and their respective action plans. Similarly, the development of the regional development strategies should be carried out taking into account the strategies of cities, towns and villages, as well as the development priorities of the so-called depressed areas. However, as the Law "On Principals of State Regional Policy" does not mandate the creation of development plans for local self-governments these bottom-up planning processes largely fail to materialise. Moreover, by not referencing non-governmental actors, the law "On the Principles of State Regional Policy" limits their potential role in the design of the various national, regional and local development strategies and plans (Figure 4.1).

Figure 4.1. Planning instruments for regional development as specified in the Law "On the Principles of State Regional Policy"



Source: Author's elaboration, based on (Verkhovna Rada, 2015[9]).

SSRD and subnational development strategies need to be continually aligned

Whereas the Law "On the Principles of State Regional Policy" indicates that the "tasks and measures" of the SSRD can be updated after three years, it does not include similar arrangements for the regional and local development strategies. This means that, in case of a mid-term modification of the SSRD, the planning instruments of *oblasts* and municipalities may become misaligned. To remedy this, any modification of the legal framework should indicate that after the first three or four years of implementation, state, regional and local authorities should conduct a mandatory assessment of the strategies in light of any significant economic, social, environmental or political changes. This assessment should not be limited to the strategy's proposed tasks and measures, but also include its results framework.

The absence of an overarching national planning law risks duplication of planning efforts

Ukraine's Law "On the Principles of State Regional Policy" did not replace but rather supplemented a series of laws enacted since 2000 that affect the regional development planning system (Annex Table 4.A.1). Each of these laws refers to different short-, mid- and long-term planning instruments, creating a highly complex patchwork of interrelated strategies, plans, programmes and projects that are often directly linked to regional and local development. This could lead to duplication of planning efforts at the different levels of government and overemphasise the development of strategies and plans, at the expense of their

implementation. It could also lead to a sub-optimal allocation of resources and create confusion about the hierarchal relationship between the various planning instruments. To promote horizontal and vertical policy coherence, the government should consider creating a national planning law that defines which long-, medium- and short-term planning instruments need to be developed, when and how the different instruments should align, and who should be responsible for their design, implementation and monitoring. Such a law should also differentiate between high-level, long-term strategies and operational short-term action plans, as well as define the funding mechanisms for each plan or strategy.

A complex interplay between the decentralisation and regional development reforms

The decentralisation and regional development reforms implemented since 2014 should be seen as interdependent and complementary in terms of their policy objectives, stakeholders and implementation arrangements. The overarching goal of both the Concept of Reforming Local Self-Government and Territorial Organisation of Power in 2014, as well as the 2015 Law "On the Principles of State Regional Policy" was to ensure the unity of the state as a "necessary basis for regional development" (National Institute for Strategic Studies, 2020[11]).

Post-2014 changes to Ukraine's multi-level governance system make it more conducive to place-based regional development

The approval of the Concept of Reforming Local Self-Government and Territorial Organisation of Power, and the passing of several legislative reforms (Annex Figure 4.C.2) made Ukraine's multi-level governance and decentralisation system more conducive to place-based regional development. For example, the Concept framework set out to ensure the availability and quality of public services, based on local needs. It also sought to optimise the distribution of power among the subnational governments according to the principles of subsidiarity, defining a basic list of responsibilities for each level. Many of them are directly related to regional and local development. They include:

- *Oblast* state administrations: regional development and development of regional infrastructure;
- Local self-governments: local economic development, planning of community territory development and the development of local infrastructure.

Moreover, the Concept framework set out to ensure that the subnational governments have the necessary material, financial and organisational resources to carry out their mandates. Combined, the actions of the government to support the implementation of the Concept framework have redefined the institutional, regulatory and financial framework in which the State Regional Policy is designed and implemented. The regulatory framework for regional development echoes many of the elements of the decentralisation reform. For example, the law "On the Principles of State Regional Policy" stressed the importance of vertical co-ordination and subsidiarity. The law also provides for the possible establishment of different actors and mechanisms that could benefit the implementation of the decentralisation reforms, including the RDAs and the Inter-Departmental Co-ordination Commission for Regional Development (ICC). The former could support the practical design and implementation of projects aimed at improved regional competitiveness, as well as increased local well-being and economic development. The latter can serve as a forum to discuss a wide variety of topics that are directly related to both the decentralisation and regional development reforms. However, despite their complementarity, the interconnected nature of both reforms also poses significant challenges to their effectiveness.

Non-linear implementation of both reform packages has created uncertainty

Since 2014, there have been continuous efforts to introduce or amend legislation related to the decentralisation and regional development reform packages. This has not been a linear process. The passing of amendments at different times, and initiated by different ministers, has led to contradictions.

This has been compounded by the rollout of the municipal amalgamation process that lasted several years, as well as the creation of new, consolidated districts in 2020. These processes were accompanied by a gradual increase in the tasks and responsibilities of municipalities and the creation of many new subventions to finance regional and local development initiatives (see Chapter 5).

As a result, the actors involved in regional development planning and implementation have had to adjust to a changing regulatory and institutional environment, as well as new fiscal realities. This has created much uncertainty and strained the ability of local government officials at all levels to take informed decisions regarding regional development. Moreover, parts of the decentralisation reform, as set out in 2014, have not yet materialised. For example, attempts to enshrine the new administrative-territorial structure and introduce a prefecture-like system at the regional and district level in the Constitution have not garnered the necessary support.

When considering additional reforms related to regional development and decentralisation, the government should emphasise those policy interventions that can generate certainty for actors at all levels in the short term and, to the extent possible, are feasible within the existing regulatory and institutional framework. This should be complemented by more long-term efforts such as modifying the Constitution and introducing a national planning law.

The increased focus on local economic development would strengthen the decentralisation and regional development reforms

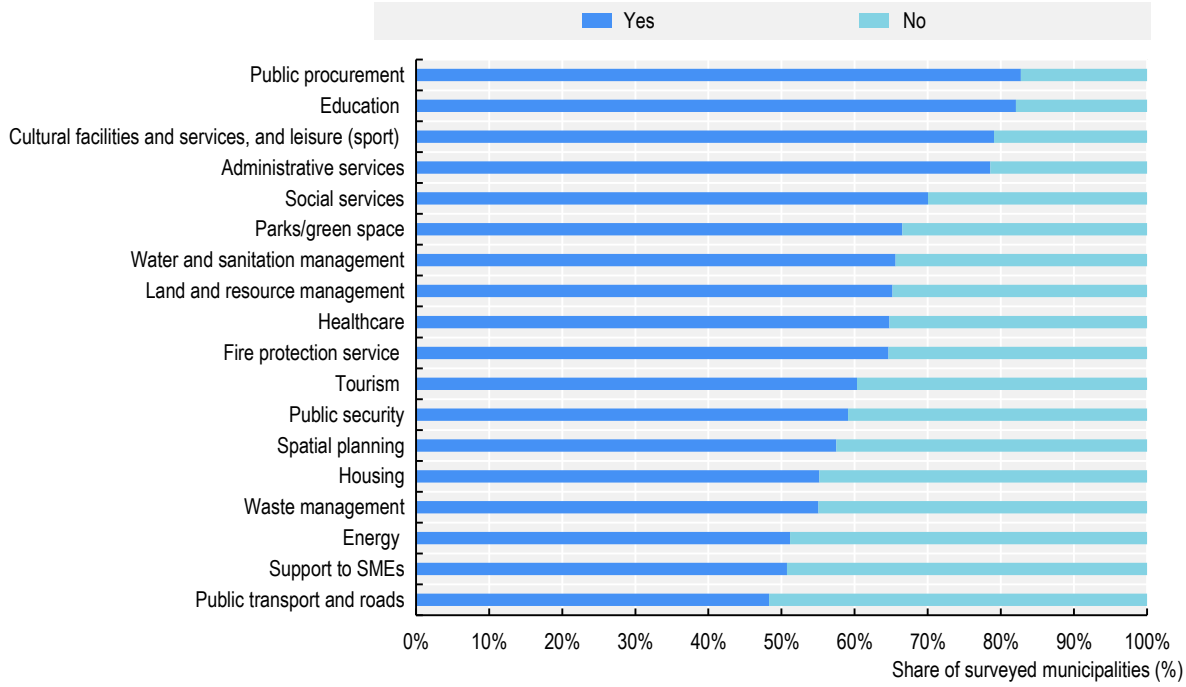
The overarching objectives of the regional development and decentralisation reforms dovetail regional and municipal economic development. There are, however, concerns that relatively little attention has been paid to increasing the capacity of subnational authorities to foster economic activity.

With the decentralisation reform, improving the delivery of various administrative and social services (e.g. education and healthcare) has become a major focus. However, fostering an environment conducive to subnational economic development has not been a policy objective of many subnational governments. This is an area in which most Ukrainian municipalities have historically had limited responsibilities, and local leaders consider the delivery of social services to be their top priority (OECD, 2021[12]). This comes in addition to a general perception among municipalities that the division of tasks and responsibilities among levels of government in areas closely related to economic development is not clear. In fact, OECD project survey results (Figure 4.2) indicate that the area in which surveyed municipalities report that there is least clarity with respect to responsibilities is public transport and roads, followed by support to small and medium-sized enterprises (SMEs), and energy (Box 4.4). In these areas, around 50% of responding municipalities indicated that there is no clarity in the division of responsibilities among levels of government. For example, it is not clear from the legislation who is responsible for financing and undertaking the construction and maintenance of local roads. While the Law “On Local Self-Government” indicates that this responsibility lies with the amalgamated municipalities, the Law “On Roads” states that it is vested in *oblast* state administrations. Conversely, the Law “On Local State Administrations” indicates that it is the preserve of the *rayons* (Verkhovna Rada, 2021[13]; Verkhovna Rada, 2021[14]; Verkhovna Rada, 2021[15]).

Box 4.4. The OECD online survey

To complement the scarce data on the results of the decentralisations reforms, the OECD asked municipalities to complete an online survey in September and October of 2021. The objective of the survey was to assess the impact of Ukraine's amalgamation reform on municipal performance. In particular, it sought to collect perspectives on how decentralisation reforms, including the amalgamation process, have affected local service delivery, finance, and co-operation with non-governmental actors, as well as their perceived current challenges. The survey included sections on the process of amalgamation, the creation of administrative service centres, administrative capacity, local finance and investment, local democracy and public participation, among others. With the support of CabMin and the Ministry for Communities and Territories Development (MinRegion), the survey was shared with all municipalities. In total, 751 municipalities, covering 119 *rayons*, as well as 24 *oblast*s, and Kyiv City, completed the survey.

Figure 4.2. Municipal perceptions of clarity in the division of tasks and responsibilities



Note: Question: Do you consider that there is clarity in the division of tasks and responsibilities in the following fields between your municipal government and other (local) governments: other municipal governments, *rayons, oblasts* and central government)? Response options: Waste management; Water and sanitation management; Public procurement; Housing; Healthcare; Social services (e.g. support for families, children, elderly, etc.); Public transport and roads; Education; Cultural facilities and services, and leisure (sport); Tourism; Parks/green space; Public security; Fire protection service; Spatial planning; Land and resource management; Support to SMEs; Energy; Administrative services; Other. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

Several elements would justify a heightened focus on promoting subnational economic development. For example, the population and labour force of almost all regions is decreasing due to a number of factors, including labour migration to the EU. This has major consequences for productivity. Moreover, Ukraine's economy is increasingly dependent on Kyiv *Oblast* and Kyiv City, with other *oblasts* falling further behind.

The government should use the next phase of the decentralisation process to strengthen the mandate and capacity of municipalities to create the conditions for increased subnational economic development. This could imply providing guidance to municipalities about the levers they can use to stimulate economic development, as well as improving support for the development of local public-private partnerships (PPPs) where appropriate. This would have to include guidance by the national government on the expertise required to set up and manage PPPs and, in particular, the multiple risks associated with such partnerships, including regulatory capture, conflicts of interest and long-term fiscal constraints on municipal finances (see Chapter 5). Guidance should also seek to ensure that subnational governments are well-informed regarding alternatives to PPPs, and the potential benefits and risks of these. It could also mean creating or modifying existing regional development subventions to facilitate the implementation of projects to support SMEs and building subnational government capacity to engage with their local business communities (e.g. to identify their needs, to co-design local investment projects). In addition, it could imply facilitating collaboration between local businesses and higher education and/or vocational institutions to ensure that education and training programmes meet current and future labour needs. Actions such as these would contribute to achieving the objectives of the SSRD and the decentralisation reforms aimed at boosting the economic well-being of citizens, as well as strengthening the fiscal capacity of all levels of government through increased tax revenues.

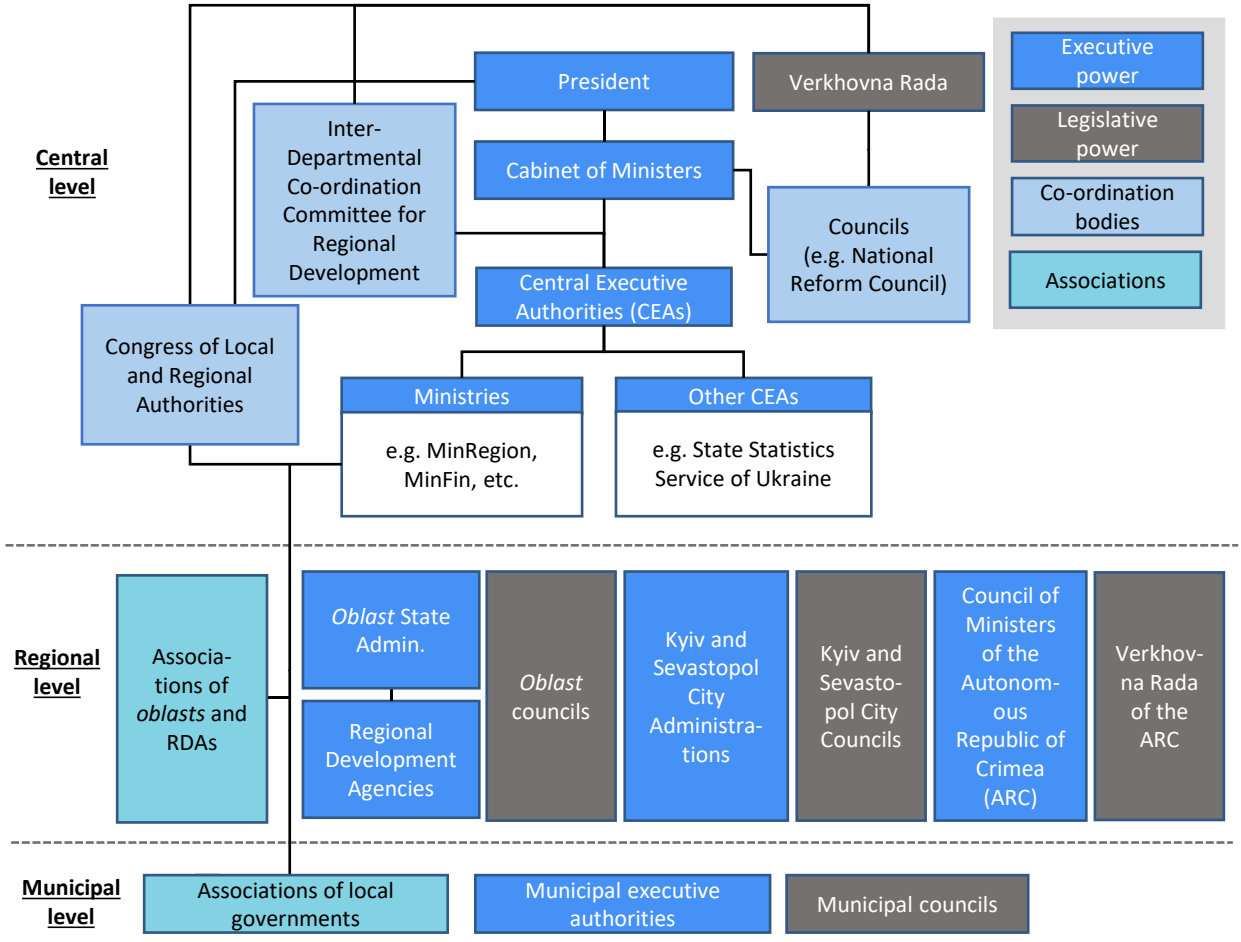
The success of these efforts depends on the effective co-operation of the wide array of public and non-governmental actors involved in the design and implementation of the State Regional Policy. Ukraine's progress in setting up an elaborate regional development governance system, and the challenges it faces in terms of multi-level co-ordination, among other elements, are addressed in the next section.

The governance of regional development in Ukraine

The governance of regional development and public investment matters. Ukraine's regional development and decentralisation reforms implemented since 2015 have redefined the composition of and interplay between the governmental and non-governmental actors. These changes reflect a gradual shift in the governing paradigm, which used to be characterised by a dominant central government that sets developments targets and uses its deconcentrated administrative structure to ensure implementation. Gradually, Ukraine is moving towards a new approach that, in principle, favours more multi-level co-operation and co-ordination and emphasises building local capacity to address local challenges. Such a change takes time, however. It requires as much a shift in administrative culture as modifications of the institutional framework.

For its regional development planning system to work effectively, Ukraine needs to consolidate the governing framework (Figure 4.3), facilitate the structural involvement of non-governmental actors in the planning cycle, and improve the functioning of established vertical and horizontal co-ordination mechanisms.

Figure 4.3. Main actors involved in regional development planning and implementation



Source: Author's elaboration.

Leadership for regional development at the national level

A wide array of public actors are involved in the regional development planning system at the national level. This reflects the cross-sectoral nature of regional development, linking policy areas such as economic development, housing, energy and education. It also explains the direct involvement of most of Ukraine's line ministries in the development and implementation of the SSRD. Three central government actors play a particularly relevant role: CabMin, the Ministry of Finance (MinFin) and MinRegion (Table 4.2). Over the past few years, centre-of-government co-ordination for regional development has remained limited, thus hampering policy cohesion.

Table 4.2. Main executive actors at the national level

Actor	Responsibilities
The Cabinet of Ministers (CabMin)	CabMin consists of the Cabinet's "presidium", which is composed of the Prime Minister of Ukraine, their Deputy Prime Ministers, as well as other ministers. All government decisions are voted on and adopted in sessions of the Cabinet. With regard to regional development, CabMin is charged with both approving the SSRD and its action plans, as well as the guidelines for their development, implementation, monitoring and evaluation.
The Ministry for Communities and Territories Development (MinRegion)	MinRegion is the central executive authority that leads the implementation of the decentralisation and regional development reforms. In particular, it is charged with managing the design, implementation, and monitoring and evaluation of the SSRD and its action plans. MinRegion is also directly responsible for the management of the SFRD (see Chapter 5).
The Ministry of Finance (MinFin)	MinFin is responsible for the formation and implementation of Ukraine's state budget and the distribution of funds among levels of government. It manages the Subvention for Implementation of Measures for Socio-Economic Development of Certain Territories (see Chapter 5). MinFin also manages the Open Budget Portal that presents fiscal data on a wide series of indicators related to national and subnational public finances. If local governments want to borrow, they need the explicit approval of MinFin.

Source: Author's elaboration.

Strengthening the position of influence of MinRegion can improve State Regional Policy co-ordination

Under the administration of President Poroshenko (2014-2019), the Minister responsible for regional development served as one of the country's Deputy Prime Ministers. Since 2019, however, the Minister responsible for regional development no longer holds the position of Deputy Prime Minister. In addition, since August 2019, three different ministers have led MinRegion, creating uncertainty about the Ministry's policy priorities and weakening the Ministry's ability to effectively co-ordinate policy at the national and subnational levels of government. This stands in contrast with the previous five years (December 2014 – August 2019) when the Minister responsible for regional development did not change. Other national government bodies, such as CabMin, have also been unable to strengthen cross-sectoral co-ordination supporting the State Regional Policy. For example, the Inter-Departmental Co-ordination Commission for Regional Development has struggled to function optimally. This co-ordination body was created in 2015 but has only held two official meetings since.

To strengthen co-ordination of the State Regional Policy, the government is advised to take a number of complementary actions. It should consider providing MinRegion with more tools to promote policy coherence, for example by ensuring that the Ministry is able to contribute to policy development in sectors with a regional-/local-level impact (e.g. housing, public utilities and transport). It could, for example, review or issue an opinion on draft policy proposals. It should also be noted that in the past, when the head of MinRegion also served as a Deputy Prime Minister, the Ministry benefited from additional "soft" powers that came with the Minister's position within the Cabinet of Ministers. These powers enabled the head of MinRegion to add a regional lens to the agendas of other Ministries and thereby contribute to horizontal policy coherence.

Subnational actors operate in an uncertain institutional setting

On paper, Ukraine's subnational governments play a key role in the implementation and financing of the country's State Regional Policy. For example, *oblast* state administrations are responsible for developing, implementing and monitoring their regional development strategies. The *oblasts* also need to ensure the implementation of the State Regional Policy at the regional level and propose initiatives to improve co-ordination among levels of government. Furthermore, *oblasts* can establish RDAs. Several elements, however, hinder the effective execution of *oblast* tasks in the field of regional development and need to be addressed. These include limited clarity regarding the tasks and responsibilities of RDAs, as well as the constitutional mandate of *oblasts*.

The unfulfilled potential of Ukraine's regional development agencies

Since the passing of the Law "On the Principles of State Regional Policy" in 2015, most *oblasts* have created an RDA (Box 4.5). The RDAs have the potential to become key actors in stimulating place-based regional and local development serving as linchpins between the different levels of government, the private sector, non-governmental organisations and academia. The RDAs, however, face a number of important challenges related to their human and financial capacity that severely limit their effectiveness.

Box 4.5. Ukraine's regional development agencies

Regional development agencies can be created by *oblasts* to support the design and implementation of projects aimed at improving regional competitiveness and economic development. To comply with official regulations, the RDAs need to have a co-founder (in addition to the *oblasts*), which can be a regional chamber of commerce, a local government association or a higher educational institution, among other actors. According to the template outlining the rules and regulations governing RDAs, the agencies have several responsibilities, including:

- Analysing the socio-economic situation and development challenges of their region and developing of proposals on ways to address them.
- Supporting the implementation of the regional development strategies, action plans, and corresponding programmes and projects.
- Increasing the investment attractiveness of the region.
- Monitoring the implementation of the SSRD in the region, as well as the Regional Development Strategy, its action plans and corresponding programmes and projects.

The template outlining the rules and regulations governing RDAs also stipulates that the RDA must be composed of subdivisions for finance and accounting, planning, project management. The relevant legislation and regulations provide limited information about how the RDAs can be funded. As of September 2021, most regions had an RDA. Only Sumy, Mykolaiv and Kharkiv *Oblasts* have not yet established their agency. The RDAs of Lviv *Oblast* and Donetsk *Oblasts* are being liquidated, the former because the *Oblast* was its sole founder, which goes against official regulations, the latter because it was not operational.

Source: Author's elaboration, based on (CabMin, 2016[16]) (MinRegion, 2021[17]).

The financial, material and human resource capacity varies significantly between RDAs. Most RDAs have staffing problems. This is primarily due to a lack of stable funding, resulting in high levels of staff turnover and difficulties in attracting qualified professionals. The majority of RDAs have five staff members or less, undermining their capacity to perform tasks such as supporting the implementation of regional and local development projects. The staffing situation of a few RDAs is much better. For example, in 2021 the RDA of Zakarpattia *Oblast* had close to 40 staff members, including accountants, project administrators and analysts (MinRegion, 2021[17]). This allows them to execute a wider set of tasks than those that only employ a director.

The heterogeneity in terms of staffing of the RDAs does not fully reflect their financial capacity. For example, the RDA of Zakarpattia *Oblast* was among those that received the most funding during the first nine months of 2021 (UAH 1 395 000). At the same time, the RDA from Zaporizhzhia *Oblast*, which according to MinRegion only has 2 staff members, received most revenue of all RDAs between January and September 2021: UAH 2 499 000 (MinRegion, 2021[17]). This begs the question of whether this RDA

is able to effectively spend these funds given its staffing constraints, unless it used (part of) the funds for consultancies. On the other side of the ledger are the RDAs from Rivne *Oblast* and Odessa *Oblast*, whose revenues totalled less than UAH 270 000, a fraction of the revenues received by some of their peers. In addition, the level of funding of the RDAs tends to vary from year to year, hampering their ability to consolidate their operations and plan for future activities.

While many RDAs only received funds from regional budgets, the revenues of others (Zaporizhzhia and Luhansk) also include funds from international donors. This reduces their dependence on the availability of public funding. Furthermore, in the first nine months of 2021, five RDAs received funds by providing paid services. Examples of initiatives in which RDAs are involved include:

- Providing training for municipal staff on issues such as project management, attracting investment, and business plan development;
- Identifying national and international funding opportunities and investors;
- Implementation of sectoral development projects (e.g. in the field of renewable energy).

There are also concerns about the effective collaboration between the RDAs and other public and non-governmental actors involved in regional planning. For example, despite the fact that the RDAs can contribute to the design of the development strategy, there is evidence that in some *oblasts* the strategy for 2021-2027 was developed without their involvement (National Institute for Strategic Studies, 2020[11]). This can be explained by the still nascent understanding among levels of government of the mandate of RDAs. In fact, for several years, a number of *oblasts* stalled the creation of their RDAs or failed to provide their RDAs with the necessary resources to function properly. All of these factors not only limit the effectiveness of the RDAs in executing their mandates, but also limit their ability to bridge the co-ordination gap between national, regional and municipal authorities (OECD, 2021[12]).

To address these challenges, in 2022, the Verkhovna Rada adopted a series of amendments to the Law “On the Principles of State Regional Policy” (Box 4.6) that provide RDAs with more clarity regarding their official tasks and responsibilities. The amendments also further regulate their ability to provide paid services, thereby strengthening their financial capacity.

Box 4.6. Amendments to the Law "On Principles of State Regional Policy"

In 2022, the Verkhovna Rada amended the Law “On the Principles of State Regional Policy". This law seeks to consolidate Ukraine’s regional development planning system, particularly at the regional and municipal levels, while improving the financial support of the State Regional Policy, strengthening the role of RDAs in general, and outlining their basic tasks.

The law specifies that municipalities can participate in the establishment of RDAs. It also provides additional detail on the design of the regional development strategies, which need to be the product of joint efforts by associations of local governments and RDAs, among other actors. In addition, the law specifies that municipalities are required to develop local development strategies, which must take into account the SSRD and relevant state forecasting documents.

Source: Author’s elaboration, based on (Verkhovna Rada, 2022[18]).

The government should also consider adopting additional regulations requiring *oblasts* to provide RDAs with a minimum level of funding to ensure their operations. In parallel, the government and RDAs are encouraged to set up peer-to-peer learning trajectories, facilitating the exchange of good practices within Ukraine and internationally. For example, the RDAs can learn from the experiences of their peers in OECD countries such as Finland and the Netherlands (Box 4.7). These peer-to-peer initiatives should have an

equitable spread among different types of municipalities (rural, settlement, urban), and have built-in dissemination mechanisms to ensure that relevant knowledge, practices and tools are being shared more widely.

Box 4.7. Regional development agencies in Finland and the Netherlands

Finland

While not regional development agencies per se, Finland's 15 Centres for Economic Development Transport, and the Environment are a form of cross-sectoral, decentralised national action to support regional competitiveness, well-being and sustainable development in each region. They cover a wide range of issues from business and industry support, transport and infrastructure to the environment and natural resources. While the Ministry of Employment and the Economy oversees the 15 Centres, they also support the implementation of policy emanating from other ministries (e.g. Environment, Transport and Communications; Agriculture and Forestry; Education and Culture; the Interior).

The Netherlands

The Netherlands has eight Regional Development Agencies (*Regionale Ontwikkelingsmaatschappijen*). The RDAs function as territorial development corporations with public shareholders, whose aim is to strengthen regional economies and increase employment. They have a particular economic focus, aiming to boost the local economy and employment by stimulating innovation, investments and internationalisation activities. They do so by helping local and international businesses to identify funding and employees, and building up business networks. The RDAs can receive funding from the national government, provinces, municipalities, as well as non-governmental organisations such as research institutions. Most revenue is spent on investment in innovative businesses, and the (re)development of industrial estates and business parks.

Source: Author's elaboration, based on (OECD, 2021[19]); Finland (OECD, 2020[4]); the Netherlands (Netherlands Chamber of Commerce, n.d.[20]).

Combined, these actions would strengthen the ability of RDAs to effectively execute their mandate, for example by facilitating multi-level co-ordination of the implementation of Ukraine's State Regional Policy. This could also help ensure that regional and local development strategies are aligned with national-level priorities. These efforts could receive a major impetus through the creation of a prefecture system, as proposed in the latest attempt to amend the Constitution.

Ukraine's proposed prefect system should support rather than control subnational decision making

The debate regarding the capacity of Ukraine's regional governments to effectively support the implementation of the State Regional Policy needs to feature the government's efforts to amend the Constitution (Box 4.8). The draft amendment presented in late 2021 proposes to significantly alter the configuration and powers of the subnational governments, including by creating a prefecture-like system at the regional and district level.

Box 4.8. The 2021 draft amendment of the Constitution

The draft amendments to the Constitution of Ukraine, presented in November 2021, propose the setup of a new administrative-territorial system. In particular, it aims to replace the *oblast* state administrations and the *rayon* state administrations with prefectures. If approved, *oblast* and *rayon* councils would receive their own executive bodies.

The draft amendments also propose to grant municipalities the right to make decisions on any issue of local importance for which the decision making power has not been transferred by the state to other bodies. This would replace the current arrangement whereby municipalities are not allowed to make decisions on issues not specifically defined by law. Similarly, the draft text proposed to give municipalities the right to sufficient financial resources, which they could freely dispose of, and to ensure that financial resources need to be commensurate with their responsibilities. Both principles—regarding the extent of their authority and financial resources—if adhered to, would strengthen the position of municipalities as the locus of local development efforts.

Source: Author's elaboration, based on (Office of the President of Ukraine, 2021[21]).

Creating a prefect system, which requires a constitutional amendment, can have several major implications for the design and implementation of the State Regional Policy. First, it would place an emphasis on the role of prefects to co-ordinate with municipalities, particularly as consultation of the municipalities by the prefects would become mandatory. There are concerns that the regional development strategies are principally developed by *oblast* state administrations to comply with legislation, rather than as a tool to guide regional and local development policy.

A prefect system would prompt the modification of existing legislation for regional development. In this process, attention to the roles assigned to the prefects in the design, implementation and financing of regional development strategies is necessary. The government should ensure that the responsibilities of the Prefects and the executive bodies of the *oblast* councils are clear and complementary, and that mechanisms are in place to hold both institutions accountable. Moreover, the government should provide prefects with the tools to co-ordinate among levels of government to ensure vertical policy coherence. In this regard, the government is advised to assess the role French prefects play in fostering regional and local development (Box 4.9).

Box 4.9. The French prefect system

The French prefect system was created to serve as an extension of national government to ensure the implementation of state policies at the local level. Several rounds of reforms have gradually adjusted the responsibilities of the prefects and their relationship with the national and subnational governments, as well as non-governmental actors. This has changed the tools they can use to promote regional development. Prefects, which operate at the French departmental, regional and defence zone level, are responsible for three broad set of tasks: to work with the police co-ordinating security and public order issues; to manage the territorial branches of state services; and to collaborate with different local bodies and companies to support the implementation of national policies.

Administrative control and supervision

Prefect control over the acts of regions, departments or municipalities (*communes*) is exercised *a posteriori*. When identifying a violation of the law, prefects can appeal a decision that has already been made.

Prefects are linchpins between levels of government

France's departmental prefectures are tasked with guaranteeing the coherence of the National government's actions in the region, and are responsible for reviewing and ensuring the legality of the acts adopted by the elected regional councils. They are also charged with allocating State funding between the departmental prefects and with supporting the creation of state-region development contracts.

Source: Author's elaboration, based on (Ministère de L'Interieur, 2014[22]; République Française, 2021[23]; Philip, 2007[24]).

As a result of different decentralisation reforms passed since the 1980s, the work of French prefects has gradually transitioned. No longer primarily executing the national government's directives, or supervising regional and local authorities, the prefects increasingly act as partners with the relevant regional and local authorities to initiate projects and help communities develop their own initiatives rather than controlling local decision making. Past reliance by prefects on control mechanisms has given way to increased use of contractual tools and incentives. Through the different co-ordination tools available (e.g. supporting state-region development contracts and serving as a key interlocutor between the National government, local authorities, and non-governmental actors), prefects occupy a unique position to support place-based regional and local development.

Ukraine's co-ordinating bodies and dialogue mechanisms for regional development

To support Ukraine's regional development and decentralisation reforms, several co-ordination mechanisms were introduced that, in principle, could contribute to horizontal and vertical policy coherence. These include the national-level Inter-Departmental Co-ordination Commission for Regional Development (ICC), the Congress for Local and Regional Authorities and the RDAs. The work of Ukraine's various local government associations and the donor-led Decentralisation and Regional Development Working Group complements these bodies. Despite their ambitious mandates and potential to boost policy coherence, the effectiveness of several of the co-ordination bodies is limited.

The value of inter-ministerial co-ordination for horizontal policy coherence

Regional development policy is, by nature, cross-sectoral. It requires a sense of ownership among the various relevant sectors and stakeholders, and also clear leadership, barring which, difficulties can arise

in the implementation phase and lines of accountability can be blurred. High-level inter-ministerial bodies can help create a sense of shared ownership and responsibility for the policy among the relevant ministries or sectors, while crystallising leadership and accountability overall. Over time, they can also strengthen shared values, facilitate collaboration at the technical level, and build trust among actors with potentially divergent interests (OECD, 2020[4]; OECD, 2011[25]).

A high-level, inter-ministerial co-ordinating body for regional development can be an effective mechanism to align interests and priorities across ministries. Such an entity can help establish a clear and transparent priority-setting process that considers territorially-differentiated needs and the impact of development initiatives and investment projects. Ultimately, this type of structure is valuable for ensuring high-level co-ordination, discussion and guidance on matters related to regional development (OECD, 2020[4]).

Experience from OECD member countries shows that horizontal co-ordination bodies chaired by a single line ministry may be limited in pursuing multi-sectoral objectives and hinder full involvement of other ministries. This particularly applies to cases in which the line ministry in question has not been given a clear mandate from the centre of government. This could render the mechanism less appropriate for co-ordinating regional development policy. Alternating the chair among participating ministries is one way to address this (OECD, 2020[4]). The higher the leadership within these types of co-ordination bodies, the stronger the incentive to participate and the greater the engagement of the different actors. However, if a high-level co-ordination body is not supported technically, for example through a secretariat, its ability to influence policy may be severely diminished.

The dominant approach to inter-ministerial committees for regional development has been to provide them with a co-ordination function to streamline policy implementation. Committees that do not meet regularly tend to have significantly less influence in defining relevant policies. Despite these challenges, several countries, including Iceland and Poland have inter-ministerial committees and bodies that effectively advocate policy reforms at the national level through horizontal co-ordination. In the case of Poland's Co-ordinating Committee for Development Policy, for example, the high-level body is supported by sub-committees that examine more technical issues. Such technical bodies may be well placed to review policies at an early stage in order to ensure that the impact on different types of regions and localities are adequately considered (OECD, 2020[4]; OECD, 2019[26]).

The Inter-Departmental Co-ordination Commission for Regional Development faces operational issues

On paper, Ukraine's Inter-Departmental Co-ordination Commission for Regional Development (ICC) (Box 4.10) is the government's primary co-ordination mechanism supporting the implementation of the State Regional Policy. It is mandated to co-ordinate the country's regional development policy, however, a number of issues hinder its effectiveness: these include the lack of official meetings being organised; the breadth of issues it should address (ranging from analysing the state of implementation of the SSRD to contributing to the digital transformation of Ukraine's regions); and the fact that its decisions are not binding.

Box 4.10. The Inter-Departmental Co-ordination Commission for Regional Development

The Inter-Departmental Coordination Commission for Regional Development (ICC) originates with the approval of the Law "On the Principles of State Regional Policy". The ICC was originally established in 2015 and chaired by MinRegion. It is a non-binding advisory body of CabMin, which aims to co-ordinate the formation and implementation of the State Regional Policy in Ukraine at central and subnational levels. In 2020, its regulation was adjusted and chairmanship passed to the Prime Minister.

The ICC has a broad set of tasks ranging from facilitating the overall co-ordination of the design and implementation of State Regional Policy (including the SSRD) to assessing the state of its implementation and identifying good international practices related to regional development. Other tasks include:

- Preparing proposals to ensure the interconnection and coherence of long-term development strategies, plans and programmes at the state, regional and local levels;
- Attracting financial resources for the implementation of priority investment projects;
- Promoting the creation of effective mechanisms for representing the interests of regions at the national level, and territorial communities at the regional level.

The Minister of MinRegion holds the position of First Deputy Chairman of the ICC. Other members include representatives from several ministries, CabMin, the Office of the President, and the Verkhovna Rada.

Source: Author's elaboration, based on (CabMin, 2015[27]).

Since the ICC's formation, only two official meetings have been organised (in March 2016 and March 2021, respectively). The lack of meetings during the previous administration (2015-2019) might be linked to two issues. First, the primary focus of MinRegion was the effective implementation of the decentralisation reforms. Second, through the role as Deputy Prime Minister, the Minister of Regional Development, Construction, Housing and Utilities had the political clout to promote a cross-sectoral approach to regional development without necessarily having to organise sessions of the ICC. The challenges to operationalise the ICC can also be linked to the absence of a legal requirement to hold a minimum number of sessions per year. Going forward, the government should consider adding such a condition to the ICC's official regulations, following the example of the National Reform Council, which, according to its regulations, must convene at least six times per year and must be supported by a specialised executive committee. A second challenge facing the ICC relates to its broad mandate. Its founding resolution identifies ten activities for the ICC's work. Minutes from the first meeting of the ICC highlighted a lack of time to discuss key issues and proposals. To avoid this issue in the future, ICC agendas should focus only on key issues and should be streamlined to leave more time for discussion.

Another further challenge is the non-binding nature of ICC decisions. The ICC is an advisory body that facilitates discussions between executive authorities rather than a formal decision-making body, and its decisions have no legal force. This risks a lack of buy-in from line ministries. In this regard, the government could, for example, consider giving the ICC a formal role in the development and/or mid-term revision of the SSRD.

The lack of buy-in from line ministries was further complicated by the fact that, until 2020, the ICC was chaired by a single ministry (MinRegion), whereas according to legislation, CabMin should be responsible for co-ordinating the activities of ministries. The current government has sought to address this challenge by adjusting the status of the ICC and appointing the Prime Minister as its chair. In principle, the Prime Minister's authority should enable more effective co-ordination of the ICC. However, the very sporadic

occurrence of commission meetings under the new chair makes it difficult to evaluate progress in this regard. In the absence of official meetings of the ICC, the donor-led Decentralisation and Regional Development Working Group has played an important role in facilitating regular exchanges between different ministries, as well as with the international donor community active in regional and local development (Box 4.11).

Box 4.11. Decentralisation and Regional Development Working Group

To support co-ordination and co-operation between MinRegion, development partners and other stakeholders active in the fields of regional development and decentralisation, the Decentralisation and Regional Development Working Group was established. This platform, which is chaired by the European Union Delegation and the Canadian Embassy in Ukraine, and whose chairperson is the Minister for MinRegion, aims to support the coherent implementation of the post-2014 regional development and decentralisation reforms led by MinRegion. It serves as a forum to ensure co-ordination in the development of future international technical assistance initiatives.

Over the past few years, different thematic subgroups have been established by the Working Group. These subgroups have examined issues such as the legal framework for decentralisation, local financing, administrative service delivery, monitoring and evaluation, and the human resource capacity of local self-governments. The groups have facilitated regular exchanges between the different international development partners and MinRegion, as well as other national and subnational authorities on advances in and challenges to the implementation of the regional development and decentralisation reforms.

Source: Author's elaboration, based on (OECD, 2021[12]; MinRegion, n.d.[28]).

An additional issue worth noting is that the ICC lacks thematic working groups to ensure that agenda items can be carefully prepared and discussed during the meetings. Despite a number of reported efforts to establish working groups beginning in 2016, no such entities have been formed. Establishing these should be a priority to improve the ICC's effectiveness. The government could, for instance, create (technical) working groups related to the monitoring and evaluation of the State Regional Policy and the SSRD, and regional development financing mechanisms. The latter could, for example, support the preparation and implementation of different grants and subventions related to regional development (see Chapter 5). By assigning chairpersonship of the working groups to different central executive agencies, the government could strengthen broad-based ownership of the ICC.

There are also opportunities to strengthen the participation of local governments in the ICC. While its regulations indicate that local governments may be involved in the work of the commission, their participation is not guaranteed. Given that several of the ICC's tasks relate to the design, implementation and monitoring of the State Regional Policy at the subnational level, the ICC should provide the local government associations with a permanent seat at the ICC's sessions. By ensuring the participation of representatives from all levels of government, through the respective local government associations, the ICC could strengthen the multi-level communication about progress in implementing regional development strategies, as well as challenges faced. This is particularly relevant as municipalities appear to have a poor understanding of the rapidly evolving legal frameworks that they are bound by, and struggle to communicate their development challenges and needs to the national government (OECD, 2021[12]).

There is a wide array of actions that the government can take in the short term to boost the capacity of the ICC to facilitate horizontal and vertical policy co-ordination. However, the responsibility for promoting and facilitating multi-level communication on regional development policy is not only the prerogative of the ICC,

but also of the Congress for Local and Regional Authorities, which are thus recommended to co-operate more closely.

The Congress for Local and Regional Authorities should facilitate upward communication

OECD experience shows that countries with well-developed vertical co-ordination arrangements have a comparative advantage when introducing and implementing reform (OECD, 2017[29]). These bodies can take different forms, such as a dedicated permanent policy exchange conference or council. Australia's National Cabinet can serve as an example. It includes the Prime Minister, as well as State and Territory Premiers and Chief Ministers with the aim of enabling consensus-based decision-making among levels of government (Commonwealth Department of the Prime Minister and Cabinet, 2021[30]). Poland has taken a different approach with its Joint Central Government and Local Government Committee (Box 4.12).

Box 4.12. Multi-level dialogue bodies in Poland

Poland's Joint Central Government and Local Government Committee supports dialogue between levels of government. This body is composed of the minister responsible for public administration and 11 representatives appointed by the Prime Minister, together with representatives of national organisations of local self-government units that work in "problem teams" and different working groups.

The Committee considers, among others, issues related to the functioning of municipalities and the state policy on local government. It develops a common position among levels of government and contributes to establishing the policy priorities of national and subnational government on matters such as municipal service management and the functioning of municipal and district government, as well as regional development and the effectiveness of voivodeship (province) government.

The Joint Committee develops social and economic priorities that can affect subnational development, evaluates the legal and financial circumstances for operating territorial units, and gives an opinion on draft normative acts, programmes and other government documents related to local government.

Source: Author's elaboration, based on (OECD, 2020[4]) (Lublinksa, 2017[31]) (Government of Poland, n.d.[32]).

Multi-level dialogue platforms, such as the one in Poland, bring together a combination of national and subnational public, private and third sector actors in a regular, formalised manner and are frequently used for co-ordinating regional development and investment priorities (OECD, 2018[33]). They can provide actors with the opportunity to share perspectives and experiences; understand the needs and problems faced among levels of government; submit proposals; negotiate with each other; and obtain help in the design, implementation and monitoring of policies.

In principle, Ukraine's new Congress for Local and Regional Authorities could perform these functions (Box 4.13). Since its creation in 2021, several meetings have already been organised that were led by the President, underscoring the government's commitment to dialogue with subnational authorities. Local stakeholders have, however, indicated that the participation of municipalities in particular has been minimal and that national government and *oblast* state administrations are the ones that decide which municipal leaders to invite, often on an arbitrary basis (OECD, 2021[12]). There are also concerns that the Congress will principally serve as a platform for the national government to present national priorities to subnational governments, rather than facilitate upward communication. The government should consider operationalising the two chambers of the Congress, and ensuring a transparent process for selecting which subnational representatives can take part.

Box 4.13. The Congress for Local and Regional Authorities

The Congress for Local and Regional Authorities was created in March 2021 and serves as an advisory body that is convened and chaired by the President of Ukraine. It effectively replaced the Council for Development of Hromadas and Territories, a short-lived state advisory body that was tasked with ensuring co-operation between the national and subnational governments on the State Regional Policy.

The purpose of the Congress is to represent, protect and advance the interests of regional and local authorities. It has been assigned a broad remit of responsibilities, from promoting effective vertical and horizontal co-ordination between state and local government bodies to promoting co-operation between the EU and Ukraine at the local government level.

It can bring together cabinet ministers, members of the Verkhovna Rada, heads of *oblast* state administrations, chairs of *oblast* and *rayon* councils, local government associations and municipalities, among other actors. The Congress will consist of two chambers: one for municipalities, the other for regions.

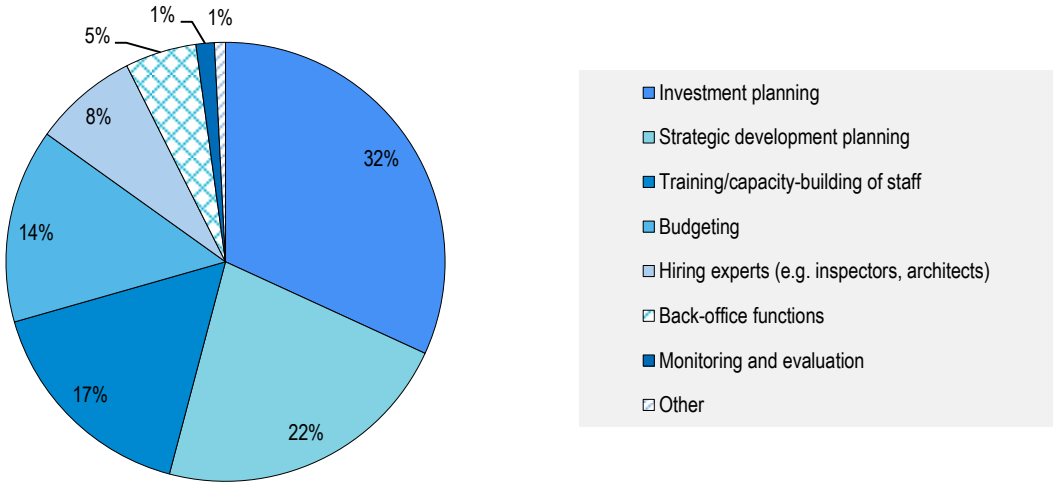
Source: Author's elaboration, based on (President of Ukraine, 2021[34]; Ukrinform, 2021[35]).

Municipalities express a need for greater multi-level co-ordination

The legislative and policy frameworks for regional development in Ukraine require municipalities, *oblasts* and the national government to co-ordinate their efforts in a large number of areas. These include the development of regional development strategies, as well as the design and submission of project proposals for different subventions (see Chapter 5).

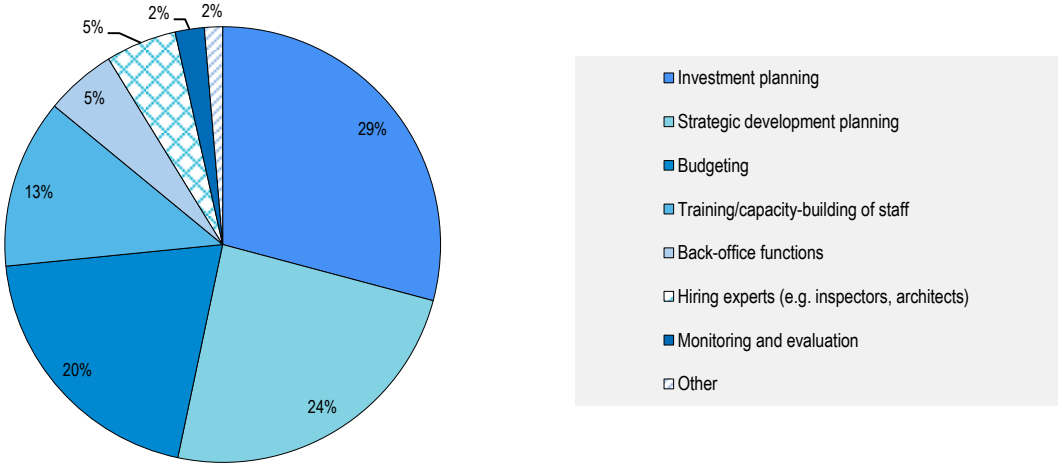
The results of the OECD online survey (conducted in 2021, prior to the Russian Federation's large-scale invasion of Ukraine on 24 February 2022) indicate that in the field of regional development and investment planning, surveyed municipalities identified a clear need to improve vertical co-ordination. A large share of consulted municipalities reported that greater co-ordination with *oblasts* was needed most in the areas of investment planning and development planning (32% and 22%, for each area respectively) (Figure 4.4). Likewise, municipalities consider that improved co-ordination with the national government is most urgent in the areas of investment planning (29%) and development planning (24%) (Figure 4.5).

Figure 4.4. Areas in which greater co-ordination between municipalities and *oblasts* is needed most



Note: Question: For which of the following administrative responsibilities would greater co-ordination between your municipality and the *oblast* state administration be needed most? Please select only one option. Full response options: Development planning (strategic development planning); Investment planning; Back-office functions; Budgeting; Monitoring and evaluation; Training/capacity building of staff; Hiring experts (e.g. inspectors, architects, etc.); Other. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

Figure 4.5. Areas in which greater co-ordination between municipalities and the national government is needed most, according to municipalities



Note: Questions: For which of the following administrative responsibilities would greater co-ordination between your municipality and the national government be needed most? Please select only one option. Full response options: Development planning (strategic development planning) Investment planning; Back-office functions; Budgeting; Monitoring and evaluation; Training/capacity building of staff; Hiring experts (e.g. inspectors, architects, etc.); Other. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

These findings illustrate the need to strengthen existing vertical co-ordination mechanisms such as the Congress for Local and Regional Authorities, as well as to facilitate the increased participation of

municipalities in RDAs and in the ICC. Improving communication among levels of government on policy priorities, local needs and capacity challenges is key to ensure the effective implementation of the SSRD, as well as the development strategies that subnational governments are responsible for. The government will need to address the co-ordination challenges outlined above for its comprehensive, multi-level regional development system to be more effective.

Ukraine's multi-level regional development planning instruments

Since the approval of the SSRD 2021-2027 in August of 2020, all *oblasts* have developed new or adjusted existing regional development strategies that are aligned with the SSRD. In addition, many municipalities have created local development strategies. The development of these planning instruments presents a major step forward in the implementation of Ukraine's State Regional Policy. They provide increased clarity regarding the strategic objectives for regional and local development, and, in principle, they also facilitate efforts to monitor the effectiveness of public interventions to increase well-being, territorial cohesion and competitiveness. To capitalise on this potential, several challenges need to be addressed. This includes strengthening the involvement of public and non-governmental actors in the design and implementation of the different planning instruments, streamlining implementation tools, and effectively linking action plans and funding.

The priorities of the State Strategy for Regional Development have shifted

The SSRD is the key planning instrument of Ukraine's regional development policy framework, defining the priorities of the country's State regional Policy. Over the past decade, the SSRDs have become increasingly instrumental in regional and local development efforts. Likewise, the government has gradually prioritised territorial cohesion as the SSRD's key strategic objective. This has been accompanied by efforts to facilitate the strategy's implementation. Several structural challenges, however, need to be addressed to ensure that the objectives of the SSRD can be achieved. Changes in the institutional context shaped the development of the new SSRD

The legislative and institutional framework supporting the SSRD 2021-2027 varied significantly from that of the SSRD 2014-2020. For example, when the SSRD 2014-2020 was designed, the territorial amalgamation processes had not yet started and no RDAs existed.

When developing the new SSRD, MinRegion took into account the SSRD's annual implementation reports. In fact, when drafting the SSRD 2021-2027, MinRegion published an analytical report that presented lessons learned from the implementation of the previous SSRD (Box 4.14). Nevertheless, the current strategy neither mentions the main achievements of the SSRD 2014-2020, nor does it make clear what will be done to avoid the challenges MinRegion identified.

Box 4.14. Lessons learned from the implementation of the SSRD 2014-2020

The Analytical Part of the Draft State Strategy for Regional Development until 2027 identified the following challenges with regard to the implementation of the SSRD 2014-2020:

- **Unpredictability of funding sources to implement the strategy.** This is particularly related to the fact that the SFRD's legal mandate to receive 1% of planned General Budget Fund revenues has never been met. In addition, no mechanisms were in place to leverage funds from ministries and other central executive bodies to implement the tasks of the SSRD.
- **Absence of a clear relationship between strategic and budgetary planning**. The strategy envisaged the implementation of 199 tasks. However, it did not clearly link the sources of funding needed to execute them.
- **Ineffectiveness of existing tools and mechanisms for implementing the strategy**. The report established that mechanisms such as State Target Programmes and agreements on regional development did not work.
- **Absence of well-functioning mechanisms to co-ordinate the implementation of the SSRD**. During the implementation of the SSRD until 2020, the Inter-Departmental Co-ordination Commission for Regional Development only met once.
- **The absence of relatively large-scale regional development projects** to stimulate job growth and economic development.

Source: Author's elaboration, based on (MinRegion, 2020[36]).

Even though more than a year has passed since the former SSRD expired, by December 2021, no official evaluation had been conducted. Going forward, the government should ensure that prior to commencing the design of a new generation of regional development planning documents, (preliminary) evaluation reports of the current strategies are developed.

Before the war, increasing territorial cohesion had become Ukraine's top regional development objective

The current SSRD represents both a continuation of and partial departure from previous state strategies. The SSRD 2021-2024 represents different elements that were also featured in the previous state strategies for regional development (Table 4.3). For example, each of the SSRDs aimed to boost the competitiveness of Ukraine's regions, and included an objective to strengthen the governance framework for regional development. There is, however, a small yet important difference between the priorities of the current SSRD and those of the previous strategies. The 2021-2027 SSRD's top objective is to strengthen territorial cohesion in the social, humanitarian, economic, environmental, security and spatial dimensions. Even though the SSRD 2014-2020 included a similar objective, it was more narrowly framed, focusing primarily on socio-economic integration. Moreover, it was situated lower in the hierarchy of objectives, after increasing regional competitiveness.

Table 4.3. Strategic objectives of last three SSRDs

SSRD until 2015	SSRD until 2020	SSRD 2021-2027
1. Increasing the competitiveness of regions and strengthening their resource potential. 2. Ensuring the development of human resources. 3. Development of interregional co-operation. 4. Creating institutional conditions for regional development.	1. Increasing the level of competitiveness of regions. 2. Territorial socio-economic integration and spatial development 3. Effective public administration in the field of regional development.	1. Form a cohesive state in the social, humanitarian, economic, environmental, security and spatial dimensions. 2. Improve competitiveness of the regions. 3. Develop effective multi-level governance.

Source: Author's elaboration, based on SSRD until 2015: (CabMin, 2006[37]); SSRD until 2020: (CabMin, 2020[38]); SSRD 2021-2027 (CabMin, 2020[39]).

In light of the country's growing economic dependence on Kyiv City and Kyiv O*blast*, however, increasing the competitiveness of all *oblasts* is also of the essence. Focusing on increasing territorial cohesion should therefore not translate into a policy that primarily aims at compensating or subsidising 'lagging' regions, but rather on investing in their economic base, taking into account local strengths and capacities.

The SSRD 2021-2027 does not clarify how special functional territories will be targeted

An important innovation of the current SSRD is that it includes elements of a place-based approach to regional development. The strategy defines place-based development policy as one that "stimulates the use of territories' own potential". A core element of the strategy's place-based approach is the identification of several types of territories[2] that require special attention from the state to boost their development and competitiveness.

In principle, the definition of functional areas that share certain traits can help guide national and subnational governments prioritise investments. It can also facilitate the creation of targeted vertical and horizontal co-ordination mechanisms. However, in the case of the SSRD, the identification of functional territories is not supported by a diagnostic of each territory's specific development challenges or comparative strengths. In addition, it remains unclear how the strategy's 17 operational objectives (Annex Table 4.B.1) relate to the functional areas. Only one operational objective is clearly linked to a functional territory [i.e. "Stimulate economic development centres (agglomerations, cities)]". This means that it remains unclear what the main challenges of the functional territories are and how the strategy proposes to address them.

Even though the strategy mentions that state programmes for the socio-economic development of individual territories will be developed, it does not detail how they will be designed, implemented or financed. It also leaves open which public and non-governmental actors will be involved in the implementation and how efforts will be co-ordinated. Even though this could theoretically provide flexibility, it also poses the risk of inaction. In fact, by late 2021, no state programmes for the socio-economic development of individual territories had yet been developed. In 2021, draft legislation was introduced to establish different planning and co-ordination instruments to help the national and subnational governments develop and implement policies for specific functional territories (Box 4.15).

Box 4.15. Proposed Law no. 5649 "On Peculiarities of Stimulating Regional Development"

Draft law no. 5649 proposes certain provisions of the Law "On the Principles of State Regional Policy". Its purpose is to stimulate the development of regions and certain types of territories that require special attention from the State to, among other elements, establish equal conditions for balanced socio-economic development, increase employment and improve living standards.

A core element of the draft law is the definition of territories that require special attention from the State. These can, for example, refer to border areas in unfavourable conditions or whose economic performance has been below the national average for several years.

The law also proposes the creation of different types of development programmes, as well as new mechanisms to stimulate the development of regions that require special attention. These include Regional Development Agreements and Inter-regional Co-operation Agreements that would allow the joint implementation of regional development projects affecting several regions.

Source: Author's elaboration, based on (Verkhovna Rada, 2021[40]).

As many of the functional territories overlap, specific *oblasts* and municipalities could simultaneously be targeted in the implementation of different programmes (e.g. programmes for border areas and struggling rural areas). At the same time, the respective subnational governments also need to implement their own development strategies. Ensuring that the wide range of possible strategies and programmes are coherent and effectively implemented requires fit-for-purpose vertical and horizontal co-ordination.

Ukraine should ensure that regional development programmes targeting the different functional territories include a clear definition of their comparative development challenges and potential. The government should also define how they relate to (and need to be aligned with) other planning instruments. In this regard, the government is advised to take stock of the experience of Piedmont, Italy (Regione Piemonte, 2021[41]). The region's Unitary Strategic Document for the programming of European funds for 2021-2027 identifies and analyses the interplay and synergies between different international, national and regional development frameworks and instruments. Taking into consideration the high number of regional and local development planning instruments that subnational governments need to create, applying this approach could help optimise complementarities and avoid overlap.

The structure of the SSRD limits the participation of public and non-governmental actors in its implementation

An additional challenge that may undermine SSRD implementation efforts relates to the contribution that public and private stakeholders can make to advance the State Regional Policy. For example, the new SSRD fails to detail the contributions different governmental actors can or should make to support its implementation, financing, monitoring or evaluation. This is a cause for concern as the main challenges encountered in the implementation of the previous SSRD stemmed from the absence of effective mechanisms to leverage funds from ministries and other central executive bodies for implementation.

Moreover, the SSRD does not mention the role that civil society organisations, the private sector and academia can play in the implementation, monitoring or evaluation of the strategy. This could limit the understanding of public institutions at all levels of government of the contribution that non-governmental actors could make to achieve regional and local development objectives. To ensure that regional and local development interventions effectively address local needs, the government should promote and facilitate the contribution of non-governmental stakeholders in the full lifecycle of regional development strategies.

To enhance the participation of key governmental and non-governmental actors, the government should involve a wide range of stakeholders in a mid-term review of the strategy. Any updated version of the strategy should also establish which actors will be involved in pursuing the different operational objectives of the strategy. This could inform and facilitate the creation of *ad hoc* working groups or technical committees—for example in the framework of the ICC—that are responsible for co-ordinating and monitoring the implementation of the SSRD. In doing so, the government could build on the Action Plan 2021-2023, which identifies the public institutions that are responsible for the implementation of the 131 tasks (CabMin, 2021[42]).

The vast number of SSRD implementation tools limits their effectiveness

The SSRD identifies several tools to support its implementation. These include the different planning instruments for regional development that are specified in the Law "On the Principles of State Regional Policy". It also mentions other instruments such as state programmes for the development of cross border co-operation and programmes for the socio-economic development of individual territories. However, it does not provide details regarding who should develop and implement these tools or how they should be linked to the SSRD.

The list of implementation tools also includes several sectoral strategies covering diverse policy areas (e.g. support to small and medium-sized enterprises, energy, and waste management) and with timespans ranging from two to 15 years. The lack of clarity about the relationship between these tools and how they can support implementation efforts adds to the strategy's complexity.

To advance its strategic objectives, the government should clarify how the various tools interact with and could contribute to implementing the SSRD. There are different ways to approach this. For example, the government could map the synergies between the thematic focus and objectives of the sectoral strategies and the SSRD, as per the example of Piedmont's Unitary Strategy Document. Furthermore, the list of tasks to be implemented under each operational objective could indicate if they are directly related to one or more of the sectoral development strategies. This could facilitate co-ordination efforts. In the mid to long term, however, the regional development planning system should be streamlined and efforts should centre on the development of a reduced amount of planning instruments that facilitate implementation.

Complementarities and tensions exist between the SSRD and the National Economic Strategy 2030

Given a possible mid-term modification of the SSRD, the government should also clarify the relationship between the SSRD and the National Economic Strategy 2030 (NES) (Box 4.16). The NES, developed under the leadership of the Prime Minister and adopted in March 2021, sets out the country's strategic objectives for several economic policy areas, as well as regional development. The existence of two potentially competing long-term, high-level strategic frameworks that deal with regional development—the SSRD and NES—could hold back regional development efforts.

Box 4.16. National Economic Strategy 2030

The objective of the NES is to "create opportunities to realize the existing geographical, resource and human potential of the country to ensure the appropriate level of prosperity, self-realization, security, rights and freedoms of every citizen of Ukraine through innovative climate neutrality no later than 2060".

The NES is divided into 20 'pillars', most of which have an economic focus. They include topics such as macroeconomic policy, trade and communication technologies. Some of the pillars cover broader topics such as quality of life, rule of law and regional development. The multi-sectoral scope of the NES positions it as a long-term national development strategy.

Although the NES includes a reference to the SSRD 2021-2027, its three strategic objectives in the field of regional development are more narrowly defined than those of the SSRD. The NES' three strategic objectives include:

- Ensuring effective regional development planning;
- Increasing the institutional capacity of local executive bodies, local governments and RDAs to ensure the development of regions and territorial communities;
- Ensuring effective financing of regional development.

Source: Author's elaboration, based on (CabMin, 2021[43]).

The regional development pillar of the NES overlaps with the third strategic objective of the SSRD: "Develop effective multi-level governance". As such, the NES does not explicitly seek to achieve the two main objectives of the SSRD: increase the competitiveness of Ukraine's regions, and strengthen territorial cohesion. Even though there is no inherent contradiction between the two strategies, the difference in approach creates a tension that could hamper implementation efforts.

In addition, the regulatory framework underlying each strategy demands that all other planning documents be aligned with them (CabMin, 2021[43]). In the absence of a national planning law, the two documents can be seen as competing. This adds to the complexity of development planning in general and regional development planning in particular.

The government could use the mid-term revisions of the NES planned for 2024 and 2027 to strengthen its link with the SSRD. In fact, the mid-term revisions could build on the lessons learned from each SSRD action plan. Furthermore, CabMin is calling for the development of "a single web portal of e-government" that presents the strategy's progress. To avoid a duplication of efforts, this portal should, to the extent possible, incorporate information regarding the implementation of the SSRD (CabMin, 2021[43]).

Challenges to implementing Ukraine's oblast development strategies

As of 2021, all *oblasts* had regional development strategies that are aligned with the SSRD, as well as action plans that identify specific projects to be implemented. There are several challenges that limit the effectiveness of the regional development strategies, which generally relate to the strategy design process, and their implementation and financing tools.

Challenges to the quality of regional development strategies and their links to the SSRD

When reflecting on the effectiveness of the regional development projects selected during the 2014-2017 period, then First Deputy Minister of Regional Development, highlighted four challenges. First, regions did not sufficiently focus on the creation of jobs. Second, some *oblast* strategies were considered to be of poor

quality. Third, when developing their strategies, some *oblasts* did not adequately incorporate input from municipalities or other key stakeholders. Fourth, the selection of projects to be financed through the different regional development funds was also generally not aimed at achieving the tasks of regional strategies (MinRegion, 2019[44]).

When developing the current regional development strategies, the government took several actions to address these challenges. For example, the strategies were developed with the methodological support from MinRegion and followed the official guidelines adopted by CabMin in 2015. *Oblasts* also set up multi-sector working groups to facilitate the design of their regional strategies and development partners were invited to propose specific projects (CabMin, 2019[45]; MinRegion, 2019[46]). Nevertheless, the participation of municipalities and non-governmental actors continued to be limited (OECD, 2021[12]). Their greater involvement could help design gender-sensitive approaches to regional development, which are currently absent from the strategies (Box 4.17).

Box 4.17. Gender and regional development

A recent study published by UN Women indicates that gender-based inequality in Ukraine is higher than in Europe and Central Asia, as determined by the Gender Inequality Index. This index shows the loss in potential human development due to disparities between female and male achievements.

Several challenges to advancing the gender equality agenda at the national and subnational levels can be identified. These include a lack of a co-ordinated and comprehensive whole-of-government approach to gender mainstreaming, as well as limited public funding for gender programming, strategies and women's rights organisations. The limited participation of women in legislative positions at the regional and national level might contribute to the fact that many regional development strategies and action plans do not reflect a gender-sensitive approach to regional development.

Opportunities to strengthen gender-based regional development

Gender-sensitive strategic goals are absent in the development strategies of all *oblasts*. Most regional strategies also do not use a systematic approach to addressing gender inequalities. Sixty-four percent of strategies include some gender-sensitive targets, and more than half of all strategies have gender-sensitive indicators. An important obstacle to gender-based regional development planning is the scarcity of human and technical resources to handle statistical data that is disaggregated by sex.

To overcome these challenges, the Government of Ukraine could consider facilitating the participation of women's groups in the mid-term review of regional development strategies and the design of the next generation of action plans. Furthermore, it should invest in providing capacity building support for subnational governments on how to adopt an integrated gender approach in the areas of strategic planning, budgeting, implementing and monitoring the State Regional Policy. Ukraine should also invest in collecting more micro-data disaggregated by sex to design policy interventions that bridge the gender divide and foster the economic and political participation of women in particular.

Source: Author's elaboration, based on (Government of Ukraine, 2019[47]; Food and Agriculture Organization, 2021[48]; UN Women, 2021[49]; DESPRO, 2020[50]).

To further improve the quality of the regional development strategies, the government should review the methodology that guides their design, monitoring and evaluation. In particular, it should provide more specific indications on how regions can conduct inclusive multi-actor and multi-sector consultation processes. It should also define the expected involvement of the RDAs in this process. Furthermore, the role of the *oblast* Project Selection Boards should be reviewed. These entities are charged with selecting regional development projects to be financed through the SFRD. The Boards are often considered to be

under direct influence of the Head of the *oblast* state administration who is appointed by the President of Ukraine. This can undermine the transparency of the project selection process and open the way for political considerations to trump technical criteria. Finally, the government is advised to adopt legislation developed by MinRegion to reinforce the link between the *oblast* strategies, as well as the other regional development planning instruments and the SFRD (see Chapter 5).

Mechanisms for monitoring the regional development strategies remain unclear

The regional development strategies tend to be ambiguous regarding the mechanisms to oversee their implementation, monitoring and evaluation. For example, the Odessa Regional Development Strategy 2021-2027 indicates that the regional council, the *oblast* state administration, municipalities, and individuals, among other actors, will be involved in tracking the implementation of the strategy. However, no information is provided about how or when the monitoring and evaluation exercises will be conducted, whether the actors will co-ordinate their efforts or how results will be disseminated (Odessa Regional State Administration, 2020[51]).

The regional strategies and their action plans also suffer from a high degree of uncertainty regarding the availability of the necessary financial resources to implement the proposed projects. In principle, the strategies can be financed through a wide variety of sources, including the SFRD, the budgets of municipalities, grants and loans. The action plans present a breakdown of the expected annual cost of proposed projects. They indicate the amount that will be financed through national, regional and local funds, as well as other sources such as domestic and foreign investments.

A recent assessment of the action plans of 13 *oblasts* highlights significant variation in the proposed sources of project financing. Most *oblast*-level projects depend on state budget funds for their implementation. For example, 91% of the action plan of Luhansk *oblast* is supposed to be financed through national funds (Родченко and Прус, 2020[52]). Other *oblasts*, for example Kherson, Donetsk and Zaporizhzhia plan to finance the majority of the costs associated with their action plans with the support of domestic and foreign investors. The action plans that depend most on local budgets include those of Lviv (45%), Poltava (36%) and Kharkiv (28%) (Родченко and Прус, 2020[52]). These differences in the sources of financing may be explained by two factors:

1. Variation in a region's openness towards and experience in identifying funding from sources other than state subventions; and
2. The comparative attractiveness of their investment projects to domestic and international investors.

The dependence of many *oblasts* on state funding comes with a substantial risk due to the unpredictable nature of major state financing mechanisms. For example, the SFRD's legal mandate to receive 1% of planned General Budget Fund revenues has never been met. This creates uncertainty about the extent to which the projects that depend on SFRD funding would be able to receive the necessary funding. This is compounded by problems related to the timely disbursement of SFRD funds by *oblast* state administrations to municipalities (OECD, 2021[12]). In addition, several of the other inter-governmental funds that could support regional and local development initiatives are competitive in nature. This means that, at the time of developing the project proposals, funding might not have been secured. *Oblasts* appear keenly aware of the challenge of securing sufficient funds to implement their regional development strategies. This is illustrated by the Odessa state administration's 2021-2024 action plan that mentions the following risks associated with implementing several of its proposed projects (Odessa Regional State Administration, 2020[51]):

- Insufficient funding for projects from the state budget and lack of alternative sources of funding;
- Non-fulfilment by regional development entities of the obligation to co-finance the implementation of investment projects; and

- Lack of local knowledge and managerial capacity to implement projects and mobilise the necessary resources.

To effectively address the challenges in implementing and financing the regional development strategies and their action plans, the government could consider a series of complementary policy interventions. First, it should mandate that the regional development strategies include implementation and monitoring plans that indicate which actors will be involved, as well as their specific tasks and responsibilities. Second, the different proposed development projects included in the action plans should detail their relevance for the development of the region. Third, the regional development strategies and their action plans should clearly indicate if the necessary funding for the different proposed initiatives has already been secured or whether the *Oblasts* or involved municipalities hope to attract funding, for example through the SFRD. Finally, the government should contemplate setting up multi-sector and multi-level regional co-ordination mechanisms to oversee the implementation of strategies. The 2030 Agenda committees created in Mexico's state governments can serve as an example (Box 4.18). Combined, these actions could help convert the regional development strategies from *de facto* 'wish lists' that lack effective financing and implementation mechanisms, into solid strategies that stimulate the implementation of regional projects linking national strategic priorities with local needs.

Box 4.18. Mexico's subnational 2030 Agenda committees

Between 2017 and 2018, Mexico's 32 states created 2030 Agenda monitoring and implementation committees. Even though the specific mandate and composition of the committees differ from state to state, they generally function as planning bodies that facilitate co-ordination between the states' three branches of government, municipalities and non-governmental actors.

The committees are charged with the intergovernmental co-ordination for the design, implementation, monitoring and evaluation of policies, programmes and actions for the achievement of the 2030 Agenda. In particular, the committees, which tend to meet twice a year, are responsible for 1) proposing specific actions to achieve the objectives of the 2030 Agenda and 2) submitting a periodic report on their results and the objectives they achieved. In addition, several of the committees are responsible for proposing adjustments to local legislation to advance the achievement of the 17 Sustainable Development Goals, and informing the national 2030 Agenda council on local progress.

Besides line ministries and strategic non-governmental actors, in most committees a representative of the national Institute of Statistics, Geography and Informatics is invited to support monitoring and evaluation efforts. Furthermore, several of the committees have created thematic working groups or regional hubs to support the local implementation of their annual work plan. These bodies ensure that the meetings of the committees impact actual policies. Other factors determining the effectiveness and continuity of the work of the committees include the leadership of the committees' president—who is often the State Governor or Secretary—as well as the extent to which non-governmental actors have an active role in shaping the committees' agenda and work.

Source: Author's elaboration, based on (UNDP Mexico, 2019[53]).

Increasing municipal capacity to implement territorial development strategies

As a result of the amalgamation process, many municipalities have taken a more proactive role in supporting local development efforts (OECD, 2021[12]). At the same time, efforts by municipalities to design local development strategies that set clear targets and guide investment are curtailed by a number of

factors. These are primarily related to municipal responsibilities for the development of local strategies, as well as their capacity to effectively execute them.

Half of municipalities reported not having a local development plan

Up until July 2022, municipalities were not mandated to design local development strategies that align with the SSRD or the regional development strategies (Box 4.6) (Verkhovna Rada, 2022[18]). This may explain why, of the 741 municipalities that responded to the OECD's online survey in September 2021 (Box 4.4), only 49% indicated that they had an officially approved local development strategy. Forty-eight percent reported that they did not and 3% were unsure. These figures are in line with findings from OECD interviews with local stakeholders, which indicated that approximately half of the 1 469 municipalities had an approved local development strategy (OECD, 2021[12]). Many of these had been developed with the support of international development partners, as well as the different local government associations (OECD, 2021[12]).

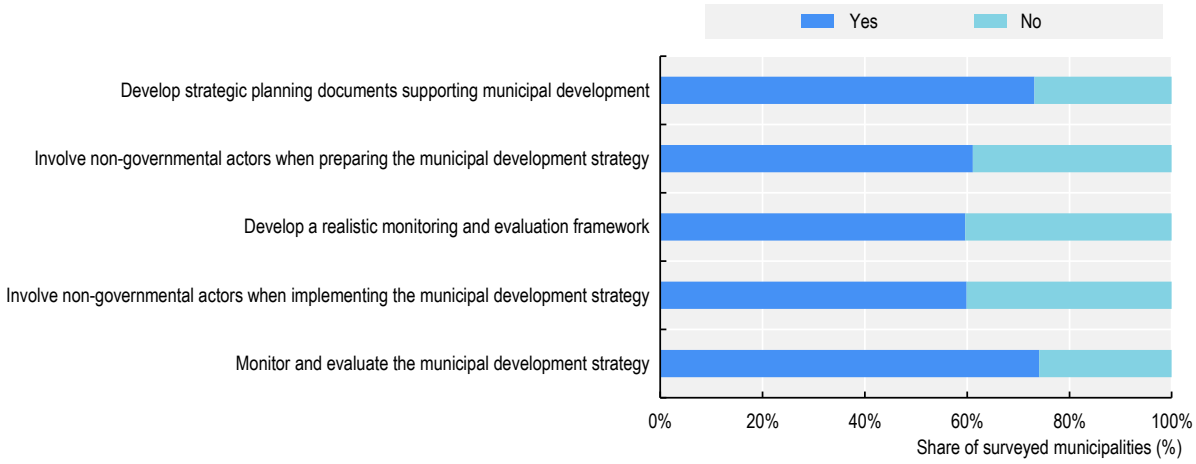
The lack of a local development strategy hampers the ability of a municipality to guide local development efforts towards clear objectives and monitor progress, as well as to develop proposals for investment projects that are coherent with local needs and capacities. Conversely, municipalities that have created an integrated local development strategy are in a stronger position to effectively contribute to the development of the regional development strategies. The availability of a local strategy, particularly one that was designed with the input of public and private actors, can provide clarity for stakeholders regarding investment priorities, which is crucial for subnational economic development. However, there are concerns that municipalities are developing extensive local development strategies that, albeit very comprehensive, are also highly complex and therefore hard to implement. To address this challenge, the government is advised to develop guidelines that emphasise the need for succinct and adaptable local strategies and corresponding action plans.

Following the recent approval of amendments to the Law "On the Principles of State Regional Policy", all municipalities will have to design a local development strategy (Box 4.6). In this effort, municipalities can use the methodology that MinRegion developed. In addition, the government is advised to facilitate peer-to-peer learning between municipalities, building on the experience that some have already gained in designing local development strategies.

Municipalities reported having sufficient capacity to develop local development strategies, but not to engage with key stakeholders

When asked about the availability of human resources (including expertise) to effectively carry out selected tasks related to the regional development planning process, 73% of municipalities reported having sufficient capacity to design development strategies (Figure 4.6). However, local stakeholders in Ukraine indicated that municipalities that were administratively amalgamated were more likely to lack the capacity to create a comprehensive development strategy (OECD, 2021[12]).

Figure 4.6. Availability of human resources to effectively carry out tasks related to the development planning process



Note: Question: Please indicate if you consider your municipality has the necessary human resources (incl. expertise) to effectively carry out the following tasks related to the development planning process? Full list of tasks: Develop of forecast and program documents of socio-economic development of the territorial community, in particular the strategy of development of the territorial community; Involve the private sector, civil society or academia when preparing the municipality's socio-economic development plan; Develop a realistic monitoring and evaluation framework with clear objectives and indicators; Involve the private sector, civil society or academia when implementing the municipality's socio-economic development plan; Carry out periodic monitoring and evaluation exercises of the municipality's socio-economic development plan. Response options per task: Yes; No. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

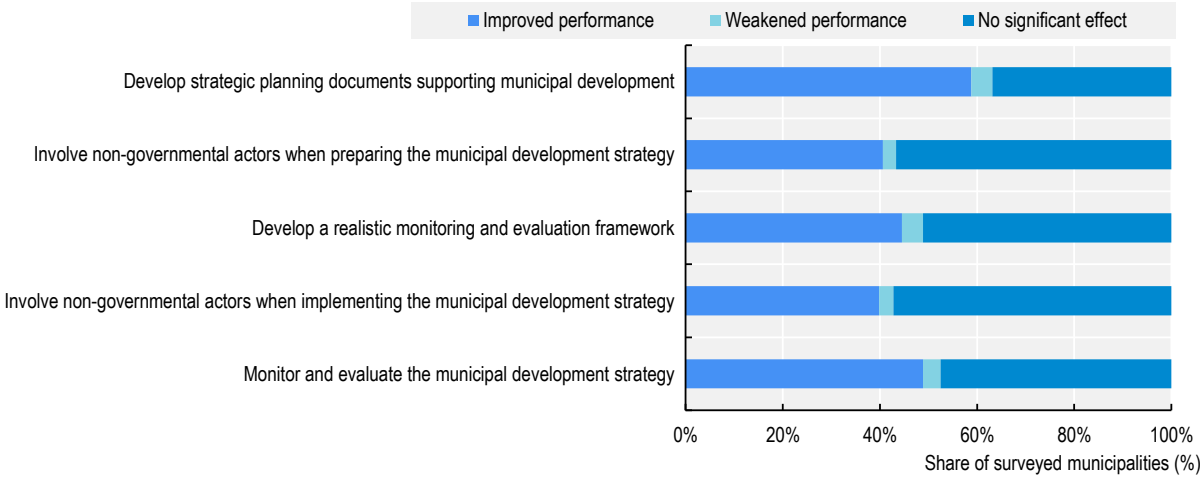
Among the municipalities surveyed, 74% reported that they have the capacity to carry out monitoring and evaluation exercises, and 40% indicate they do not have the necessary expertise to develop a monitoring and evaluation framework with clear objectives and indicators. This means that any capacity building support for municipalities in the field of monitoring and evaluation should primarily focus on how to set indicators and define realistic targets. MinRegion has indicated that it is planning to develop methodological guidance for municipalities to address this issue (OECD, 2021[12]).

Another issue revealed by the survey was the lack of human resources to effectively involve the private sector, civil society or academia when preparing the municipality's development strategies (39% of responding municipalities) or implementing them (40%). Through dialogue processes with CSOs, academia and businesses, as well as the application of surveys and other consultation methods, municipalities can obtain valuable information about local needs and priorities. As such, ensuring a robust consultation process at the local level is critical to enabling effective priority setting.

Many municipalities reported that the decentralisation reforms have been positive for their development planning capacities

The OECD project's online survey indicated that Ukraine's decentralisation reforms (including the amalgamation process) have had a generally positive effect on municipal performance in areas related to the development planning process (Figure 4.7). Of the surveyed municipalities, 59% indicated that it had improved their ability to develop local development strategies. A majority (49%) reported that their ability to periodically monitor and evaluate their development strategy improved.

Figure 4.7. Impact of the decentralisation reform on the performance of municipalities in the field of regional planning



Note: Question: What impact has the decentralisation reform (including the amalgamation process) had on the performance of your municipal government (in the following areas) related to the development planning process? Full list of tasks: Develop of forecast and program documents of socio-economic development of the territorial community, in particular the strategy of development of the territorial community; Involve the private sector, civil society or academia when preparing the municipality's socio-economic development plan; Develop a realistic monitoring and evaluation framework with clear objectives and indicators; Involve the private sector, civil society or academia when implementing the municipality's socio-economic development plan; Carry out periodic monitoring and evaluation exercises of the municipality's socio-economic development plan. Response options per task: Improved performance; Weakened performance; No significant effect. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

The majority of municipalities consider that the decentralisation reforms (including the amalgamation process) have not increased the participation of local businesses (e.g. private sector representatives) in municipal decision making (Annex Figure 4.C.1). Rather, most surveyed municipalities reported that the reform process either had no effect (or sometimes even a negative effect) on local businesses' participation in local policy-making.

These results suggest that municipalities may not have received sufficient guidance on how to foster inclusive public-private dialogue or to ensure that local strategies take into account the constraints and opportunities facing the local private sector. This is a particular area of concern given the SSRD's objective to increase territorial competitiveness. Well-structured public-private dialogue processes can contribute to mutual understanding between government and the business community about, for example, how to strengthen the local investment climate. To address this challenge, the government could make the allocation of funds to municipalities to stimulate economic development conditional on private sector representatives being involved in the project design.

Municipalities reported that individual citizens are participating more in local decision making

The perceived impact of the decentralisation reforms on the participation of individual citizens in various spheres of local decision making is relatively positive (Annex Figure 4.C.2). A majority of municipalities reported that the reform process has increased citizen participation in areas such as the design of the municipal development strategies (58%). At the same time, however, a majority of municipalities indicate that the reforms had either no effect on or decreased citizen participation in areas such as the monitoring of the municipal development strategy; the identification of investment needs; and the design of investment

projects. This may be explained by the fact that several proposed legal amendments to provide a framework for public participation and consultation have not passed.

The government should consider introducing legislation to clarify the tools and mechanisms through which citizens can participate in municipal decision making. These include participatory budgeting, referenda and petitioning. It also requires the updating of existing legislation to make public consultation an integral part of development and investment planning at the national and subnational levels. This would help ensure that a wide range of citizens' perspectives are systematically considered in municipal decision making, facilitating the identification of community priorities and a triangulation between various local interest groups. In turn, this will help to enhance trust in government.

Combined, these findings suggest that some municipalities might be falling behind their peers in terms of development planning and implementation. This could entrench territorial disparities. The government should consider providing more systematic capacity building support to municipalities in the aforementioned areas and particularly in the fields of stakeholder consultation, as well as monitoring and evaluation. In doing so, the government should leverage the expertise and experience many municipalities have gained in these fields. In interviews with municipalities, peer-to-peer exchange was mentioned as one of the most effective methods of capacity building (OECD, 2021[12]).

The next section discusses how Ukraine can boost the production and use of micro-level information and therefore evidence–based decision making in the field of regional development at all levels.

Effective data management for regional development policy

Well-developed, outcome-oriented performance measurement systems are fundamental to the success of regional and local development policies. They allow national and/or subnational governments to measure the effectiveness of policy and spending (Mizell, 2008[54]; Phillips, 2018[55]). Performance measurement systems generally combine monitoring and evaluation mechanisms containing indicators and can help governments at all levels determine if their actions are obtaining the desired results or if adjustments are necessary. Over the past few years, Ukraine has taken important steps to increase the availability of territorially-disaggregated information on issues related to regional development. However, more action is needed to ensure informed decision making. It is thus essential to set up a solid regional development performance monitoring system, and to invest in the general capacity of the government to produce, analyse and share information.

Evidence-based decision making for regional development

A well-designed monitoring and evaluation system offers policy actors at all levels timely information to enhance decision making throughout the policy and investment cycles. A key step in developing such a system is determining performance indicators that are appropriate for the objective at hand (Box 4.19). When developed together with subnational actors and even non-governmental actors, and coupled with realistic targets, indicators can promote capacity development, encourage performance improvements, and strengthen transparency and accountability at all levels of government (Mizell, 2008[54]) (Phillips, 2018[55]) (OECD, 2009[56]).

Box 4.19. Distinguishing between different types of indicators

An indicator is a measure that can capture different types of information and provides insight for evidence-based decision making. Indicators are generally divided into four categories:

- **Input indicators** reveal what resources (e.g. people, money, and time) are used in what amounts to produce and deliver goods and services.
- **Output indicators** capture the goods and services that activities produce (e.g. number of local civil servants trained, the number of SMEs that received financial support, kilometres of roads built).
- **Outcome indicators** capture the dimension that is expected to change as a result of an intervention (policy, programme, or project). Outcome indicators show the real-world changes that practical outputs will produce (e.g. the percentage of people who have improved their situation in the labour market within a certain number of months after their participation in training).
- **Impact indicators** relate to the expected impact of a policy intervention on the economy or society in general. They measure changes in the long term.

In determining what to measure, two factors are particularly important: the objectives of the monitoring system, and the objectives of the policy/programme/project.

Source: Author's elaboration, based on (OECD, 2009[56]).

Having access to reliable, timely and disaggregated data can help governments at all levels understand and make informed decisions about how to best boost regional economies, redress territorial inequalities and improve the well-being of local communities. It allows decision makers to develop place-based regional and local development strategies and plans that take into account the comparative strengths of different localities, identify specific and urgent development gaps. It also enables them to build on these strategies and plans in order to propose territorially-differentiated policy solutions.

More robust performance measurement would enable Ukraine's national and subnational governments to better understand the impact of their regional development policies, strategies and investment projects. It could also offer insight into the factors contributing to or detracting from regional and local attractiveness, and potentially improve policy continuity.

To improve evidence-based decision making in the field of regional development, Ukraine needs to build subnational government capacity to produce, analyse and disseminate up-to-date territorially-disaggregated information on a wide range of topics. Promoting a management style that focuses on learning, rather than control is also necessary. In addition, Ukraine should strengthen the role that the State Statistics Service of Ukraine (SSSU) plays in gathering, analysing and disseminating data across ministries and among levels of government. Doing so could not only support regional and local development but also improve evidence-based decision making across government, regardless of the policy or topic at hand.

Increased efforts to provide micro-level data on regional and local development

MinRegion, as well as key development partners, seem to be acutely aware of the challenges posed by the scarcity of micro-level data on regional and local development, particularly at the municipal level. This has spurred the development of several initiatives aimed at improving the availability of territorially-disaggregated data and creating a municipal performance monitoring system.

In 2021, MinRegion launched a survey among municipalities to obtain their suggestions regarding the topics they would like to see included in a new system of local statistics (MinRegion, 2021[57]). Likewise, together with the Organization for Security and Co-operation in Europe it created the Hromada Performance Monitoring Platform[3], which presents territorially-disaggregated data related to population, physical infrastructure and public finances. The creation of this platform represents an important step forward in the availability of data that allow all levels of government, as well as development partners, to gain insight into different aspects of municipal performance.

The platform presents several opportunities for improvement. First, it does not contain information or links that would allow users to obtain a copy of the presented data. Second, the majority of the statistics included on the platform are not included in the SSSU's statistics portal. This undermines the function of the latter portal as the main source of official statistics. Moreover, it creates uncertainty about which institutions are responsible for producing the data presented on the Hromada Performance Monitoring Platform. These challenges could be overcome through a series of practical actions such as ensuring that all data presented on the platform are also included on the SSSU website and by offering users the possibility to download the data. The government is also advised to include metadata for each indicator. This would allow users to understand, for example, what the units of measurement for the different indicators are, how the data were gathered and by whom.

MinRegion has also been involved in a pilot initiative, organised by the USAID-financed DOBRE project, to contribute to the development of a municipal performance management system. As part of this initiative, a set of indicators related to three service areas was developed. These indicators were subsequently tested in different communities. The findings of the pilot confirmed the scarcity of information in municipalities to assess their performance. This particularly applied to municipalities that had recently amalgamated (DOBRE, 2021[58]).

The findings from the DOBRE pilot initiative help explain why nearly half of the municipalities surveyed by the OECD reported that they lack the capacity to develop a realistic monitoring and evaluation framework (Figure 4.6). In addition, as mentioned earlier, a majority of municipalities reported that the decentralisation reforms implemented since 2014 had either had no significant effect on—or in fact weakened—their performance in areas such as developing local strategies (Figure 4.7).

There are signs that over the past few years the access of municipalities to some data gathered at the regional and national level has decreased. Certain statistics that used to be available to municipalities prior to 2018—for example on foreign direct investment—appear to be no longer accessible (OECD, 2021[12]). This has prompted some larger municipalities to contract private enterprises to generate data they need for local decision making. Given the financial constraints that particularly smaller municipalities face, this might not be an option for them. As such, the scarcity of data, combined with municipal challenges to access databases, may actually contribute to existing disparities between local authorities.

Addressing the above-mentioned challenges requires continued investment in the capacity of the national and subnational governments to produce, analyse and share reliable data. It particular, it is important to vastly expand the list of well-being indicators for which territorially-disaggregated data are produced, moving well beyond the indicators presented on the Hromada Performance Monitoring Platform.

Besides investing in the capacity of national and subnational governments to generate disaggregated data on indicators (e.g. the number of students enrolled in primary schools, drinking water coverage and local waste collection), the government is advised to focus on obtaining information on citizen and user experience with public services (Box 4.20).

Box 4.20. Citizen and user satisfaction surveys

In many OECD member countries (e.g. Australia, Canada, Chile, Italy, Norway), asking citizens about their overall satisfaction with selected services has become an indicator that national and local authorities often turn to for a quick measure of whether services are performing well against user needs and expectations. In fact, user satisfaction is one of the most common indicators of service performance because it reflects actual user experience with a specific services, and it is generally faster and cheaper to collect, process and disseminate than objective measures of performance. This makes user satisfaction surveys especially suitable for Ukraine.

Satisfaction surveys can be developed and disseminated by the national government, but also by regional and local governments. The latter is particularly relevant for those public services for which subnational governments have a shared or exclusive mandate. However, the national government is well-advised to co-ordinate the design and dissemination of the subnational satisfaction results to ensure comparability. In addition, as not all *oblasts* and municipalities may have experience with developing and disseminating satisfaction surveys, national government and international partners may need to provide support to build the necessary skills.

Source: Author's elaboration, based on (OECD, 2022[59]).

In addition, the government should further explore the potential of "big data". This requires investing in the capacity to make sense of raw, digital datasets to understand their potential for evidence-based decision making, as well as the associated challenges. The benefits of using such datasets include increasing the efficiency and effectiveness of public services. For example, big data collected from social media and mobility apps can help mitigate traffic jams. Challenges include developing the tools necessary to make sense of vast datasets, and using data from social media without compromising the privacy of citizens, for example (Singh, Srivastava and Johri, 2014[60]). Successful use of data also hinges on the willingness of the private sector and academia to collaborate with public actors, including by sharing data and analytical tools.

It is important to stress that a solid performance measurement system complements citizen satisfaction data with information on processes (e.g. waiting times in administrative service centres or hospitals), outputs (e.g. access to drinking water), and outcomes (e.g. Are people better off as a result of the service?). Moreover, quantitative data may be needed to understand the extent to which the satisfaction data generated through surveys can be generalised to the whole population (OECD, 2022[59]).

Actions to better understand any changes in the performance of municipalities would help improve the ability of all levels of government to assess the results of their initiatives and support informed decision making on future initiatives. Beyond this, a concerted effort to strengthen the dissemination of available statistics among levels of government is necessary. Many of these actions depend on the ability of the SSSU to effectively co-ordinate the national statistics system.

Strengthening the State Statistics Service can support regional development performance monitoring

The SSSU is the central executive body in the area of statistics and the main actor of the country's national statistical system. This makes it a fundamental actor in any effort to strengthen evidence-based decision making by public actors, at the national and subnational levels. However, it faces a series of challenges that include reductions in its territorial presence and the lack of co-ordination mechanisms to support the generation, analysis and dissemination of development statistics. Over the past few years, the territorial

presence of the SSSU has drastically changed. Whereas in 2017 the institution had 545 district offices, they were subsequently closed due to budget cuts (Laux et al., 2017[61]). The territorial reorganisation came at a critical time as it coincided with the merger of many municipalities whose administrative and service delivery responsibilities increased, and with it their demand for up-to-date data. Taking into account the implications of the territorial reorganisation for the SSSU, the government should consider investing in the ability of its staff to provide training for subnational governments to produce, analyse and disseminate development statistics. Such capacity building efforts should not only focus on strengthening technical skills but also promote the use of evidence as a learning tool, rather than as a means of control.

In addition, the SSSU's current portal and those of its regional offices do not meet the standards of modern statistical and geographical data reporting. This limits the ability of governments at all levels, as well as non-governmental actors, to easily identify and exploit the available data for decision making purposes. This challenge is compounded by the fact that territorially-disaggregated data can often be found on the platforms of different ministries, such as MinFin and MinRegion. Consequently, users often do not know where to look for information or how to match sectoral statistics that might be published on different online portals. This is particularly problematic when users are looking for data on cross-cutting topics such as regional and local development.

On top of this, several of the online portals that include subnational data do not present the unique codifiers of administrative-territorial units. This complicates integrating or comparing different datasets. Given the inherent complexity of managing micro-data in a context of gradual amalgamation, the government should ensure the widespread use of the codifiers for each administrative-territorial unit. Furthermore, efforts need to be oriented towards expanding the available data on the SSSU portal and integrating those data that are presented on the portals of other state institutions.

The creation of inter-agency statistics commissions could increase data availability

No formal co-ordination body exists to facilitate the regular and systematic exchange between the SSSU and other government institutions to support the generation, analysis and dissemination of development statistics. Given the scope of the challenges with regard to production and dissemination of data discussed previously, the government should consider creating inter-agency commissions that are charged with defining the sectoral data needs, establishing standards to generate and present statistics. It should also ensure that current databases are up-to-date and new ones are developed, with safeguards to ensure respondent confidentiality.

The co-ordination structure of the Mexican Institute of Statistics, Geography and Informatics could be used as an example (Box 4.21). Through complementary co-ordination bodies, this institute facilitates high-level, and technical co-ordination among public authorities to promote an institutional culture oriented towards the generation, dissemination and use of data for decision making processes. Following this example, Ukraine could create a technical statistical committee on regional development that is responsible for setting standards for the generation of information on regional development, identifying new sources of data, as well as determining the information necessities of national and subnational authorities. Such a committee could also be instrumental in promoting the use of evidence in the development of regional and local development strategies, as well as the design of monitoring and evaluation mechanisms. Likewise, it could serve as a mechanism with which the country can identify the capacity building needs of national and subnational authorities and to discuss how to best address them.

Box 4.21. Mexican Institute of Statistics, Geography and Informatics

The National Institute of Statistics, Geography and Informatics (Instituto Nacional de Estadística y Geografía - INEGI) is Mexico's autonomous public institution responsible for regulating and co-ordinating the National System of Statistical and Geographical Information (Sistema Nacional de Información Estadística y Geográfica - SNIEG), as well as collecting and disseminating information about the country in terms of territory, resources, population and the economy.

The SNIEG is formed by the different thematic subsystems that are charged with producing, integrating and disseminating "information of national interest". Each subsystem has different Specialised Technical Committees that contribute to the production, integration and dissemination of statistical and geographical information. The subsystems are composed of representatives from public institutions whose mandates relate to the topic at hand. Representatives from the private sector, academia, civil society organisations and international institutions can also be invited to participate. The Technical Committees' develop annual work plans, meet each semester and report annually on the results of their activities, contributing to the transparency of their actions.

One of the permanent Specialised Technical Committees deals with regional and urban development. Its tasks include setting technical standards for the generation of information on regional development, promoting knowledge about it among public institutions, generating indicators related to regional development that can be included in the National Indicators Catalogue, and identifying the information needs for public decision making in the field of regional development.

Source: Author's elaboration, based on (INEGI, n.d.[62]; INEGI, 2020[63]; INEGI, 2021[64]; INEGI, 2017[65]; INEGI, n.d.[66]).

Finally, an inter-agency statistics commission on regional development could spearhead the creation of a publicly accessible regional development monitoring platform. Such a platform could allow governmental and non-governmental users alike to get acquainted with the country's regional objectives and see how the national and regional governments perform on the indicators that are included in the SSRD and the regional development strategies. It could also include information on the actors that are implementing programmes and projects that contribute to the different regional development objectives. Scotland's National Performance Framework[4] and Mexico's 2030 Agenda monitoring platform[5] are examples of monitoring platforms that can help governments communicate their development objectives and territorial performance with a wide audience.

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Verkhovna Rada (2012), *Закон України "Про державне прогнозування та розроблення програм економічного і соціального розвитку України" [Law of Ukraine "On State Forecasting and Development of Programs of Economic and Social Development of Ukraine"]*, https://zakon.rada.gov.ua/laws/show/1602-14#Text (accessed on 4 December 2021). [70]

Verkhovna Rada (2005), *Закону України Про стимулювання розвитку регіонів [Law "On stimulating development of regions]*, https://zakon.rada.gov.ua/laws/show/2850-15#Text (accessed on 15 October 2021). [67]

Родченко, В. and Ю. Прус (2020), "Стратегічні пріоритети просторово-економічного розвитку регіонів україни [Strategic priorities of spatial and economic development of the regions of Ukraine]", *The actual problems of regional economy development*, Vol. 1/16, pp. 133-145, https://doi.org/10.15330/apred.1.16.133-145. [52]

Notes

[1] The Budget Code of Ukraine defines subventions as inter-governmental transfers of funds to be used for specific purposes through procedures defined by the authority that decides to provide the subvention (Verkhovna Rada, 2021[74]).

[2] The SSRD 2021-2027 identified the following functional territories: agglomerations; large cities; mid-sized cities; small cities; 'mono-functional' cities whose economies are based on mining activities and chemical and oil processing industries; rural territories in adverse conditions; mountainous territories of the Ukrainian Carpathians; the Azov-Black Sea macro region; zones of influence of international motorways; border regions (incl. those in adverse conditions); and temporarily occupied territories and territories and objects of natural reserve.

[3] Hromada Performance Monitoring Platform: https://tdukr.maps.arcgis.com/apps/MapJournal/index.html?appid=47f24b79311f44e2863eabe27ccbdc81&fbclid=IwAR3NdmVaXZD_ojyJnqt41UF01jJ5eOuNZLfJALashZLhfl2mg8w5cdv0ohk

[4] Scotland's National Performance Framework: https://nationalperformance.gov.scot/

[5] Mexico's 2030 Agenda monitoring platform: https://agenda2030.mx/#/home

Annex 4.A. Key legislation in the fields of regional development and decentralisation

Annex Table 4.A.1. Key legislation affecting the territorial planning responsibilities of the government

Law	Description
The Law "On Stimulating the Development of Regions"	This Law, adopted in 2005, provided for the establishment of "regional contracts" to facilitate investment financing by the national government and *oblast* state administrations. However, only seven of such regional development agreements have been developed and implemented, and none of them were considered successful. The law also allowed for the development of programmes to overcome the "depression" of certain territories. However, no such initiative was implemented.
Law "On State Target Programmes"	This 2004 law provides for, among other elements, the creation of national programmes of economic, scientific and technical, social, national and cultural development, and environmental protection. These programmes could cover the entire national territory or a significant number of its regions, have a long implementation period, and could be implemented by central and local executive bodies.
Law "On the General Scheme of Territorial Planning"	The General Scheme established by this 2002 law covers two consecutive periods (2002-2011 and 2012-2020). It defines the priorities and conceptual solutions for the use of the country's territory, improvement of development of industrial, social and engineering infrastructure and formation of the national ecological network. It refers to the needs of separate territories that should be reflected in state programmes of economic and social development.
Law "On State Forecasting and Development of Programs of Economic and Social Development of Ukraine"	This law from 2000 mandates the design and implementation of a wide array of planning instruments including a series of short- and mid-term forecasting and strategic planning documents at the national, regional and city level.

Source: Author's elaboration, based on: the Law "On Stimulating the Development of Regions" (Verkhovna Rada, 2005[67]); the Law "On State Target Programmes" (Verkhovna Rada, 2020[68]); the Law of Ukraine "On the General Scheme of Territorial Planning of Ukraine": (Verkhovna Rada, 2012[69]); and the Law "On State Forecasting and Development of Programs of Economic and Social Development of Ukraine": (Verkhovna Rada, 2012[70]).

Annex Table 4.A.2. Core elements of the post-2014 decentralisation reforms and their relation to regional development

Law	Description
Law of Ukraine "On Voluntary Amalgamation of Territorial Hromadas"	The 2015 law regulates the process of voluntary amalgamation of territorial communities. It was a central piece of legislation in the creation of the Concept framework.
Law "On Local Self-Government in Ukraine"	This law defines the system of local self-government in Ukraine, its principles of organisation and activity. It also establishes the legal status and responsibilities of local self-government officials.
Law "On Local State Administrations"	This 2001 law specifies the organisational arrangements for executive bodies at the subnational level, their mandates, as well as tasks and responsibilities. It defines the institutional and organisational framework within which the *oblasts*, *rayons* and municipalities can implement development policies. Ukraine's parliament is reviewing a proposal to amend the law in light of the creation of 1 469 amalgamated municipalities and the reorganisation and consolidation of 136 districts. The proposed bill seeks to improve the oversight of local authorities' decision making, as well as subnational representation of the national government by establishing the legal preconditions for a prefecture-like system
Law "On Co-operation of Territorial Hromadas"	This 2014 law defines the principles, forms and financing of co-operation between municipalities. The promotion of inter-municipal co-operation was one of the key features of the 2014 decentralisation reform. It sought to facilitate the creation of economies of scale and improve the cost-effective delivery of services by amalgamated municipalities. In 2021, the Cabinet of Ministers (CabMin) developed a

	proposal to amend the law to further facilitate the establishment and implementation of inter-municipal co-operation agreements.
Budget Code of Ukraine	The Budget Code determines the legal basis of the budget system and establishes the sources of revenue of the different government levels. In 2012, the Budget Code was supplemented by Article 24-1, creating the SFRD, which is a key source for financing regional and local development projects.

Source: Author's elaboration, based on: the Law "On Voluntary Amalgamation of Territorial Communities"; the Law "On Local Self-Government in Ukraine": (Verkhovna Rada, 2021[14]); the Law "On Local State Administrations": (Verkhovna Rada, 2021[15]); the Draft Law on Amendments to the Law of Ukraine "On Local State Administrations": (Verkhovna Rada, 2020[71]); the Law of Ukraine "On Co-operation of Territorial Communities": (Verkhovna Rada, 2014[72]); and the Draft Law on Amendments to the Law of Ukraine "On Co-operation of Territorial of Territorial Hromadas": (Verkhovna Rada, 2021[73]).

Annex 4.B. Objectives of the SSRD 2021-2027

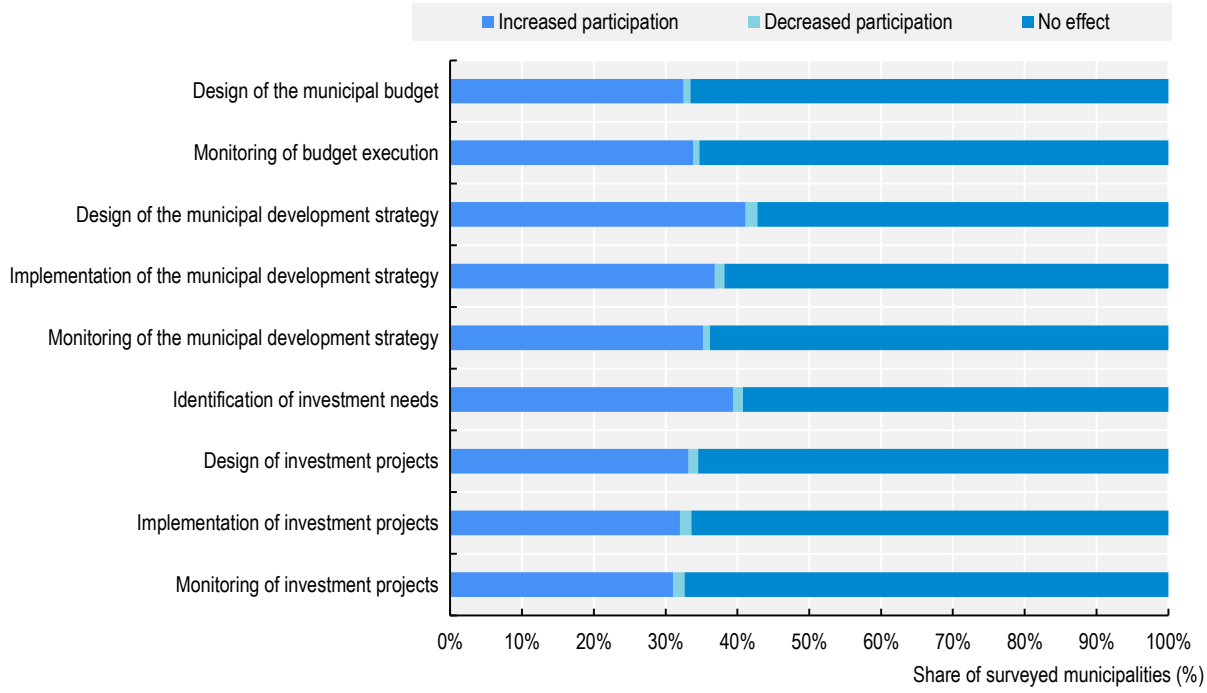
Annex Table 4.B.1. Operational objectives per strategic objective of the SSRD 2021-2027

Form a cohesive state	Improve competitiveness of the regions	Develop effective multi-level governance
1. Stimulate economic development centres (agglomerations, cities). 2. Preserve the environment and ensure sustainable use of natural resources, strengthen the opportunities for development of territories in need of state support (macro-and micro-level). 3. Create conditions for the reintegration of the temporarily occupied territories of the Autonomous Republic of Crimea and Sevastopol city, the temporarily occupied territories in Donetsk and Luhansk *Oblasts* into the Ukrainian space. 4. Infrastructure development and digital transformation of regions. 5. Form a unified educational, informational and cultural space across the entire territory of Ukraine. 6. Effective use of the economic potential of cultural heritage for sustainable community development.	1. Human capital development. 2. Support for entrepreneurship development, business internationalization in the small and medium-sized business sector. 3. Strengthening investment attractiveness of territories, supporting investment attraction. 4. Support for introduction of innovations and growth of the technological level of the regional economy, support of innovative enterprises and start-ups. 5. Sustainable industrial development.	1. Formation of effective local self-government and public authorities on a new territorial basis and in line with the new administrative and territorial structure of Ukraine. 2. Formation of horizontal and vertical co-ordination of state sectoral policies with the State Regional Policy. 3. Build effective system of public investment across all levels of government. 4. Build capacity within State Regional Policy actors. 5. Assuring equal rights and opportunities for women and men, preventing and countering domestic violence and discrimination. 6. Building a system of information and analytical support and developing managerial skills for decision making based on objective data and spatial planning.

Source: Author's elaboration, based on (CabMin, 2020[39]).

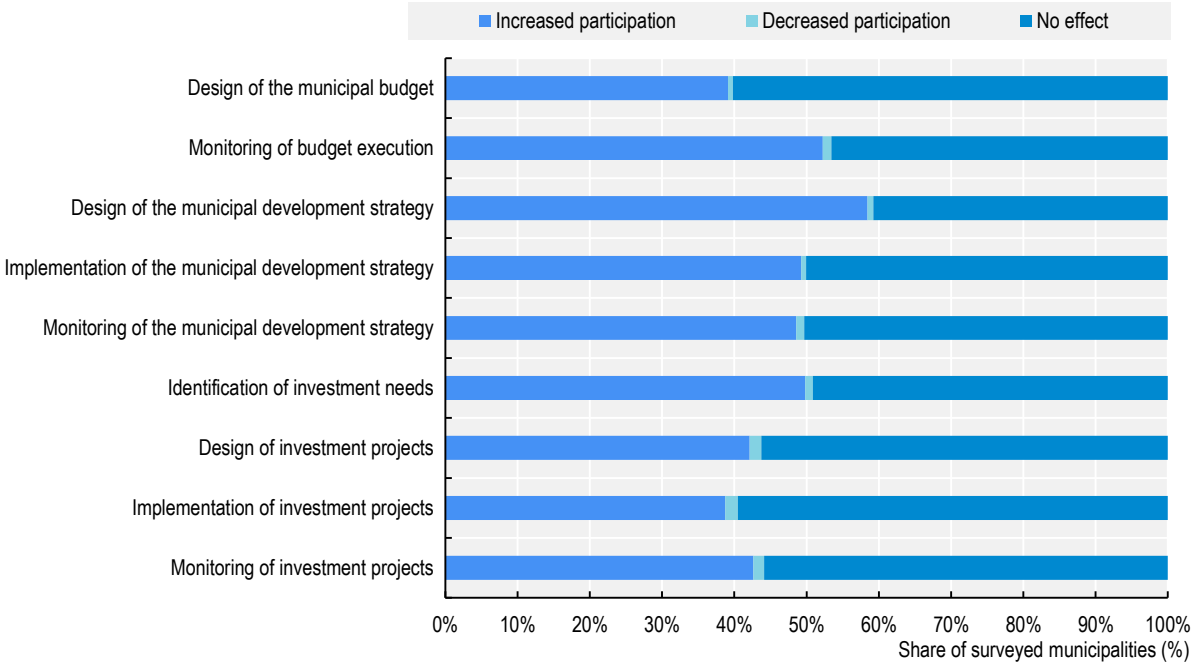
Annex 4.C. Results from the OECD survey

Annex Figure 4.C.1. Participation of local businesses in municipal decision making



Note: Question: What effect have the decentralisation reforms (including the amalgamation process) had on the participation of local businesses (private sector representatives) in the following areas of municipal decision making? Full list of areas of municipal decision making: Design of the municipal budget; Monitoring of budget execution; Design of the municipal socio-economic plan (strategy of development of the territorial community); Implementation of the municipal socio-economic plan (strategy of development of the territorial community); Monitoring of the municipal socio-economic plan (strategy of development of the territorial community); Identification of investment needs; Design of investment projects; Implementation of investment projects; Monitoring of investment projects. Response options: Increased participation; Decreased participation, No effect. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

Annex Figure 4.C.2. Participation of individual citizens in municipal decision making



Note: Question: What effect have the decentralisation reforms (including the amalgamation process) had on the participation of individual citizens in the following areas of municipal decision making? Full list of areas of municipal decision making: Design of the municipal budget; Monitoring of budget execution; Design of the municipal socio-economic plan (strategy of development of the territorial community); Implementation of the municipal socio-economic plan (strategy of development of the territorial community); Monitoring of the municipal socio-economic plan (strategy of development of the territorial community); Identification of investment needs; Design of investment projects; Implementation of investment projects; Monitoring of investment projects. Response options: Increased participation; Decreased participation, No effect. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

5 Public funding for regional development in Ukraine

This chapter explores the framework surrounding regional and local development funding in Ukraine. It assesses the different mechanisms used by the national, regional and municipal governments to fund regional development. First, the chapter describes how basic fiscal indicators related to subnational investment have changed over the past few years. Second, it examines how the distribution of Personal Income Tax could be modified to reduce territorial inequalities and to strengthen service delivery. Third, it takes a close look at the wide variety of intergovernmental grants and subventions that have been established to fund regional and local development. It takes a particularly close look at how certain practices, such as co-funding requirements, could affect regional convergence efforts. Finally, the chapter addresses the capacity of local governments to manage investment, as well as the use of public-private partnerships.

Preface: Building on Ukraine's regional development funding mechanisms to support recovery from the war

This chapter assesses the different mechanisms that are used by the national, regional and municipal governments to fund regional and local development. In particular, it analyses the wide array of intergovernmental grants and subventions[1] for regional development, and the way in which certain characteristics of these funds risk limiting regional convergence efforts. The chapter also addresses the capacity-related challenges facing local governments to effectively manage investment.

Considerations for funding Ukraine's national recovery plan at the subnational level

The data and analysis presented in this chapter are relevant for designing and implementing subnational level mechanisms to fund Ukraine's post-war reconstruction and recovery. The discussion of regional and local development funding is central to advising policy makers on how to set up mechanisms to fund the implementation of local reconstruction and recovery projects. At the same time, it is important to acknowledge that the conditions under which the reconstruction and recovery funds need to operate will differ from those designed for regional development. For example, in the recovery context there is a need to achieve swift results, especially in response to humanitarian needs and rebuilding critical infrastructure (e.g. roads, schools, hospitals, housing) (see Chapter 2). In addition, the combined domestic and international financing that will be available for reconstruction will likely be higher than the regional development funds allocated prior to the war. This will put additional pressure on the capacity of governments at all levels—which, as highlighted in this chapter, are already strained—to effectively allocate funding to meet local needs, as well as to ensure that funds are managed transparently and efficiently.

Similarly, the discussion of the strengths and challenges faced by municipalities when managing regional development investments presented in this chapter can inform the design of interventions aimed at boosting their capacity to manage recovery funds. More generally, by detailing the significant advances Ukraine has made since 2014 in funding regional development, this chapter highlights the steps that domestic and international policy makers can take to establish mechanisms to fund subnational recovery and reconstruction. The following paragraphs present key findings from this chapter.

The government should avoid fragmentation of subnational recovery funding

In testament to the importance that Ukraine assigned to regional development policy, between 2015 and 2019, the national government's budget allocation for regional and local development rose significantly, from slightly over UAH 11 billion to almost UAH 76 billion (U-LEAD, forthcoming[1]). The significant increase in regional development funding since 2015 has enabled the implementation of many projects, ranging from improving economic development and energy efficiency to upgrading local water supply, sewage, and roads. It also provided subnational governments with invaluable experience and skills in managing investment funding, which the government can build on to ensure efficient investment for subnational recovery and reconstruction.

Ukraine's framework for funding regional development, however, has been quite fragmented. Between 2015 and 2019, a total of 110 grants and subventions linked to regional and local development were implemented by a wide range of institutions. This risks increasing costs related to the administration of funding, as well as overlap among different funds in terms of objectives and target groups. Given the fragmentation of regional development funding and the wide array of national-level institutions involved in managing the different funds, the absence of a formal body to co-ordinate regional development funding risks undermining the coherence of regional development spending.

As Ukraine advances in establishing mechanisms to fund subnational reconstruction and recovery, creating a limited number of dedicated funds and subventions to ensure that overarching government objectives are met would be important to limit fragmentation. In addition, to ensure a coherent approach to funding post-war recovery efforts, the government should consider the formation of a centre-of-government body responsible for co-ordinating recovery funding. It will be important to ensure representation of subnational governments that adequately reflects their territorially-differentiated needs and absorption capacities. This body could be linked to the National Council for Recovery.

Investment in local "hard" infrastructure should be complemented by investment in skills

Over the past few years, intergovernmental expenditure on regional development has predominantly focused on "hard" infrastructure, such as roads, bridges, hospitals, factories. Between 2015 and 2019, spending on "hard" infrastructure accounted for 59% of all spending on regional development (U-LEAD, forthcoming[1]). Most investment targeted the construction and maintenance of roads.

Despite these significant investments, however, the vast destruction caused by Russia's war against Ukraine has drastically increased the need for investment in "hard" infrastructure. By August 2022, damage to Ukraine's buildings and infrastructure as a result of the invasion was estimated at over USD 108 billion, and will likely rise further. Up to 129 000 residential buildings, over 900 healthcare institutions, 23 000 kilometres of roads and 2 200 education institutions have been destroyed or damaged as a result of the war (KSE, 2021[2]).

Investment in hard assets (e.g. reconstruction of roads, schools, hospitals, electricity grids) should be the priority during the reconstruction and recovery period. At the same time, however, complementary investments in human capital, as well as support for small and medium-sized enterprises (SMEs) will be essential. OECD analysis highlights that, generally, investing in "hard" infrastructure alone has little impact on regional growth unless it is associated with "soft" investments (e.g. human capital, innovation) (OECD, 2009[3]; OECD, 2020[4]). Indeed, this was also flagged, albeit prior to the war, as a priority by municipalities in an OECD survey (Figure 5.8). Striking the right balance between investment in "hard" and "soft" infrastructure is particularly important in the context of Ukraine's post-conflict recovery, as many skilled workers have fled the country. This means that the upskilling of internally displaced people may be necessary to facilitate their economic integration into their host communities.

Subnational recovery funding needs to be at the right territorial scale

Prior to the invasion, regional development funding was heavily concentrated in small projects with relatively low economic impact. For instance, between 2015 and 2019, the majority of the initiatives funded through the flagship State Fund for Regional Development (SFRD) only targeted a specific community (63%), and just 8% of projects had a more regional-level focus (Figure 5.10). The dominance of projects that target local-level improvements creates the risk that resources will be used in a less-than-strategic way, as many small projects may tackle similar issues that could have benefited from inter-municipal or inter-regional intervention.

As Ukraine moves forward in designing mechanisms to fund subnational recovery projects, the government should prioritise projects that have a cross-jurisdictional focus in order to achieve economies of scale and increase the resilience of local communities to future natural or manmade shocks. The government could also consider setting up different funding 'windows' for initiatives that either have a local, district or regional focus. Determining the right territorial scale of subnational recovery initiatives requires a solid assessment of the particular needs of municipalities across the country and where such needs coincide or diverge. To the extent possible, this needs to be combined with feasibility studies and robust cost-benefit analysis so recovery funds are spent effectively and efficiently. In cases when the government may be unable to conduct full-scale cost-benefit analyses due to their complexity, policy makers should ensure that possible investment projects are still ranked following a more basic assessment of their expected cost and impact.

The allocation and spending of local recovery funds should be transparent and accountability mechanisms should be in place

The government should ensure that decision-making processes regarding the allocation and execution of recovery funding are transparent and that the involved actors at all levels of government are held accountable. This is particularly important as audit reports published prior to 2022 mention the strong political influence over the distribution of Socio-Economic Subvention funds, which have been used for political campaigning in local constituencies. Ukraine is advised to set up mechanisms to oversee the effective, efficient and transparent use of recovery funding, thereby reducing the risk of regional development funds being awarded based on electoral considerations.

Assessments made by the State Audit Service regarding the legal and efficient use of local resources, which were published prior to Russia's large-scale invasion of Ukraine on 24 February 2022, revealed important violations and shortcomings in the field of public procurement (CabMin, 2021[5]). As such, the government and international partners are advised to support municipalities on issues related to local public procurement and transparent decision making, for example, by providing targeted training or by developing easy-to-use procurement guidelines. Efforts to this effect would be in line with the OECD *Recommendation of the Council on Public Procurement*, which calls upon countries to develop the necessary public procurement expertise in their workforce so as to be able to continually deliver value for money efficiently and effectively (OECD, 2015[6]). The government and international partners could build on the public procurement training programmes that the European Union-funded U-LEAD programme has provided to different municipalities. It could also leverage the online training course on electronic calls for proposals in the education sector that this donor initiative developed together with the Ministry of Digital Transformation of Ukraine (U-LEAD, 2022[7]). This should be coupled with measures such as mandating internal auditing by municipalities. Doing so requires, among other elements, providing municipalities with financial and capacity building support to conduct reliable and effective internal audits, and learn from audit results.

Increased expertise of municipalities to manage investment can support recovery efforts

As it advances with its National Recovery Strategy, Ukraine, supported by international partners, should pay close attention to the capacity of subnational government to absorb and process recovery funding. Ukraine can build on the expertise gained by many municipal governments since 2015 in managing funds from different regional development subventions. This includes experiences in identifying local needs, developing project proposals, and implementing investment projects. According to OECD survey results, 76% of surveyed municipalities reported that they had the human resources to develop investment proposals (Figure 5.13). However, there are signs that the quality of project proposals developed by municipalities remains very low (U-LEAD, 2022[7]; OECD, 2021[8]). To address this challenge, Ukraine is encouraged to set up peer-to-peer learning trajectories, for example with European municipalities, to facilitate the exchange of approaches and good practices on the preparation, implementation, and monitoring and evaluation of investment projects.

Close attention also needs to be paid to the question of how to oversee the effective, efficient and transparent use of national and international recovery funding by subnational governments. According to OECD survey results, 87% of surveyed municipalities indicated that they had the necessary human resources to implement transparent procurement processes with appropriate control systems.

Larger cities should explore public-private partnerships and alternatives to support the subnational recovery

Despite the potential of public-private partnerships (PPPs) to generate resources for investment projects, their use by Ukrainian municipalities is limited (Box 5.11). According to OECD survey results, only 10% of

surveyed municipalities reported that they were engaging with the private sector through PPPs. Public distrust in co-operation between the public and private sector, as well as regulatory uncertainty are cited as the main obstacles to setting up PPPs (Figure 5.15).

When determining whether to promote PPPs as a mechanism to support recovery efforts, the government should recall that, generally speaking, only larger cities have the fiscal and institutional capacities needed to implement such partnerships. It should also consider improving outreach to larger municipalities and the private sector about the potential of PPPs, their regulatory framework, while emphasising the multiple risks involved in setting up this type of collaboration. Fiscal risks relating to the use of PPPs are critical to consider. This is particularly the case given the detrimental impact of Russia's war on Ukraine's subnational fiscal and human resource capacities. In general, PPPs risk being used to overcome public financial management controls, which can have negative long-term fiscal repercussions for subnational governments. In fact, PPPs should only be undertaken where they are affordable and produce greater value for money than would be provided by the delivery of public services or investment through traditional means, and never to overcome budget constraints.

Introduction

Since 2015, Ukraine has witnessed a marked increase in regional and local development funding—a testament to the importance that the government assigns to regional and local development policy. Between 2015 and 2019, the central government budget allocations to regional and local development increased from slightly over UAH 11 billion (or 1.9% of the total national budget) to almost UAH 76 billion (6.9% of the total national budget) (U-LEAD, forthcoming[1]). This marked increase is due to the implementation of key elements of the regional development and decentralisation reforms since 2014 (see Chapter 4), including the creation of several subventions to fund subnational investment projects. These subventions are, however, not the only source of funding for regional and local development. Others include loans from national and international financing institutions, financial support provided by foreign governments and donor organisations, as well as public-private partnerships (PPPs). Furthermore, Ukraine's fiscal equalisation system, which aims to help subnational governments deliver comparable levels of public services, should also be considered when designing regional and local development policy, its funding and financing. While not specifically designed to boost regional development, the equalisation system has a profound impact on subnational government capacity to finance investment.

Despite the increase in funding, Ukraine's capacity to invest in its regional development agenda has been met by four principal challenges. First, the mechanism through which the Personal Income Tax (PIT) is allocated across municipalities—60% of PIT funds go to municipalities, 15% to *oblasts* and 25% to the national government—appears to negatively affect PIT revenues of many smaller municipalities. Under current legislation, a company must allocate its employees' PIT to the municipality where the company is registered. As a result, employees in large companies with offices and staff in different parts of the country pay income tax in the municipality in which the company is legally registered, which might not correspond to the place where (most of) their employees actually do their work or indeed live. Second, Ukraine's regional development funding framework is relatively fragmented and heavily focused on funding the maintenance of "hard" infrastructure. Investing in "hard" infrastructure alone has little impact on regional growth unless it is associated with investment in areas such as human development and innovation (OECD, 2009[3]; OECD, 2020[4]). Prior to the war, this focus undermined the effectiveness of regional development policy as a means to boost regional competitiveness and growth. Third, the co-funding criteria of several of the country's major regional development funds hamper the ability of poorer municipalities to compete for funding to fulfil their investment needs. Together, these elements risk undermining the objectives of Ukraine's regional development policy (e.g. building regional cohesion and stimulating competitiveness) by entrenching regional disparities.

To capitalise on the increased funding for regional and local development, Ukraine needs to adjust the distribution mechanism of PIT and address the fragmentation of intergovernmental subventions for regional and local governments. In addition, the design of intergovernmental grants and subventions should better reflect territorially-differentiated investment needs and fiscal capacities. It also requires strengthening oversight mechanisms and the capacity of local governments to manage investments. These actions would help align Ukraine's regional and local investment frameworks with the OECD's *Recommendation of the Council on Effective Public Investment across Levels of Government* to which it adhered in 2018 (OECD, 2014[9]).

This chapter first looks at how Ukraine's basic fiscal indicators related to subnational revenues and expenditures, particularly related to investment, have changed over the past years. Subsequently, it deals with Ukraine's fiscal equalisation mechanism and explores how one of its core elements, the distribution of PIT, could be redesigned to strengthen service delivery and public accountability. It then reviews the wide variety of intergovernmental transfers used to fund regional and local development. Finally, this chapter takes a critical look at how local government fiscal and human resource capacity to manage investment has changed during the municipal amalgamation process, and discusses the use of PPPs.

Box 5.1. Recommendations for increasing the effectiveness of Ukraine's funding for regional and local development

The following recommendations should be considered in a timeframe that is appropriate to the current context of war and post-war reconstruction and recovery.

To help Ukraine optimise the effects of the equalisation system on regional convergence and growth, the government is advised to:

- Modify legislation to base personal income tax (PIT) allocation on place of residence, thereby maximising its potential to provide municipalities with financial resources commensurate with the demand for public services and investment in their territory, while also strengthening local political accountability.
- Improve data processing systems related to a citizen's place of residence to allow the government, instead of employers, to allocate PIT to subnational governments.
- Conduct an ex-ante study to determine how the different proposals to reform the PIT allocation system would affect the fiscal health of the national, regional and municipal governments, as well as the size of the horizontal fiscal equalisation system necessary to offset, at least in part, territorial disparities in PIT revenues.
- Set up a national/subnational government task force to identify policy interventions that would improve the efficiency and effectiveness of the PIT allocation reform, based on the findings of the ex-ante study.

To improve the effectiveness of Ukraine's grants and subventions for regional development, the government is advised to:

- Streamline the number of grants and subventions for regional development, but not reduce their value, in order to increase spending efficiency, avoid overlap and strengthen the quality of implementation. This could be done, for example, by:
  - Reallocating a higher share of regional and local budget grants and subventions to a single fund (e.g. the SFRD) managed by MinRegion.
- Reinforce the capacity of the Inter-Departmental Co-ordination Committee for Regional Development (ICC) to effectively co-ordinate regional development policy and funding, for example by:
  - Ensuring that, if sub-committees are established within the ICC, one or more support the design, implementation and monitoring of Ukraine's regional development funding mechanisms.
- Balance investment in "hard" and "soft" infrastructure as a means to promote balanced regional development, for example by:
  - Ensuring that funds and subventions with a cross-sectoral focus, such as the SFRD, facilitate investment in areas such as innovation and skills, as well as "hard" infrastructure.
- Adjust the SFRD distribution formula to improve regional convergence, for example by:
  - Linking the formula to the population and GDP per capita of *rayons* instead of *oblasts* or increasing the share of SFRD funds allocated to those territories that have a relatively low GDP.
- Ensure that poorer municipalities, those with limited technical and financial capacities, as well as those most affected by Russia's war against Ukraine, can compete for regional development

funding against their wealthier peers and/or those with greater technical capacities by, for example:

- Providing municipalities with more clarity on eligibility criteria.
- Boosting their technical skills to develop competitive proposals.
- Linking co-funding requirements to the fiscal capacity of municipalities.
- Setting up a complementary general block grant that provides all *oblasts* and municipalities with a minimum level of funding to implement their respective regional and local development strategies. This must be coupled with robust oversight mechanisms to ensure that investment projects meet clear local and/or cross-jurisdictional needs.
- Modifying the SFRD regulations to promote funding of multi-year projects that have a cross-jurisdictional focus.

To help strengthen the ability of regional and municipal governments to fund regional development and finance investment in the medium and long term, Ukraine is advised to:

- Develop and implement methodologies that municipalities can use to identify investment needs, given the scarcity of territorially-disaggregated data, and to effectively engage with governmental and non-governmental actors.
- In collaboration with international development partners, provide training and advice to municipalities, particularly those with more limited capacities, in areas such as stakeholder engagement, as well as monitoring and evaluating investment projects.

To improve the legal and efficient use of regional development funding in the short to medium term, Ukraine is advised to:

- Mandate internal auditing by all municipal governments. This requires, among other elements, providing municipalities with financial and capacity building support to conduct reliable and effective internal audits, and learn from audit results.
- Ensure effective communication between the municipalities, the State Audit Service, and the ministries that manage regional development funds to identify common challenges and bottlenecks in financial management and procurement, and propose tailored actions to address them.

To increase the responsible use of public-private partnerships as a means to fund and finance regional and local development in the short and medium term, Ukraine is advised to:

- Improve outreach to larger municipalities and the private sector about the potential of PPPs, the regulatory framework and, in particular, the multiple risks involved in setting up and managing a public-private collaboration. This could also include national government guidance regarding alternatives to PPPs that present value for money, and their potential benefits and risks.
- Develop and disseminate training material for municipalities on assessing the value-added of PPPs, managing such partnerships, as well as establish a transparent system to track the use of public funds and determine their effectiveness.

Sources of regional development funding in Ukraine

Since 2015, Ukraine has made significant progress in its approach to planning for regional development at the national, regional and local levels. Regional and local development initiatives are funded through multiple sources, including intergovernmental transfers, shared taxes, such as PIT, as well as own-source taxes of subnational governments. Furthermore, both national and subnational governments receive donor support to finance regional and local development projects, and under certain conditions some subnational governments can borrow from national and international credit markets.

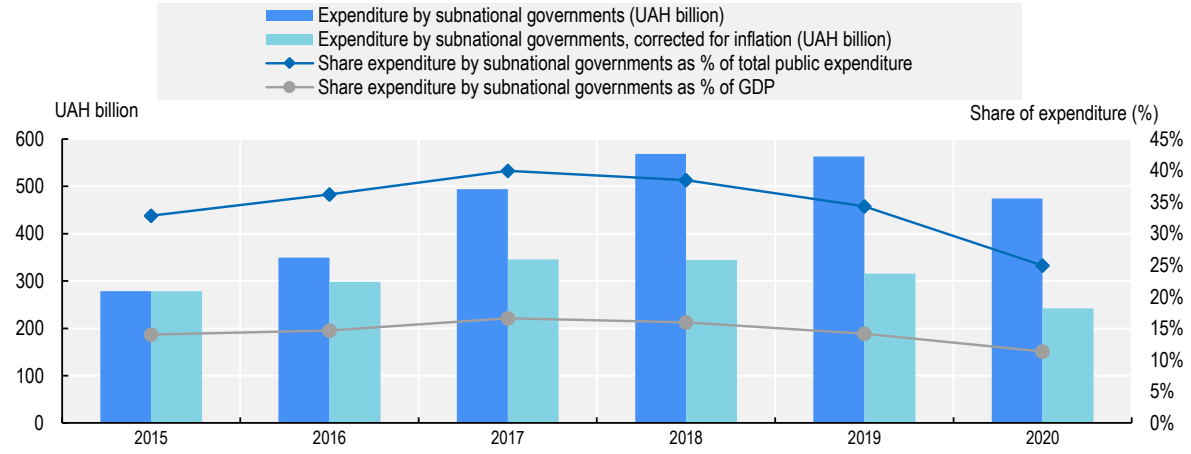
Ukraine's performance on selected fiscal indicators since 2015

An assessment of Ukraine's performance on a series of fiscal indicators related to subnational revenues and expenditures since 2015 points to challenges in the ability of *oblasts*, *rayons* and municipalities to fund and finance investment. It also shows a continued dependency of subnational governments on transfers by the central government and revenues from PIT.

Share of subnational expenditure as part of all public expenditure has remained stable

Between 2015 and 2019—prior to the COVID-19 pandemic—Ukraine reported an increase in subnational expenditure (i.e. *oblasts*, *rayons* and municipalities combined) in nominal and real terms (Figure 5.1). Over this five-year period, the share of subnational expenditure as a percentage of total public expenditure fluctuated between 33% and 40%, similar to the European Union (EU-28) average (34% in 2019), but below that of the OECD (40%) (OECD, 2022[10]). It was also similar to that of Poland (34%) whose population and three-tiered subnational government structure is relatively comparable to that of Ukraine (OECD, 2022[10]).

Figure 5.1. Subnational expenditure, 2015-2020



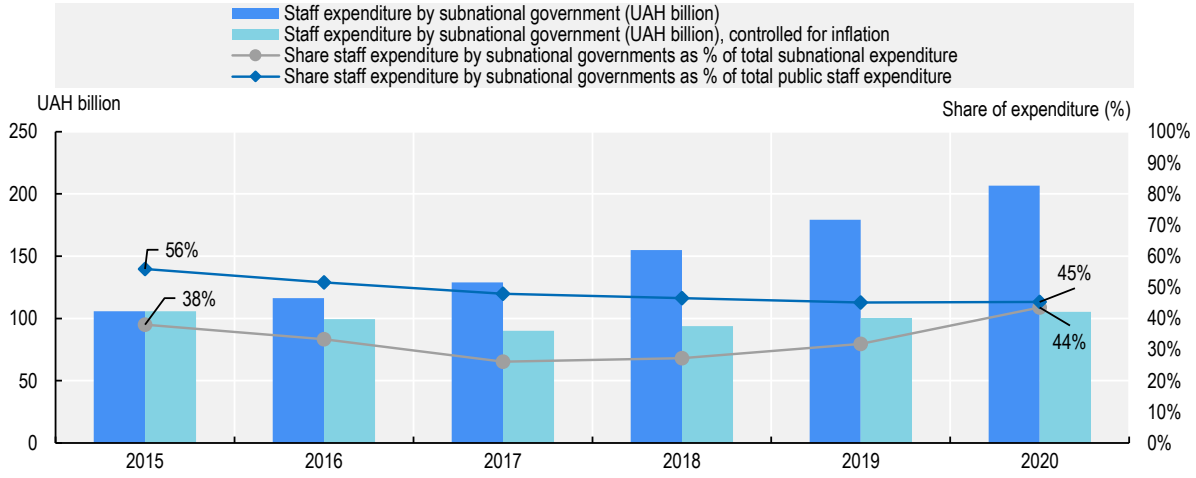
Source: Author's elaboration, with data from (IMF, 2022[11]; World Bank, 2022[12]; World Bank, 2021[13]).

In 2020, however, the spending share by subnational governments dropped sharply to only 25% (OECD, 2022[10]; IMF, 2022[11]), reflecting in large part the decision of the government to reduce the size of several funds open to subnational governments in order to create the COVID 'Stabilisation Fund'. This fund was used, in part, to make additional payments to medical workers and assistance to the elderly, and to help subnational governments cope with the pandemic. Another factor contributing to this decrease were changes in the mechanisms for funding social protection and healthcare. Since 2019, a significant part of

expenditures in both areas are funded directly from the national budget. In 2019, Ukraine's subnational expenditure as a percent of gross domestic product (GDP) was 14%, similar to that of Italy and Poland (OECD, 2022[10]). The large drop in subnational expenditure between 2019 and 2020 meant that between 2015 and 2020, subnational expenditure actually declined in real terms (-13%).

Ukraine's subnational governments continue to be important public employers, albeit less so than in 2015. Whereas in 2015, the share of subnational staff expenditure of all public staff expenditure was about 56%, by 2019 this decreased to 45%, and was stable in 2020 (Figure 5.2). This is below the 2019 averages of the EU-28 (51%), the OECD (62%) and Poland (53%) (OECD, 2022[10]). The reduction between 2015 and 2020 can be explained by the fact that in this six-year period, staff expenditure by the national government increased more rapidly (298%) than that of subnational governments (194%). Moreover, this period coincides with the rollout of the municipal amalgamation process. In real terms, subnational expenditure on staff costs remained relatively stable between 2015 and 2020.

Figure 5.2. Staff expenditure by subnational governments, 2015-2020



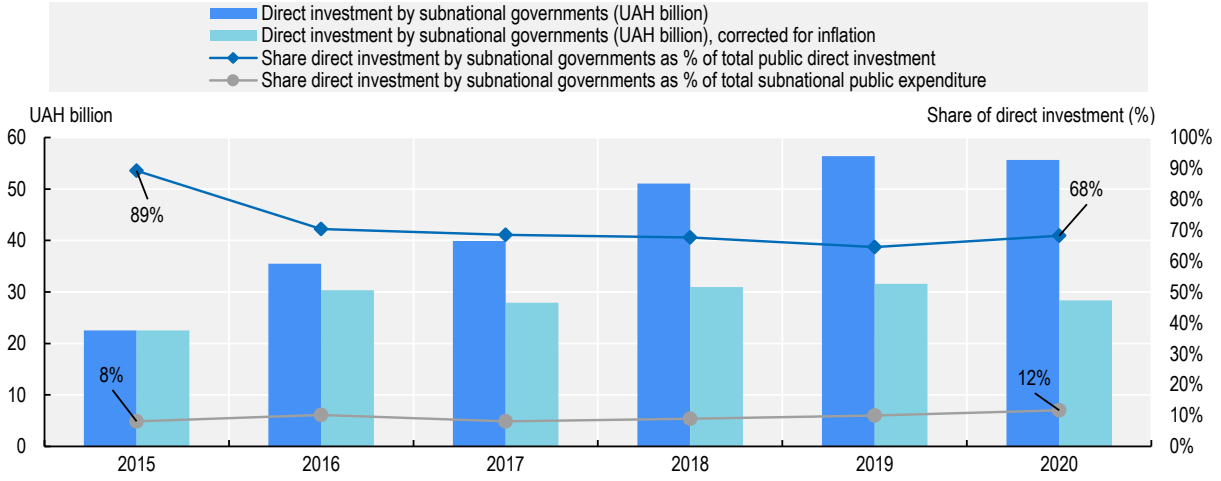
Source: Author's elaboration, with data from (IMF, 2022[11]; World Bank, 2021[13]).

Between 2015 and 2020, the share of subnational staff expenditure as part of all subnational public expenditure fluctuated between 26% and 44%, peaking in 2020 (IMF, 2022[11]). The marked increase between 2019 and 2020—from 32% to 44%—reflects the sharp drop in the overall expenditure by subnational governments and an increase in nominal staff costs. In 2019, the share of subnational staff expenditure as part of all subnational public expenditure was similar to the EU-28 average (both 32%) yet less than that of the OECD (35%) and Poland (38%) (OECD, 2022[10]).

Share of subnational investment as part of total subnational expenditure increased slightly

Between 2015 and 2020, direct investment by subnational governments increased both in nominal and in real terms (147% and 26%, respectively) (Figure 5.3). Meanwhile, the share of subnational direct investment as a percentage of total public direct investment dropped 21 percentage points. Despite dropping from 89% in 2015 to 68% in 2020, the share of subnational investment in total public direct investment remained well above the 2019 EU-28 (54%) and OECD (56%) averages, as well as that of Poland (49%). It was similar to that of Colombia (69%), Germany (68%), Japan (70%) and Switzerland (68%) (OECD, 2022[10]). As such, Ukraine's subnational governments continue to play a pivotal role in public investment. Between 2015 and 2020, the share of direct investment by Ukraine's subnational governments of all subnational expenditure increased slightly, from 8% to 12%.

Figure 5.3. Direct investment by subnational governments, 2015-2020



Source: Author's elaboration, with data from (IMF, 2022[11]; World Bank, 2021[13]).

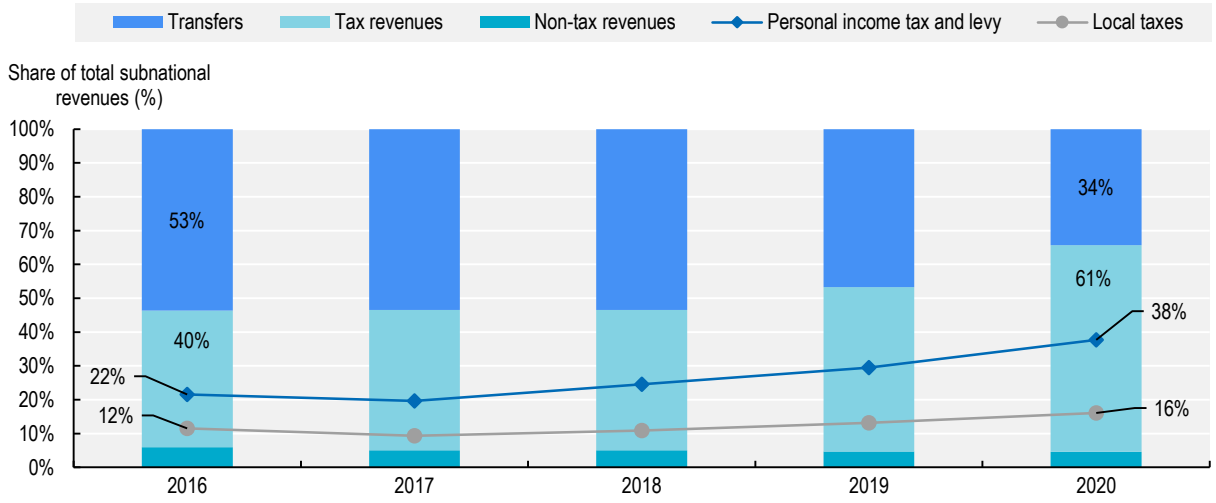
These fiscal indicators should be interpreted with caution as *oblasts* and *rayons* are composed of both deconcentrated and decentralised entities. This means that parts of their budgets, although categorised as "local government sector" in national accounts, should be classified as "central government sector". For example, *oblast* executive committees are not elected. They represent the central government and report to a presidentially appointed *oblast* governor. Conversely, *oblast* and *rayon* councils have relatively few powers. As a result, the data presented above tends to overestimate the weight of the subnational sector.

Central government transfers remain a major source of subnational revenue

Between 2016 and 2020, subnational revenues increased significantly in nominal terms: from UAH 366 billion in 2016 to UAH 471 billion in 2020. However, when controlling for inflation, subnational revenues actually declined by 23% over this five-year period (CabMin, 2021[5]; World Bank, 2021[13]). Over these same years, subnational tax revenues as a share of total public tax revenues increased from 22% to 25%. While this is lower than the 2019 OECD average of 31%, it is slightly above that of the EU-28 (23%) and of Poland (20%) (OECD, 2022[10]; IMF, 2022[11]). This change was, however, accompanied by a reduction in the share of subnational revenue as part of all public revenue: from 40% in 2016 to 28% in 2020. Over the five-year period, revenue of the national government increased by 182% compared to 128% for subnational governments.

Between 2016 and 2020, the share of central government transfers as part of all subnational revenues dropped significantly, from 53% to 34% (Figure 5.4). This is less than the OECD and EU-28 averages of 38% and 45% respectively (IMF, 2022[11]; OECD, 2022[10]). It is also well below that of Poland (60%) (OECD, 2022[10]). A large portion of this reduction came between 2019 and 2020 (from 46% to 34%) (CabMin, 2021[5]; OECD, 2022[10]). This can be attributed to the government's decision to cut the size of several funds, including the SFRD, in order to create the COVID Stabilisation Fund, as well as the aforementioned changes to the mechanisms for funding healthcare and social services. As central government transfers are often earmarked, this limits the scope for subnational governments to adapt spending to local investment needs. Generally speaking, lowering subnational government dependence on earmarked intergovernmental transfers increases their relative fiscal autonomy.

Figure 5.4. Change in the composition of subnational revenue, 2016-2020

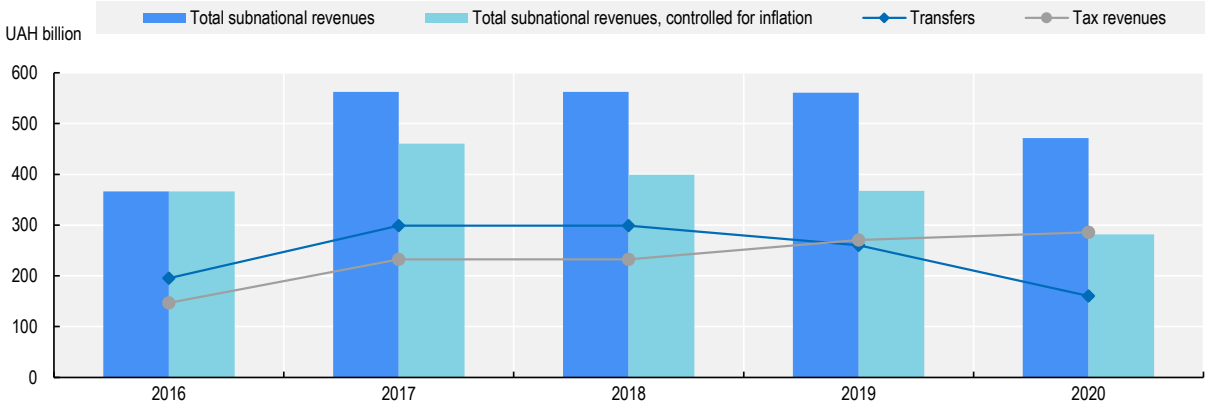


Note: Transfers include, among other elements, grants and subventions from the national budget. Income from capital transactions, revenues from the European Union, foreign governments, international organisations and donor institutions, as well as revenues from Budget Trust Funds are excluded from this list as, during the 2016-2020 period, on average, they each represented less than 1% of all subnational revenues. Grants from local budgets to other local budgets and subventions from local budgets to other local budgets are not incorporated in this chart.
Source: Author's elaboration with data provided by the Cabinet of Ministers of Ukraine (2021[5]).

Own-source taxes continue to represent a minor part of subnational government revenues

Between 2016 and 2019, the share of tax revenues—including own-source and shared taxes—as part of all subnational revenues, increased gradually, from 40% to 48% (Figure 5.4). In 2020, however, it jumped to 61% (CabMin, 2021[5]; OECD, 2022[10]). This is not the result of a change in the mandate of subnational governments to raise local taxes or an increase in the percentage of shared taxes that they are allowed to keep. Rather, it reflects a gradual increase of tax revenues, as well as a marked decrease in the amount of state transfers between 2019 and 2020 as a result of the creation of the COVID Stabilisation Fund (Figure 5.5.). Moreover, it reflects changes to the funding of certain costs related to social services and healthcare.

Figure 5.5. Subnational revenues from taxes and transfers, 2016-2020



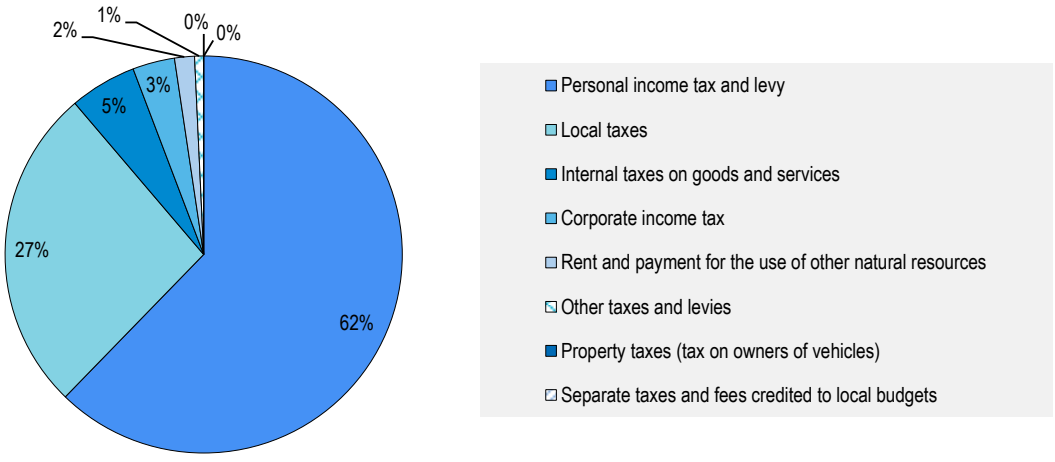
Note: Official transfers include, among other elements, grants and subventions from the national budget, as well as grants and subventions from local budgets. Total subnational revenues, include intergovernmental transfers from the state budget.
Source: Author's elaboration with data provided by the Cabinet of Ministers of Ukraine (2021[5]).

The revenues generated through the PIT as part of all subnational revenues, which are shared among levels of government, increased by 16 percentage points between 2016 and 2020. In 2020, 38% of all subnational revenues came from PIT (Figure 5.4) (CabMin, 2021[5]; OECD, 2022[10]).

As explained in more detailed later this chapter, PIT and Corporate Income Tax (CIT) are the main elements of the country's fiscal equalisation system, with the former generating the highest level of resources. Currently, *oblasts* receive a 15% share of PIT, municipalities receive 60%, and 25% goes to the national government[2]. An exception is Kyiv City, which receives 40% of PIT, meaning that 60% of PIT that is generated in Kyiv City flows into the national budget. This makes the criteria for PIT allocation a crucial element in determining subnational fiscal capacity, and thereby their ability to invest in regional and local development initiatives (OECD, 2018[14]; Verkhovna Rada, 2022[15]). CIT, on the other hand, is shared only between *oblasts* and the national government. In 2020, 2% of subnational revenues came from CIT.

As previously mentioned, tax revenues represent a significant share of total subnational revenues, the majority of which comes from shared taxes and a relatively small part from local taxes (i.e. property tax, tourist tax, single tax and certain user charges and fees). Between 2016 and 2020, the share of local taxes as part of all subnational revenues remained relatively stable, fluctuating between 12% in 2016 and 16% in 2020 (CabMin, 2021[5]; OECD, 2022[10]). In 2020, local taxes represented 27% of revenues received by subnational bodies from taxes and fees, including those redistributed by the central government (Figure 5.6). This is two percentage points less than in 2016 (29%). This reflects limited legislative changes to expand the ability of subnational authorities to raise taxes.

Figure 5.6. Breakdown of subnational taxes and fees, 2020



Note: Breakdown of taxes according to information provided by the Cabinet of Ministers. The "Local taxes" category includes property tax (other than tax on owners of vehicles), tourist tax, single tax and certain user charges and fees.
Source: Author's elaboration with data from the (CabMin, 2021[5]).

The share of subnational expenditure on education and economic development as part of total subnational expenditure has increased

Between 2016 and 2020, there were important changes in the expenditure patterns of subnational governments. In particular, the share of subnational government expenditure on education increased from 27% to 42%, on economic development from 10% to 20% and on general public services from 5% to 10% (Table 5.1). In fact, the subnational expenditure on these three functional areas increased significantly both in nominal and real terms. Conversely, the share of subnational expenditure on social protection as part of total subnational expenditure significantly decreased, from 30% in 2016 to 5% in 2020. This is attributed,

in part, to the fact that in recent years certain payments to families with children were funded through the national budget, instead of local budgets (U-LEAD, 2021[16]). Moreover, between 2019 and 2020, the share of subnational expenditure on healthcare as part of total subnational expenditure also decreased as the funding of certain costs was centralised (U-LEAD, 2022[7]).

Table 5.1. Distribution of subnational government expenses by function, 2016-2020

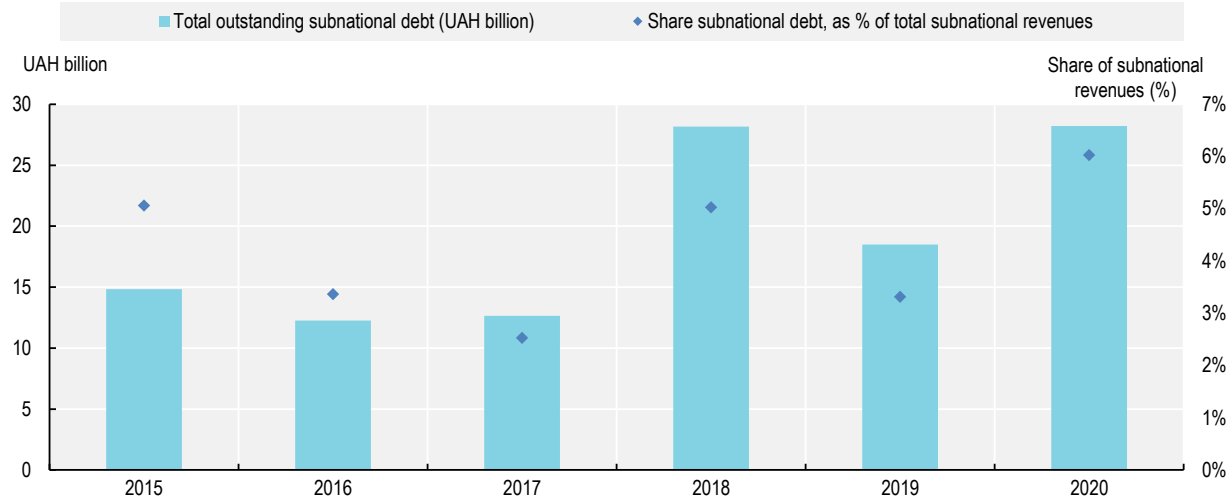
Functional area	2016		2020		
	UAH billion	Share of total expenditure	UAH billion	UAH billion (adjusted for inflation)	Share of total expenditure
General public services	19	5%	48	29	10%
Defense	0	0%	0	0	0%
Public order, & safety	0	0%	2	1	0%
Economic affairs	35	10%	94	56	20%
Environment protection	1	0%	2	1	1%
Housing & community amenities	18	5%	32	19	7%
Health	63	18%	51	30	11%
Recreation, culture, & religion	12	3%	22	13	5%
Education	95	27%	199	119	42%
Social protection	106	30%	24	14	5%
Total	**349**	**100%**	**475**	**283**	**100%**

Source: Author's elaboration with data from (IMF, 2022[11]).

Subnational debt almost doubled in five years, but remains relatively low

Between 2015 and 2020, subnational debt almost doubled in nominal terms, from UAH 14.8 billion to UAH 28.2 billion. However, as a share of total subnational revenue, Ukraine reported only a minor increase; from 5% in 2015 to 6% in 2020 (Figure 5.7). Moreover, when controlling for inflation, in 2020, subnational debt was about the same as in 2015. Furthermore, subnational debt continues to represent only a very small part of all public debt, fluctuating between 0.6% and 1.4% between 2015 and 2020. This is well below the 2019 EU-28 (14.5%) and OECD (22%) averages. It is also well below the share of subnational debt as part of all public debt in Poland (8.9%) (OECD, 2022[10]). Compared to OECD member countries, only Greece (0.5%) has lower subnational debt as a share of all public debt. This trend can be explained by the fact that in recent years no significant changes have been made to the legislative and regulatory framework related to borrowing by subnational governments. As such, in effect only the councils of *oblasts* and major cities can borrow.

Figure 5.7. Subnational debt, 2015-2020



Source: Author's elaboration with data from (IMF, 2022[11]; World Bank, 2021[13]).

The data provided above highlight several key issues and challenges with respect to funding and financing regional development, which will be explored in the following sections. These include the PIT allocation system, the variety of intergovernmental subventions and grants used to fund regional and local development projects, and the investment capacity of local governments after the amalgamation reforms.

The impact of fiscal equalisation and PIT allocation on regional inequalities

Although not specifically conceived as an instrument to support regional development funding, Ukraine's fiscal equalisation mechanism, through the distribution of PIT, has a strong effect on the ability of subnational governments to fund basic service delivery, as well as to make strategic investments. As such, it is essential to understand how the fiscal equalisation mechanism works and to what extent certain aspects of it may hamper the impact of Ukraine's regional development policy. For example, the PIT allocation mechanism allows multi-office companies to credit the PIT of their employees to the municipality in which the companies are registered—often larger municipalities—and not necessarily where their employees live or work. This undermines the capacity of smaller municipalities to fund service delivery and finance investment, requiring substantial horizontal equalisation to offset at least a portion of the fiscal disparities across municipalities.

Limited evidence on the impact of the equalisation system on territorial convergence

Fiscal equalisation—the transfer of financial resources to and among subnational governments (Box 5.2)—can allow subnational governments to provide their residents with similar levels of public services at comparable levels of taxation by levelling fiscal capacities among different subnational governments (OECD/KIPF, 2016[17]; OECD, 2021[18]). Equalising transfers are usually non-earmarked, as in the case of Ukraine, which increases the relative fiscal autonomy of jurisdictions that would otherwise have fewer resources.

Box 5.2. Fiscal equalisation

Fiscal equalisation can be necessary to reduce regional disparities, in particular regional differences in fiscal capacity and expenditure needs of subnational governments. It is particularly necessary in the context of a decentralisation process. Without proper corrective mechanisms, decentralisation can result in increased inequalities among subnational governments, depending on their geographic location, socio-economic features, capacity constraints and fiscal potential. By redistributing funds from wealthier governments to those that face higher per capita costs or lower per capita revenue capacities, fiscal equalisation systems promote the principles of solidarity and territorial cohesion.

The dual functions of fiscal equalisation—to promote equality while enabling autonomy—give rise to a key challenge for policymakers: designing a system that allows differentiated public goods to be provided according to regional and local needs, while enabling comparable levels of public services to be delivered among subnational governments. In addressing this challenge, it is important to bear in mind the economic objectives that underpin equalisation, such as facilitating regional convergence and bolstering growth or mitigating the economic losses associated with interregional disparities that could arise from in-country migration.

Different modalities of fiscal equalisation

Generally speaking, three types of fiscal equalisation can be identified: revenue, cost, and gap-filling.

- **Revenue equalisation** seeks to reduce differences in the fiscal capacities (per capita) of subnational governments. Germany and Canada are examples of countries with a revenue equalisation system. Revenue equalisation may give subnational governments an incentive to increase tax rates (i.e. thresholds) in order to reduce the tax base and to obtain higher equalisation grants. Setting tax rate ceilings and floors may reduce such strategic behaviour by subnational governments.
- **Cost equalisation** aims to compensate subnational governments with higher per capita costs relative to other local authorities, so that they do not face an undue burden in delivering a baseline level of public services. The equalisation systems of several OECD member states (e.g. Estonia, Lithuania and Norway) integrate both cost and revenue equalising components. Cost equalisation that relies on actual spending may give subnational governments an incentive to inflate their budgets and lead to increased equalisation payments. In addition, cost equalisation payments that seek to compensate small municipalities that have relatively high costs for operating a school or hospital could prevent them from investing in measures to reduce service delivery costs, for example through amalgamation or inter-municipal co-operation.
- **Gap-filling equalisation** seeks to bridge the gap between per capita costs and revenues for each subnational government, rather than consider either side of the ledger in isolation. Several OECD member states, including Australia, Italy and Japan, are generally recognised to have gap-filling equalisation systems.

Most equalisation systems combine elements of these three modalities of fiscal equalisation. Equalisation may take place vertically, from higher levels of government to financially weaker lower levels of government, or horizontally, across the same level of government from wealthier jurisdictions to poorer ones.

The difficulty lies in designing a system that can combine solidarity and equity principles with economic efficiency. In addition, policy makers should ensure that the equalisation system provides subnational governments with incentives to develop their economic and fiscal base, and to take measures to improve the quality and cost-efficiency of local service delivery.

Source: Author's elaboration, based on: (OECD/KIPF, 2016[17]; Dougherty and Forman, 2021[19]; OECD, 2007[20]; OECD, forthcoming[21]).

While there is evidence that fiscal decentralisation facilitates regional convergence, there is some debate over whether fiscal equalisation might actually hinder long-term development incentives in an attempt to correct short-run disparities in fiscal capacity (Bartolini, Stossberg and Blöchliger, 2016[22]). In this regard, it is important to note that fiscal equalisation policies generally do not aim to reduce income inequalities or stimulate territorially balanced economic growth, which are objectives generally associated with regional development policy (OECD, forthcoming[21]).

Data on Canadian provinces show that equalisation payments contribute to increases in unproductive expenditure, slowing convergence (Hailemariam and Dzhumashev, 2018[23]). Conversely, a study on German municipalities found that increasing equalisation rates can lead to less distortionary taxation choices by local governments, which could be conducive to growth and productivity (Holm-Hadulla, 2020[24]). Moreover, OECD analysis shows that there is no significant correlation between fiscal equalisation and regional income equality (OECD, forthcoming[21]).

At the same time, fiscal equalisation and regional development policies can be complementary. Even when the objectives and target groups of fiscal equalisation and regional development policy may be different, the outcomes of both tools are closely related. For example, “regional development policies that succeed in reducing regional income disparities may lessen the need for generous fiscal equalisation schemes” (OECD, forthcoming[21]). However, both tools should not be conflated. Equalisation should be the main purpose of equalisation transfers, just as regional development funds should be used to boost regional development. Combining too many objectives in a single grant or transfer programme may give way to an overly complex system that fails to achieve its multiple objectives.

Ukraine’s recent modifications to the equalisation system make it fairer

Ukraine’s 2014 amendments to its Budget Code introduced an equalisation mechanism for subnational government revenues rather than expenditures, basing it on two taxes: the Personal Income Tax (PIT) and Corporate Income Tax (CIT), with the former generating the highest level of resources. The system, which takes revenue performance into consideration when calculating the equalisation grants, is designed to improve horizontal equality between local governments, while avoiding incentives for municipalities to undermine their own tax capacity (Box 5.3) (OECD, 2018[14]). Before a 2020 amendment to the Budget Code was passed, the system was imbalanced, benefiting those subnational governments with the fewest service delivery responsibilities.

Box 5.3. Ukraine's equalisation systems: base and reverse grants

Ukraine has two horizontal equalisation mechanisms, one for *oblasts* and one for municipalities. They are based on the following:

1. The population of the subnational government (*oblasts* or municipalities);
2. Received shared tax revenues: PIT and CIT in the case of *oblasts,* and PIT in the case of municipalities;
3. Tax capacity index of each *oblast* and municipality. This is the ratio between the tax capacity per person of a local budget and the average tax capacity per person of the budgets of the same level of subnational government (e.g. municipalities or *oblasts*).

The tax capacity index determines which subnational governments will receive a basic grant, which ones will pay the reverse grant and which ones will be unaffected by the mechanism.

Oblasts and municipalities with a tax capacity index of less than 0.9—measured against the national average—receive a basic grant amounting to up to 80% of the difference between their tax capacity and the 0.9 threshold. However, if their tax capacity index is more than 1.1, then 50% of their revenue surplus (i.e. 50% of the PIT revenues that exceeds the 1.1 threshold) is deducted and transferred back into the State budget through a reverse grant. Subnational governments with revenues between 90% and 110% of the country's average are not subject to compensation or deduction.

As a result, equalising transfers neither allow poorer subnational governments to overtake one another in terms of fiscal capacity, nor wealthier ones to fall below one another in terms of fiscal capacity. Furthermore, by intentionally keeping equalisation below 100%, it seeks to stimulate the development of own-source revenues. Local revenues from sources other than PIT and CIT are not subject to equalisation.

Use of the equalisation system as an incentive for voluntary amalgamations

As an incentive for voluntary amalgamations during the reform period, only "towns of *rayon* significance", villages and rural settlements that merged could retain their share of PIT (OECD, 2018[14]). This left non-amalgamated municipalities without access to important public resources necessary for carrying out administrative tasks or for funding service delivery, possibly exacerbating territorial disparities.

Source: Author's elaboration, based on (OECD, 2018[14]).

Until 2021, the equalisation baseline of *rayons*, cities of *oblast* significance and amalgamated municipalities was calculated together. This lowered the equalisation baseline for cities of *oblast* significance, while raising it for *rayons* and amalgamated communities. As such, for the 2016-2018 period, cities of *oblast* significance paid the most into the PIT system through reverse grants and received the least in return through base grants (SKL International, 2019[25]). Conversely, *rayons*, which have limited service provision responsibilities, paid the least into the system, but got the most out of it. During the same period, the convergence effect of the equalisation system[3] was highest for *rayons* and significantly lower for cities of *oblast* significance and amalgamated municipalities (SKL International, 2019[25]). As part of a 2020 amendment to the Budget Code, *rayons* no longer receive a share of the PIT fund. This modification makes the PIT distribution more commensurate with the assignment of responsibilities among levels of subnational government.

The current PIT allocation system undermines efforts to reduce territorial disparities

The PIT is a cornerstone of subnational government ability to fund regional and local development projects and boost local well-being. However, the way the PIT distribution mechanism is set up, and in particular the role companies have in allocating the tax, runs the risk of contributing to territorial disparities.

Private companies play an outsized role in the distribution of PIT funds

Ukraine's practice of allocating PIT to the municipality where the employer is legally registered rather than place of residence has three important ramifications. First, large companies with offices located throughout the country credit the PIT payments of their staff to the local government in which the company is legally registered. These payments might not correspond with the place where (most of) their employees work. This facilitates the tax administration of large companies as it enables them to credit the PIT to just one local government. This benefits larger municipalities where large companies are often registered, at the expense of smaller, frequently rural, communities. In turn, this increases the need for equalisation and requires that the base/reverse grant system be larger than necessary (Box 5.3). Third, it creates the conditions for companies to use PIT as a bargaining chip with local authorities, as companies can change their place of registration (and thus where the PIT payments are allocated). This gives them significant negotiating power (e.g. for favourable operating conditions) over local authorities, who do not wish to risk losing PIT funds (KSE, 2021[26]).

The current PIT allocation system may undermine democratic control

The current link between PIT allocation and place of employment (or more accurately place of company registration) risks undermining local democratic control. In principle, the more a municipality's revenues and expenses are determined by democratically elected councils, the more likely it is that they will make planning and budgeting decisions that contribute to meeting residents' needs and demands. Basing PIT allocation on place of residence—often the place where demand for and use of services such as public transport, education, healthcare, etc. is greatest—could strengthen democratic control. However, the positive effect that changing PIT allocation to place of residence can have on democratic control is dependent on the size of the equalisation mechanisms. Having a relatively large equalisation system in which many municipalities either receive a basic grant or pay the reverse grant could weaken the direct link between taxpayers and local leaders. Currently, however, Ukrainian municipalities where large multi-office companies are registered may spend the PIT contributions of people who do not live or work in their locality, who do not vote for them and to whom they are not politically accountable.

Possible profound implications of alternative PIT allocation systems

In early 2021, the Office of the President of Ukraine issued a decree giving the Cabinet of Ministers three months to submit draft legislation that would credit part of the PIT to local budgets, according to the registered place of residence of taxpayers. In response, over a dozen different amendments have been presented and were being reviewed when Russia launched its large-scale invasion of Ukraine on 24 February 2022.

Some of these proposals called for PIT to be shared with local governments based on where people work; while others proposed that PIT distribution should be based on place of residence or on a hybrid system that is linked to both place of work and of residence (Levitas, 2021[27]). A closer look at how some European countries such as Croatia and Romania manage the distribution of the PIT provides an indication of the pros and cons associated with the different models proposed. These include how complex the models are to establish, the incentives that they may provide to subnational governments to stimulate economic development, and the need for a strong equalisation system to offset any territorial disparities in PIT revenues (Table 5.2).

Table 5.2. Advantages and disadvantages of the alternatives to Ukraine's PIT allocation system

Description and examples	Advantage	Disadvantage
National PIT collection. Some countries such as the Slovak Republic earmark a set share of the national PIT yield for local governments and then allocate these funds to them through a formula based mainly on population size.	- Relative simplicity of the model. No specific information on employee's place of work is required. - Any year-on-year change in the amount of the PIT funds collected nationally will affect all local governments equally. This pairs the volume of the PIT disbursements with any changes in the overall economy.	- As the allocation of PIT funds is not linked to the PIT generated in each territory, local governments do not have a clear fiscal incentive to boost local employment.
PIT disbursement based on place of residence. Countries such as Belgium, Croatia, Italy and Sweden link PIT disbursement to the place where workers live. In Croatia, municipalities and cities are allowed to establish a PIT surcharge.	- This system connects the financial interests of subnational governments' electorates with the performance of subnational governments, thereby serving as an incentive for subnational governments to boost their economies. - Giving subnational governments influence over the local PIT rate can serve as a tool to strengthen political accountability. This positive effect could, however, be undermined by the need for a large equalisation system.	- A strong equalisation system is required, otherwise unproductive communities and those with a high share of informal employment will not receive many PIT funds. - This model may create incentives for municipalities to attract high-salary workers, risking gentrification effects. - The model does not give municipalities direct incentives to increase local employment. - The institutions involved in gathering and distributing the funds require up-to-date granular data on citizens' place of residence, and establish effective mechanisms to exchange information.
PIT disbursement based on place of work. In such a system, like the one used in Romania, PIT allocation is based on the place where people actually work, instead of where their employers are registered. The national government is responsible for PIT allocation.	- This system is potentially politically attractive due to the relative simplicity of the reform, compared to the other alternatives.	- Kyiv City and cities with large urban centres would be 'overfunded' at the expense of surrounding municipalities where urban workers live. - To offset this effect, the equalisation system (e.g. base and reserve grants) may have to be larger than for some of the alternative models.
Hybrid PIT distribution system. In such a system—an option currently being discussed in the Verkhovna Rada—PIT distribution would be partially based on the place of residence and place of work.	- This system has the potential to compensate local governments for the costs they incur when providing services, such as public transportation, to people who work but do not live in their jurisdictions and vice versa.	- This system requires up-to-date information on both people's place of residence and work, making it complex to manage.

Source: Author's elaboration, based on (Levitas, 2021[27]; Hrvatski sabor, 2017[28]; Hrvatski sabor, 2020[29]; Miličević, Bubaš and Majić, 2019[30]; Verkhovna Rada, 2021[31]; OECD, 2018[14]).

Changing PIT allocation involves identifying potential 'winners' and 'losers' and taking corrective policy decisions

The government should consider opting for a PIT reform based on place of residence as it appears to have the highest potential for providing municipalities with financial resources that are commensurate with the demand for public services and investment, while also strengthening local political accountability. However, an ex-ante study would be required to determine how the reform would affect the fiscal health of the different subnational governments, as well as that of the State. A 2021 report estimates that changing PIT allocation to the taxpayer's place of residence will increase PIT revenues of poorer rural municipalities by 50% to 70% (U-LEAD, 2021[32]). Careful consideration should be given to the question of how to compensate Kyiv City, which potentially stands to lose the most when allocating PIT based on place of residence. Ukraine should also consider giving larger municipalities some leeway to set a surcharge, as they too stand to lose if PIT allocation is based on place of residence, following the example of Croatia (Table 5.2). The ex-ante impact study should also be used to assess the effect that linking PIT allocation

to place of residence would have on municipal disparities in PIT revenues, which influences the size of horizontal fiscal equalisation system.

Any reform of the PIT allocation mechanism should ensure that the government, instead of employers, allocates PIT to *oblasts* and municipalities. This requires investing in better information and data processing systems. Developing and operating such systems entails close collaboration among the State Treasury Service, the Ministry of Finance (MinFin) and the Ministry of Digital Transformation. In February 2022, an online service to change one's place of residence was set up, which could be an important stepping stone for changes to the PIT allocation mechanism, as it enables the government to have up-to-date information on where people live. This is particularly relevant given the high number of internally displaced people in Ukraine.

The government could also consider creating a task force in which representatives from all affected parties (i.e. municipalities, *oblasts* and Kyiv City), as well as state level institutions participate to discuss the findings of the ex-ante study, and to identify policy interventions that would improve the efficiency and effectiveness of the PIT allocation reform. It is, furthermore, imperative to closely monitor the roll out of the eventual reform to assess its impact on the fiscal capacity of subnational government. In particular, this will help determine how the reform affects the investment capacity of municipalities, as well as identify any negative externalities that require further intervention.

As a key source of non-earmarked revenue for municipalities, *oblasts* and Kyiv City, PIT is pivotal to their ability to fund regional and local development projects and boost local well-being. As such, improving the fairness of the PIT allocation mechanism needs to be part and parcel of any effort to strengthen Ukraine's regional development funding system.

Regional development funds in Ukraine

In 2019, the Government of Ukraine's financial support for regional and local development was approximately seven times greater than in 2015 (U-LEAD, forthcoming[1]). The creation of different intergovernmental grants and subventions helped contribute to this increase. However, the effectiveness of these funds is undermined by a series of challenges such as a fragmented and relatively unstable fiscal framework, an emphasis on funding "hard" regional and local infrastructure, and the prevalence of small-scale local projects. This affects the ability of national and subnational governments to boost regional competitiveness and growth. Most importantly, the current set-up of many of the grants and subventions for regional and local development may aggravate, rather than reduce, regional disparities.

The proliferation of regional and local development funds leads to fragmented decision making

Subventions and grants with a regional or local development dimension in Ukraine have been in plentiful supply. Between 2015 and 2019, a total of 110 grants and subventions linked to regional and local development—with a total budgetary allocation of UAH 209 billion—were implemented. Over this period, the share of subnational funding as a percentage of public spending grew from 2.1% in 2015 to 6.5% in 2019. It also became more fragmented, with the number of annual grants and subventions substantially rising between 2015 and 2019 (U-LEAD, forthcoming[1])[4]. This makes the administration of funding more costly and could lead to overlap. It could also make it harder for subnational governments to understand relevant regulations and whether or not they are eligible to apply for public funds.

The 110 grants and subventions were implemented by 20 different entities, including the Ministry of Communities and Territories Development (MinRegion), MinFin, 11 line ministries and three *oblast* state administrations. Less than 25% of budgetary allocations for regional and local development funds were the responsibility of MinRegion, undermining its role in supporting regional development across the whole

of government, and fragmenting decision making (U-LEAD, forthcoming[1]). Only three of the nine largest regional and local development grants and subventions—amounting to more than UAH 5 billion during the 2015-2019 period—were managed by MinRegion (Table 5.3).

Table 5.3. Largest regional and local development grants in Ukraine between 2015 and 2019

Name of grant	Volume over 2015-2019 period (UAH)	Years implemented	Managing institution	Competitive/non-competitive	Sectoral / geographical focus
Subvention for State Highways	56 624 815 507	2015-2019	Ukravtodor	Non-competitive	Sectoral
Subvention for Local Public Roads	26 207 118 000	2018-2019	Ukravtodor	Non-competitive	Sectoral
Socio-Economic Subvention	17 724 516 171	2015-2019	MinFin	Competitive	Cross-sectoral
SFRD	17 446 036 426	2015-2019	MinRegion	Competitive	Cross-sectoral
Highway Improvements (Lviv-Uman and Byla Tserkva-Kherson)	8 685 483 727	2017-2019	Ukravtodor	Non-competitive	Sectoral and geographic
Local Infrastructure Subvention	6 301 027 665	2016-2019	MinRegion	Non-competitive	Sectoral
Rural Healthcare Subvention	6 000 000 000	2017-2019	MinRegion	Competitive	Sectoral

Note: This chart only includes grants worth over UAH five billion between 2015 and 2019. Two other initiatives where spending was over UAH five billion included "Financial Support of Agricultural Producers" and "State Support of Livestock Breeding, Storage and Processing of Agricultural Products, Aquaculture (fish farming)". However they were excluded from the OECD analysis on account of their sectoral focus.
Source: Author's elaboration with data retrieved from U-LEAD (forthcoming[1]).

The proliferation of grants and subventions presents a co-ordination challenge that could potentially undermine spending efficiency, the quality of implementation, and the effectiveness of the different intergovernmental transfers. This is particularly difficult given the problems associated with the Inter-Departmental Co-ordination Committee for Regional Development (ICC) and the Congress for Local and Regional Authorities described in Chapter 4.

To address this challenge, the government should consider reallocating a higher share of regional and local budget grants and subventions to a single fund (e.g. the SFRD) managed by MinRegion. This would help ensure that overarching government objectives in the regional and local development sphere are met. MinRegion should also reinforce its efforts to effectively co-ordinate the different regional and local development funds, even when such funds are implemented by other ministries.

If it is deemed politically unfeasible to merge funds, it would be even more urgent to operationalise the ICC as a body that effectively co-ordinates regional development policy and funding. Ukraine should consider creating a sub-committee within the ICC whose objective could include co-ordinating the design, implementation and monitoring of Ukraine's regional development funding mechanisms. This sub-committee could be tasked with monitoring possible overlap in the thematic and geographic focus of different grants. It could also propose monitoring frameworks to assess how effectively different funding mechanisms support the achievement of the government's main regional development policy objectives. Moreover, it could function as a forum to discuss policy and legislative solutions to challenges related to issues such as the ability of subnational governments to provide co-funding, and their human resource capacity to manage investment processes. Finland's Advisory Committee on Local Government Finances and Administration offers some insights to consider. While it focuses primarily on local government finances, the scope of its functions, its composition and the frequency of its meetings could be relevant if Ukraine decides to create a regional development funding sub-committee within the ICC (Box 5.4).

Box 5.4. Finland's Advisory Committee on Local Government Finances and Administration

The Local Government Act provides for the establishment of an "Advisory Committee on Local Government Finances and Administration". The Committee is a fundamental actor in the negotiation procedure between the national government and municipalities. Its key function is to provide a forum where the following topics, among others, can be discussed:

- Development plans and proposed legislation related to local government finances and administration.
- Proposals concerning local government finances and administration.
- The division of costs between the national and local governments.
- Other significant matters concerning local government finances and administration.

The Committee includes representatives from the Ministry of Finance, as well as from the Ministry of Education and Culture, the Ministry of Social Affairs and Health and the Association of Finnish Local and Regional Authorities. The Advisory Committee, which meets between 10 and 15 times per year, may set up different technical chambers to facilitate discussion.

Source: Author's elaboration, based on (Association of Finnish Local and Regional Authorities, 2021[33]; Ministry of Finance of Finland, 2022[34]).

Possible overlap among subnational funding mechanisms may lead to an inefficient use of funds

As a result of the proliferation of funds for regional and local development, there is significant thematic overlap in the scope of subventions (Table 5.4). This may create uncertainty among subnational governments regarding which institutions are responsible for a specific topic and lead to a duplication in reporting efforts. Good examples of this are the SFRD and the Subvention for the Implementation of Measures for Socio-Economic Development of Certain Territories" (Annex Box 5.A.3) (CabMin, 2015[35]; CabMin, 2012[36]). Between 2015 and 2019, the two subventions were almost identical in size and targeted many of the same investment objectives (e.g. improving energy efficiency, water supply, sewage, or heating networks in local communities, as well as purchases of public transport infrastructure) (Verkhovna Rada, 2014[37]). Despite these similarities, the two funds are managed independently of one another: the SFRD by MinRegion and Socio-Economic Subvention by MinFin.

Table 5.4. Examples of potential overlap in the focus areas of the main funds for regional and local development

Area of potential overlap	Sources of funding and managing institution
Purchase of medical equipment	- Subvention for the Implementation of Measures for Socio-Economic Development of Certain Territories (MinFin) - Subvention for the Implementation of Measures Aimed at the Development of the Healthcare System in Rural Areas (MinRegion)
Investment in infrastructure for local roads, energy efficiency initiatives, water supply and sewage	- SFRD (MinRegion) - Subvention from the State Budget to Local Budgets for the Formation of Infrastructure of Local Hromadas (MinRegion)

Investment in infrastructure for local roads	- Subvention from the State Budget to Local Budgets for the Construction, Reconstruction, Repair and Maintenance of Highways in General Use of Local Importance, Streets and Roads of Communal Importance in Settlements (Ukravtodor) - Subvention from the State Budget to Local Budgets for the Formation of Infrastructure of Local Hromadas (MinRegion)

Source: Author's elaboration, based on (CabMin, 2012[36]), (CabMin, 2017[38]), (CabMin, 2015[35]), (CabMin, 2016[39]).

The possible overlap among the different funds does not in and of itself portend an inefficient use of resources. It can, however, pose the risk that some government initiatives aimed at supporting the regional and local levels duplicate each other, possibly resulting in an inefficient use of scarce public resources. This may be particularly true of the overlap between thematically similar budget funds that are being administered in separate government departments, such as the SFRD and the Socio-Economic Subvention (CabMin, 2015[35]; CabMin, 2012[36]).

In this regard, the government should consider combining thematically overlapping subventions and funds into consolidated ones with multiple budget lines. This would facilitate centre-of-government co-ordination and ensure that the institutions directly involved co-ordinate the grant and subvention design, implementation, and monitoring and evaluation mechanisms. In addition, if a sub-committee for regional development funding is created, this co-ordination body could be tasked with identifying possible overlap in proposed funding mechanisms and ensuring that corrective action is taken.

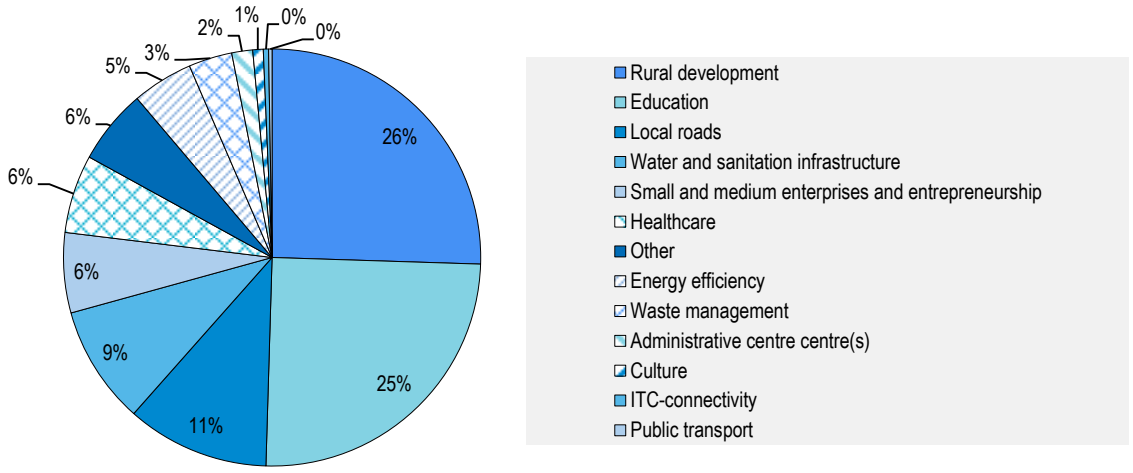
Regional development spending focuses heavily on "hard" infrastructure

Intergovernmental spending on regional development has predominantly focused on "hard" infrastructure Even though there is clear merit in investing in, for example, the construction or maintenance of roads, OECD analysis highlights that this alone has little impact on regional growth unless it is associated with "soft" investments (e.g. human capital development, innovation, research and development, SMEs, etc.) (OECD, 2009[3]; OECD, 2020[4]). A crucial challenge for policy makers is how to strike an adequate balance between both types of investment.

The government's emphasis on "hard" infrastructure is illustrated by the fact that the two largest subventions during the 2015-2019 period were implemented by Ukravtodor, the State Agency for Motor Roads (Table 5.3). Combined, these two funds amounted to nearly UAH 83 billion (CabMin, 2017[40]). In fact, spending on "hard" infrastructure accounted for 59% of all spending on regional development (U-LEAD, forthcoming[1]). Moreover, the European Investment Bank (EIB) and the Ukrainian government signed, in late 2020, loans totalling EUR 640 million, some of which will be used to finance projects at the municipal level to rehabilitate social infrastructure (e.g. hospitals, schools, kindergartens, post offices), improve public utility services and repair damaged administrative buildings, and other key social infrastructure (European Investment Bank, 2020[41]).

The dominant focus of these funds on "hard" infrastructure contrasts with the top investment priorities expressed by municipalities (Figure 5.8). A plurality of municipalities surveyed by the OECD in 2021 reported rural development (26%) and education (25%) to be their main investment priorities. Eleven percent of respondents considered local roads as a main investment need. This was followed by water and sanitation infrastructure (9%), healthcare, and small and medium-sized enterprises (SMEs) (both 6%) (OECD, 2021[42]).

Figure 5.8. Top municipal investment priorities



Note: Question: What is your municipality's top investment priority? Please select only one option. Full response options: Education; Healthcare; Culture; Local roads; Public transport; Rural development; Administrative centre centre(s); ITC-connectivity (e.g. access to broadband, digitalisation); Waste management; Water and sanitation infrastructure; Energy efficiency; Small and medium enterprises and entrepreneurship; Other. The questionnaire was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

The COVID-19 crisis provoked a renewed focus on the relevance of investing in research, skills and innovation. For example, hospitals rely on "soft" investment for developing new treatments. Going forward, the government should strike a more complementary balance between "hard" and "soft" infrastructure spending. Funds that have a cross-sectoral focus, such as the SFRD, could be better used to boost investment in areas such as innovation and skills.

The SFRD as the flagship regional development funding mechanism

The SFRD (Box 5.5) is the government's key funding mechanism to stimulate regional competitiveness, facilitate subnational cohesion, and fund the State Strategy for Regional Development (SSRD) and the *oblast* (regional) development strategies. The SSRD, is a competitive, grant-based fund, managed by MinRegion. Until late 2021, the SSRD was legally mandated to receive 1% of all planned revenues from the General State Budget Fund of Ukraine. In 2022, this was increased to 1.5%. Due to its size and cross-sectoral focus, the SFRD is a crucial source of funding that *oblasts* and municipalities can use for regional and local development projects in areas as varied as healthcare, public transport and culture. The effectiveness of the SFRD, however, is undermined by a series of challenges including the stability of its funding, project selection procedures, the type of projects that are funded, as well as the capacity of local governments to develop quality project proposals. Several of these obstacles are not unique to the SFRD but are also characteristic of other subventions that disadvantage poorer municipalities and risk exacerbating regional inequalities.

Box 5.5. Basic structure of the State Fund for Regional Development

State Fund for Regional Development (SFRD) funds are allocated to regional development programmes and projects that correspond to the priorities and tasks outlined in the SSRD, as well as regional development strategies. The grant is open to *oblast* state administrations, regional development agencies and local governments (notably amalgamated municipalities). A pre-requisite for receiving funding is being able to co-fund at least 10% of the total project cost through local budgets.

Allocation of funds between *oblasts* and Kyiv City

Beginning in 2022, the SFRD should be composed of at least 1.5% of the revenues from the General Fund of the State Budget. Previously this was 1%. The SFRD funds are disbursed to each *oblast state administration* and Kyiv City according to the following formula:

- The distribution of 80% of attributable funds is based on *oblast* population (as a percentage of the national population).
- The remaining 20% is based on the gross regional product per capita (for regions where this indicator is less than 75% of the national average).

Selection procedures for project proposals

The selection procedure for projects seeking funds from SFRD has two stages. First, candidates submit proposals to a regional-level commission, which is led by *oblast state administrations* and can include a range of other stakeholders, such as municipalities, regional branches of associations of local governments and relevant research institutions. Second, the commission reviews the proposals according to criteria set by MinRegion, and then draws up a shortlist of projects to receive funding. In the second stage, the shortlist is reviewed by a national-level commission, which makes the final decision. The commission must be comprised of at least 50% of the members of parliament (MPs) that sit on the Verkhovna Rada Budget Committee, as well as MinRegion representatives.

Source: Author's elaboration, based on (CabMin, 2015[35]; OECD, 2018[14]; MinRegion, 2021[43]).

Adjusting the SFRD distribution formula could improve regional convergence

Several changes could be made to the SFRD allocation formula to support regional convergence efforts. For instance, the allocation formula currently takes into account differences in population and GDP per capita at the *oblast* level. This allows the fund to cater to regionally differentiated needs and assets. However, as there are significant economic and socio-demographic disparities within *oblasts,* the government could consider linking the formula to the population and GDP per capita of *rayons* instead of *oblasts*. This would allow the government to allocate SFRD funding with more precision, which would benefit less-affluent municipalities that often struggle, in comparison to wealthier cities for instance, to fund investment projects through private sources (e.g. loans from international financial institutions). This change could also be justified by the fact that the majority of SFRD-funded projects are limited in geographic scope, 63% focusing on just one community. In recent years, less than 10% of SFRD projects had a regional focus, the rest focused on individual *rayons*. To enable such a modification of the allocation formula, the State Statistics Service of Ukraine (SSSU) and MinRegion could build on the *rayon*-level data that is already being gathered. However, if Ukraine decides to implement the PIT reform based on place of residence as discussed earlier—which may affect *rayon* GDP per capita—the government should consider reviewing the manner in which GDP per capita of *rayons* is calculated, in order to ensure that it adequately reflects local economic activity.

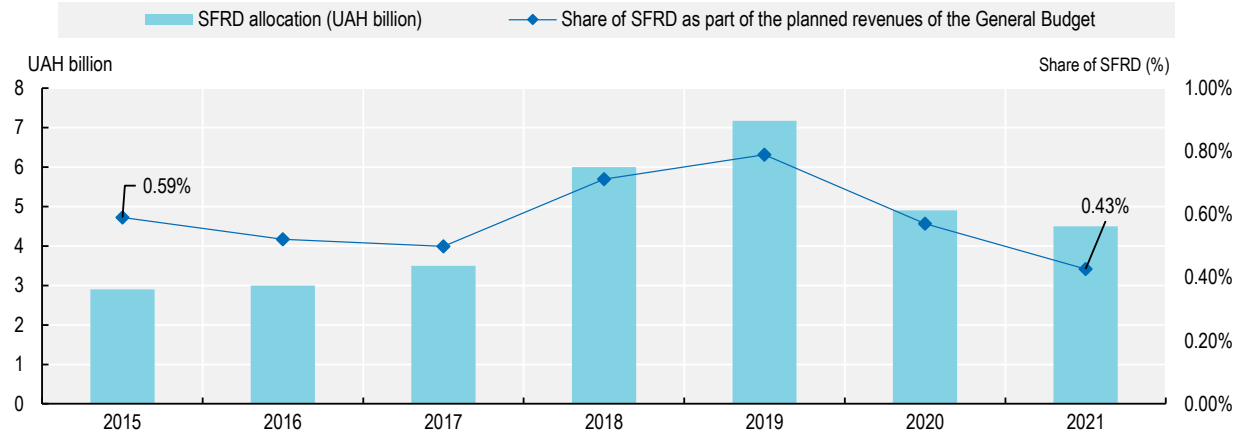
Additional indicators could be used to better identify territories that are in the greatest need of SFRD funds. For example, the government could take into account regional GINI coefficients, regional human development indexes or assess the capacity of regions to mobilise investment funding through sources other than the SFRD. However, such measures would make the allocation formula more complex. To facilitate this shift, the government would need to invest in the generation and dissemination of territorially disaggregated data, including on non-financial indicators.

Other options have been proposed to increase the amount of SFRD funding that reaches less affluent subnational governments. One possibility is to significantly increase the share of SFRD funding allocated on the basis of GDP per capita (U-LEAD, 2022[7]). This would directly benefit the relatively poor regions, but does not necessarily address the underlying issue of subregional disparities.

SFRD funding remains below the legally mandated level

A second concern is related to the volume of the SFRD. Between 2015 and 2021, the percentage of funds allocated to the SFRD fluctuated between 0.43% and 0.79%, remaining well below the then legally mandated level of 1% of planned General Budget fund revenues (Figure 5.9). This is despite the fact that, between 2016 and 2019, the EU provided budget support worth EUR 38 million to the government to support its regional development policy, which contributed to the volume of the SFRD (Box 5.6). It is important to note, however, that the budget support was not intended to exclusively fund the SFRD. Moreover, the execution rate of the SFRD fell between 2015 and 2019 (U-LEAD, forthcoming[1]).

Figure 5.9. SFRD funding, 2015 and 2021



Source: Author's elaboration data from (Verkhovna Rada, 2015[44]; Verkhovna Rada, 2016[45]; Verkhovna Rada, 2017[46]; Verkhovna Rada, 2018[47]; Verkhovna Rada, 2018[48]; Verkhovna Rada, 2020[49]).

Box 5.6. The European Union budget support programme for regional development

Between 2016 and 2019, the EU sought to contribute to Ukraine's social, economic, and territorial cohesion, increasing the well-being of its citizens through the Sector Reform Contract (SRC) "Support to Ukraine's Regional Policy". As part of this agreement, EUR 50 million was committed as budget support to bolster the social, economic, and territorial cohesion of Ukraine, and enhance the well-being of citizens throughout the country.

The budget support programme provided Ukraine with a framework and funds to experiment with new ways of funding regional and local development policy. Of the EUR 50 million, only EUR 38 million was disbursed as various key targets of the SRC were not met. This amounted to about 9% of the total budget allocations for the SFRD in the same period.

The 2020 evaluation of the SRC found that "concerns remain about the sustainability and mainstreaming of improvements across the system". It also indicated that a lack of capacity and unclear responsibilities at the local level are major hurdles to the success of regional development policy. This is exemplified by the overreliance on many small-scale infrastructure projects with low economic impact.

The SRC evaluation report concluded that the "establishment of the policy, legislative and institutional framework for regional policy, though fundamental, is not in itself sufficient to bring about the social and economic changes required to raise regional parity and promote regional economic and social development". Based on the findings of the 2020 evaluation report, among other elements, the EU decided not to renew the budget support for regional development but rather to invest in supporting local capacity to develop and implement local regional development plans and initiatives.

Source: Author's elaboration, based on (Ecorys, 2021[50]) (U-LEAD, 2018[51]).

Changes to the Budget Code defined the share of SFRD funds for national and regional investment and development initiatives

In early 2022, Ukraine amended the Budget Code to strengthen the SSRD's effectiveness. The amendments specified that SFRD funds should be used to implement investment programmes and regional development projects that are aligned with SSRD priorities, as well as those of the regional development strategies. Specifically, 30% of SFRD funds should be used to fund programmes and regional development projects that contribute to the SSRD. The remaining 70% should be used to fund programmes and regional development that ensure the implementation of the regional development strategies. These changes can strengthen the relationship between the SFRD and the different national and regional development planning documents. This is a particularly salient point as historically the link between the SFRD funded projects and the different regional development planning instruments has not been optimal. To illustrate this point, between 2015 and 2017 the objectives of the development projects funded through the SFRD contributed to achieving only 17% of objectives of the regional development strategies (MinRegion, 2019[52]). Earmarking a specific percentage of the SFRD for the implementation of regional development plans could help overcome this challenge. It would have to be paired, however, with efforts to improve financial planning at the national and subnational levels to make sure that the allocation of funds matches the thematic scope of the different development strategies.

The 2022 changes to the Budget Code did not include clear provisions to ensure that the legally mandated funding and the actual funding align. In other words, despite the change in the law, the actual funds assigned to the SFRD may continue to be (well) below the official threshold of 1.5% of all planned revenues from the General Budget Fund of Ukraine. In the absence of such regulations, the government is advised

to consider several complementary actions. First, the ICC—including any (technical) working group related to regional development funding that it may establish—is advised to hold an annual meeting to review the parts of the draft State Budget that are related to regional development and issue recommendations for modifications in case less than 1.5% of the General Fund of the State Budget is proposed to be allocated to the SFRD. Second, the Verkhovna Rada's Committee on State Building, Local Governance, Regional and Urban Development is advised to use its participation in the process of developing and reviewing the State Budget of Ukraine to emphasise the legal commitment of allocating 1.5% of the General Fund of the State Budget to the SFRD.

The 2022 changes to the Budget Code also do not address a series of other fundamental problems with the SFRD, such as those related to its co-funding requirements. Furthermore, unlike legislative changes proposed by MinRegion in 2020, the 2022 changes to the Budget Code only earmark a specific percentage of the SFRD for the implementation of the SSRD and the regional development strategies, but not the local development plans.

A 2020 proposal to amend the Budget Code, developed by MinRegion sought to gradually increase the volume of the SFRD for the relevant budget period in 2023 to 3% of the planned revenues from the General Budget Fund of Ukraine (Box 5.7). If approved, the law would also have fixed the share of funding that could be used to implement the SSRD, the regional development strategies and the municipal development strategies. Thus, it would not only have strengthened the position of the fund as the main (cross-sectoral) funding instrument for regional development, it would also have enabled municipal development strategies to guide local investments more effectively.

Box 5.7. Draft Law No. 4200 "On Changes to the Budget Code of Ukraine"

The draft law proposed changes to the Budget Code of Ukraine and aimed to amend the article of the law that legislates the use of the SFRD. If approved, the SFRD would receive no less than 3% of the total projected revenue of the General fund of the draft State Budget of Ukraine.

The existing regional disbursement criteria would be complemented by the following formula link to the different regional development planning instruments:

- 50% of the funds are allocated to implementing programmes and projects under the auspices of the State Strategy for Regional Development (SSRD).
- 30% of the funds are allocated to implement the tasks defined by regional development strategies.
- 20% of the funds are allocated to implement municipal development strategies.

As is currently the case, regional development programmes and projects that are undertaken at the local level would be required to secure co-funding from local budgets at a minimum threshold of 10%.

If adopted, the draft law would also have reduced parliamentarians' participation in the project selection commission. If approved, members of the Verkhovna Rada would be able to represent up to 50% of the commission's members. Currently they make up at least 50%. At the same time, the law would not alter the requirement that at least 10% of allocated funding to a region be channelled towards investment programmes and projects that promote the development of local sports infrastructure.

Source: Author's elaboration, based on CabMin (2020[53]).

Parliamentarians play a major role in the selection procedures for competitive funding mechanisms

One issue that needs to be critically reviewed is the very active role of parliamentarians in the Verkhovna Rada in selecting projects for the SFRD and the Socio-Economic Subvention.

Despite the SFRD and the Socio-Economic Subvention being formally managed by MinRegion and MinFin respectively, legislation stipulates that at least 50% of the membership of the commission for project selection for each fund should be parliamentarians that sit on the Verkhovna Rada Budget Committee. This gives them significant power over the allocation of the funds (CabMin, 2012[36]). Representatives from the ministries that manage each of the funds form a minority in the respective selection committees. Without the adequate transparency and accountability mechanisms in place, this risks allocating project funding on the basis of electoral considerations. Different audit reports mention the political influence over the distribution of Socio-Economic Subvention funds, which have been used for political campaigning in local constituencies (National Institute for Strategic Studies, 2020[54]). This not only results in a loss of valuable resources, it also erodes trust in public institutions and elected officials, as well as policies associated with regional and local development.

Municipalities consider the issue of bias in the selection process to be the most important obstacle to obtaining funding through the different funding mechanisms for regional development (Box 5.8) (2021[42]). This signals a significant lack of confidence in the fairness of the project selection process.

Box 5.8. Main obstacles to obtaining funding, according to the municipalities

As part of the OECD online survey, municipalities were asked what they consider the main challenges to receiving funding through: i) the SFRD and ii) other funding mechanisms for regional development. For both questions—one related to the SFRD alone, the other to additional mechanisms for funding regional development—a plurality of the 741 surveyed municipalities reported that "bias in the selection process" of their proposals is the most important obstacle (22% and 24% or respondents respectively).

Approximately one in every three municipalities reported that factors related to their financial situation—either because of a lack of financial means to provide the necessary co-funding, or the costs associated with the design of the proposal—constitute the key impediment to obtaining funding through the different funding mechanisms. With regard to the SFRD, 18% consider that changing the priorities of the SFRD are the biggest obstacle. This hints at a perceived lack of clarity about the extent to which the SFRD can provide funding to meet local investment priorities. The identification of investment priorities is generally not seen as an obstacle. Only 1% of municipalities reported that this is the biggest challenge to obtaining funds through the SFRD.

Note: Annex Figure 5.B.2 and Annex Figure 5.B.3 present a more detailed breakdown of what municipalities consider the top challenge to receiving funding through the SFRD and other funding mechanisms. The questionnaire was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

Any modification of the SFRD—or any other competitive funding mechanism—requires a reevaluation of the involvement of parliament in the allocation of funds. In particular, the government should consider providing the executive branch with a stronger say in the review and selection of project proposals. Meanwhile, parliamentarians should double down on their mandate to hold the different ministries involved in regional and local development accountable for their performance in implementing legislation that is relevant to regional and local development. This could mean, for instance, ensuring that the legally established percentage of funds from the revenues of the general budget fund is actually distributed to the

SFRD. To strengthen the transparency of this process, observer status could be awarded to representatives of the different associations of local governments, civil society organisations and/or international institutions with expertise in the field of local government funding and development. The collaboration between the United National Development Programme (UNDP) and the Mexican government could serve as an example. The Federal Government of Mexico invited UNDP to support the development and implementation of its Sovereign Sustainable Development Goals Bond, which seeks to expand the country's investor base by accessing international funds committed to sustainable economic development. Besides being able to review the development of the bond framework, UNDP can comment on the bond impact report, to strengthen its transparency (UNDP, 2020[55]).

The role of oblasts in initial project selection needs to be further scrutinised

Oblasts occupy a key position between the national government and municipalities in terms of initial project selection and disbursal of SFRD funds, as well as other competitive funding mechanisms. Depending on the specific subvention, the role that *oblasts* could play according to current legislation runs the risk of undermining their effectiveness, as well as transparency.

The government should consider amending the legislation for funding mechanisms by including clear criteria and a systematic consultation of municipalities. This is particularly relevant for the Socio-Economic Subvention and Subvention for Developing Healthcare in Rural Areas (Annex Box 5.A.1). For both subventions, *oblast* state administrations submit preliminary proposals to a national-level commission suggesting which local projects should receive funding (CabMin, 2017[38]; CabMin, 2012[36]). The legislation foresees no role for municipalities in shaping these proposals. Moreover, the subventions lack criteria that could outline a basis on which projects should be awarded, such as development gaps in local communities (CabMin, 2012[36]) (CabMin, 2017[38]). This raises the risk that initial project funding decisions could be made based on inaccurate or incomplete information, or lobbying of *oblast* state administrations by municipalities.

A second concern related to the participation of *oblast* state administrations in the regional development subventions is the lack of transparency about how they evaluate and score project proposals. This applies to the SFRD in particular. Municipalities can submit proposals to a regional-level commission, which is led by *oblast* state administrations. The commission reviews the proposals according to criteria set by MinRegion, and then draws up a shortlist of projects to receive funding. Afterwards, the shortlist is reviewed by a national-level commission, which makes the final decision. To improve the transparency of this process and increase the quality of proposals going forward, the regional commission's evaluation of project proposals should be shared with municipalities—a point that is not included in the SFRD legislation.

There are also concerns about whether municipalities are receiving their allocated funding from *oblasts*. For example, in the case of the SFRD, the distribution of funds is only mentioned in relation to *oblasts* and not to municipalities (CabMin, 2015[35]). The legislation thereby implies that the municipal share of SFRD funds is meant to be transferred to them by *oblasts*. OECD interviews with local stakeholders indicated that there have been instances where *oblasts* did not distribute funds in a timely manner, or even at all (OECD, 2021[8]). This factor might partially account for the low SFRD execution rates between 2015-2019, which have fluctuated between 63% and 89% (U-LEAD, forthcoming[1]).

Certain eligibility criteria risk putting poorer municipalities at a disadvantage

Many of the largest subnational subventions in Ukraine are awarded competitively and require municipalities to meet co-funding criteria. Given the vast differences in the fiscal capacity of municipalities, such criteria risk undermining the ability of poorer municipalities to obtain the funding necessary to fulfil their investment needs. This can further entrench territorial disparities.

To obtain funding through the Socio-Economic Subvention municipalities need to ensure that infrastructure maintenance can be paid from local budgets (CabMin, 2012[36]). In other instances, local governments need to co-fund at least 10% of the total project through local budgets. This applies to the SFRD and the Subvention for Developing Healthcare in Rural Areas (CabMin, 2015[56]; CabMin, 2017[40]). If municipalities are unable to meet the co-funding requirements, *oblasts* can provide funding if they consider the project to be sufficiently important (OECD, 2021[8]). However, it is unclear what criteria need to be met for *oblasts* to support municipal co-funding efforts. There is therefore a risk of arbitrary decision making.

In principle, making co-funding a prerequisite for funding can be useful. It can help leverage resources and increase local government ownership of development projects. At the same time, co-funding requirements risk entrenching the gap between wealthy and poor municipalities as they place an uneven strain on local budgets. Many Ukrainian municipalities consider the lack of financial means to provide co-funding the main obstacle to obtaining funding (Annex Figure 5.B.2; Annex Figure 5.B.3). In addition, more than 10% of surveyed municipalities indicated that the costs associated with the design of proposals for the SFRD and other funding mechanisms represent the main impediment to obtaining development funds.

The criteria for competitive subnational subventions can also reduce the pool of municipalities that are eligible to receive funding. The SFRD is an example of this. Its selection committee assesses projects according to five criteria: 1) contribution to the development of municipalities/overcoming a specific development challenge; 2) expected impact of the proposed project; 3) innovativeness of the proposal; 4) share of co-funding from local budget and; 5) the extent to which the proposed project includes social, economic and environmental components (MinRegion, 2019[57]). The innovation criterion risks putting municipalities with weaker administrative capacity at a disadvantage, given that they are likely to have limited in-house capacity with which to design proposals for innovative projects. By strengthening outreach to municipalities and prioritising their capacity building, the government could provide municipalities with more clarity on the eligibility criteria and the application procedures of competitive subventions, as well as their capacity to develop competitive proposals.

Different practical actions could be taken to address these issues, such as linking co-funding requirements to the fiscal capacity of municipalities. For example, those municipalities with the least fiscal capacity could be exempt from providing co-funding altogether. The data on the financial situation of the municipalities presented on the Open Budget Portal of MinFin could support this effort. The government would, however, need to make sure that the adjusted regulations include provisions to prevent municipalities from undermining their own tax capacity. Another solution would be to strengthen Ukraine's revenue equalisation mechanism to ensure that all municipalities have the possibility to cover the co-funding requirements.

In the medium or long term, the government could also consider creating a complementary general grant that provides all *oblasts* and municipalities with a minimum level of funding to implement their respective regional and local development strategies. Such a grant would complement the own-source revenues that municipalities can provide, as well as any funds they obtain from non-governmental actors. It would not only provide subnational authorities with more predictable and stable funding to implement investment projects linked to their regional and local development strategies, it would also increase their ability to spend funds to meet their particular investment needs—within the framework of the officially approved regional and local development plans. In order to ensure the effective use of the grant, the government is advised to establish clear guidelines for how the funds can be used. For example, the guidelines could indicate that projects would have to be developed and implemented by more than one municipality and address clearly-established cross-jurisdictional investment needs. Moreover, robust oversight mechanisms would have to be in place to ensure that the funding that subnational governments receive as part of the general grant is implemented in compliance with official guidelines. In addition, policy makers would have to ensure that such a grant does not disincentivise municipalities from identifying alternative sources of funding for local development initiatives.

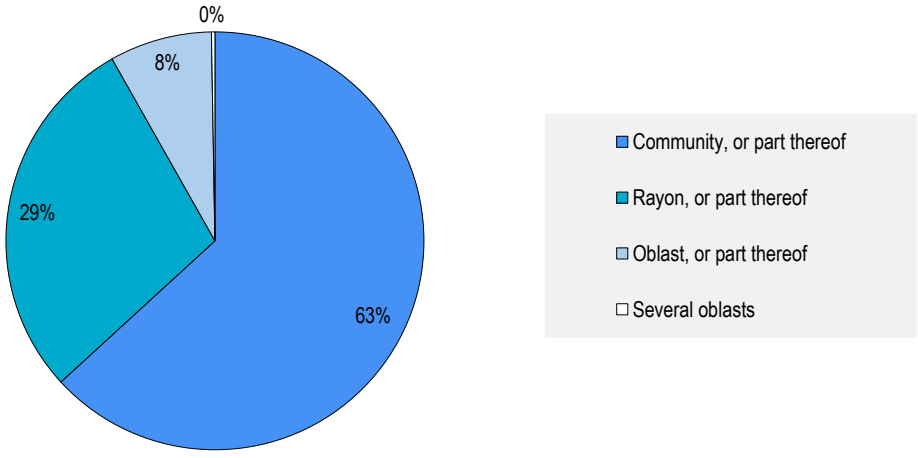
Unless policy interventions such as these are taken, poorer municipalities and those with limited technical capacity to develop competitive project proposals may continue to miss out on funding opportunities, possibly exacerbating regional disparities.

Prevalence of local and small-scale projects risks fragmenting investment

Additional challenges to the effectiveness of the projects funded through the SFRD are related to their territorial scope and timespan. Despite important improvements between 2015 and 2018, the timespan of projects is relatively short, possibly limiting the impact and sustainability of the development initiatives.

While in 2015, 99.8% of all projects lasted only one year, in 2018 this decreased to 76.5%. During the same period, the share of projects lasting either two or three years increased to 18% and 6%, respectively (Figure 5.10). The average geographical focus of the projects did not change much, however. The majority of the initiatives were targeting a specific community (63%). Less than 30% focused on a *rayon*, and only 8% of projects focused on the *oblast* level. Moreover, between 2015 and 2018, only five projects had a distinct interregional focus (0.3%) (U-LEAD, 2018[58]). An example of a community project is the construction of a sports and recreation complex in Dubrovytsia, Rivne *Oblast* (Rivne Regional State Administration, 2020[59]). An example of a project with a wider geographical focus is the reconstruction of the Lviv Regional Clinical Perinatal Centre (Verkhovna Rada, 2019[60]).

Figure 5.10. Geographic focus of SFRD projects between 2015 and 2018



Source: Author's elaboration with data from (U-LEAD, 2018[58]).

The predominance of short-lived projects that target improvements at the community level could lead to a suboptimal use of resources, as many small projects might tackle similar issues that could benefit from inter-municipal or inter-regional intervention.

In an attempt to increase the strategic use of SFRD funding, in 2021, CabMin passed a resolution establishing that only projects worth UAH 10 million or more could be funded through the SFRD (MinRegion, 2021[61]). Beyond this measure, the government should consider amending the fund's regulations to encourage the funding of multi-year projects that have a cross-jurisdictional focus. For example, additional points could be awarded to initiatives that are developed by multiple subnational governments and propose a solution for a particular district- or region-wide development challenge. An alternative could involve organising different funding 'windows' for initiatives that either have a local, inter-municipal or regional focus.

The SFRD heavily funds the maintenance of "hard" infrastructure

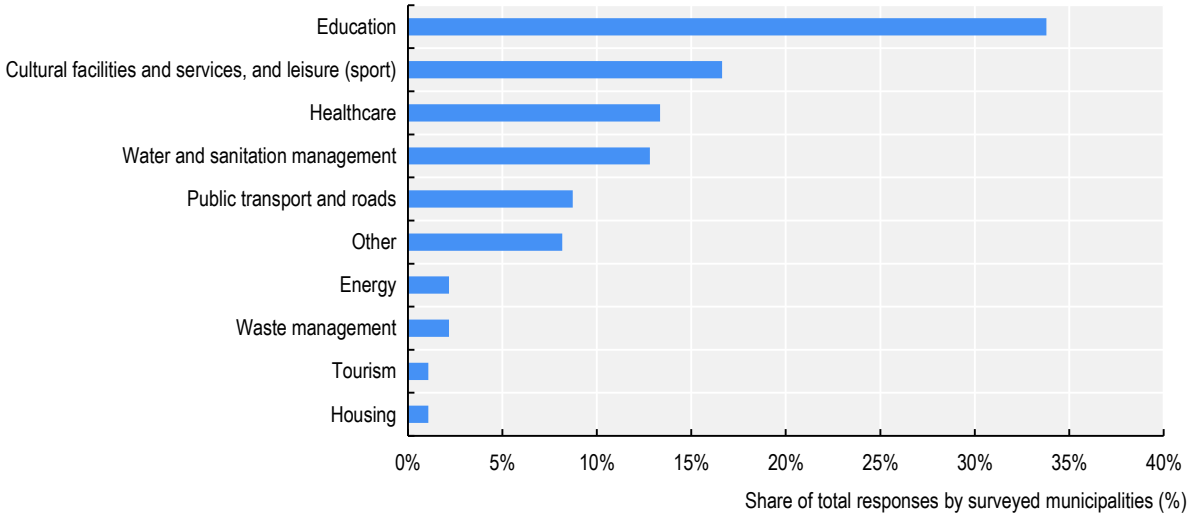
The predominance of investment in "hard" infrastructure discussed earlier also applies to the SFRD. During the 2015-2019 period, most projects funded through the SFRD targeted secondary education (including the construction of education facilities), followed by utilities supply (gas, heat, and electricity), road transport infrastructure and water supply. The thematic areas that were least targeted included promoting entrepreneurship and agricultural and non-agricultural businesses in rural areas (U-LEAD, 2018[58]).

Two factors can explain the SFRD's overreliance on "hard" infrastructure projects. First, municipal authorities tend to believe that the regional development policy framework is geared towards satisfying existing "hard" infrastructure needs (Ecorys, 2021[50]). Second, investments in tangible, "hard" infrastructure projects are often prioritised by local leaders who see them as tools to bolster public support for their administrations (National Institute for Strategic Studies, 2020[54]).

Taking into account the various national government initiatives that specifically target the maintenance and upgrading of "hard" infrastructure, the government could consider adjusting the SFRD guidelines to strike a better balance between investments in "hard" and "soft" infrastructure. The latter refers to investments in innovation, SME development, local competitiveness and human capacity (e.g. skills training or retraining). Spending on "soft" infrastructure often takes time to generate results. In addition, the results of investment in, for example, SME development are often not as tangible as, for instance, the construction of roads, bridges or schools. It is not uncommon that the latter are prioritised by local leaders seeking to bolster their public approval ratings. For example, *oblast* state administrations and municipalities could be required to present project proposals that contemplate spending a minimum percentage of funds on such issues. Such a quota for investment in "soft" infrastructure could replace the existing one for sports.

Indeed, at least 10% of funding through the SFRD must be channelled into investment programmes and projects that promote the development of local sports infrastructure. Albeit small, a sector-specific quota limits the capacity for municipalities to design and fund projects that meet their specific needs, and reduces autonomy in decision-making and development prioritisation. This quota might contribute to the marked differences in the investment priorities of municipalities and the sectoral focus of SFRD-funded projects (Figure 5.11). According to municipalities, more than 18% of the projects that received SFRD funds are related to "cultural facilities and services, and leisure (sports)".

Figure 5.11. Sectoral focus of SFRD-funded projects, as reported by municipalities



Note: Often projects related to education and healthcare involve significant spending on the construction of schools, kindergartens and health clinics. These can be characterised as "hard" infrastructure investments. Question: In which of the following areas was the project (projects) implemented that received funding through the State Regional Development Fund implemented? You can choose several options. Response options: Waste management; Water and sanitation management; Housing; Healthcare; Public transport and roads; Education; Cultural facilities and services, and leisure (sport); Tourism; Energy; Other. The questionnaire was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

The prevalence of projects related to culture and sports makes sense when looking at the quota used in the SFRD allocation system and the thematic focus of the SSRD. In addition, investment in sports can have a direct contribution to regional and local economic activity (European Commission, 2016[62]). However, it does not reflect the self-identified investment needs of municipalities. As shown in Figure 5.8, culture was prioritised by just 1% of respondents. The government should consider removing the quota for sports infrastructure. Another option would be to replace it by one that better matches municipal investment needs, prioritises economic development, and/or balances "hard" and "soft" infrastructure investment.

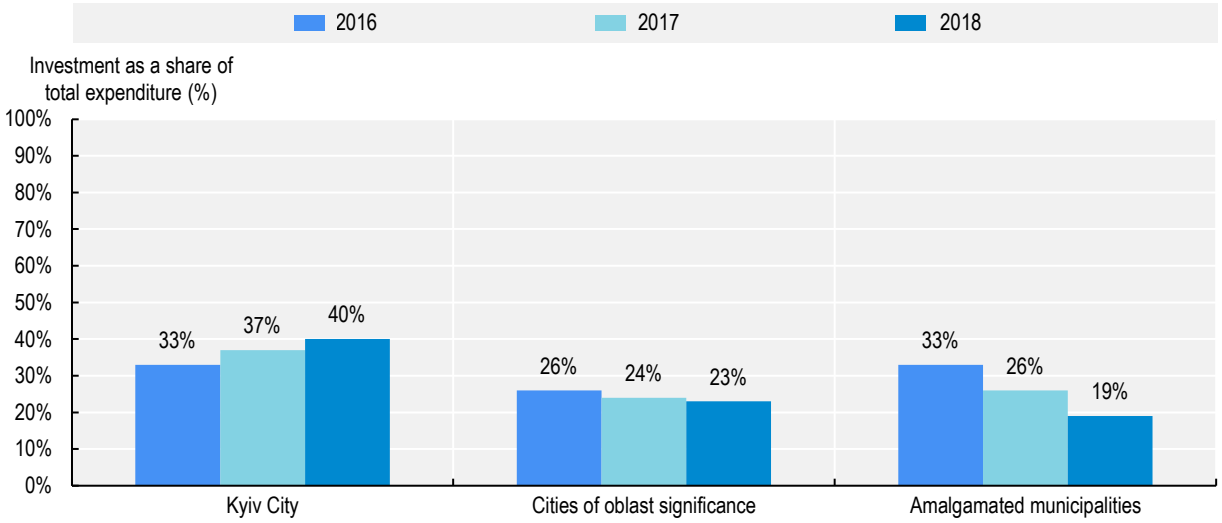
Subnational investment capacity

Even though the share of all investment by *oblasts, rayons* and amalgamated municipalities combined as a percentage of total public direct investment declined by 21% between 2015 and 2020, it still represents 68% of all public investment, which is well above the OECD average (56%) (OECD, 2022[10]; IMF, 2022[11]). In the same period, the share of direct investment by Ukraine's subnational governments as part of all subnational expenditure, remained relatively stable, fluctuating between 8% and 12% (IMF, 2022[11]). There is evidence, however, of divergence in the investment capacity of different subnational governments (e.g. Kyiv City versus amalgamated municipalities) and in local skills to effectively manage investment processes. Furthermore, several mechanisms that subnational governments can use to increase investment, such as borrowing and public-private partnerships, could be better exploited.

The investment capacities of different subnational governments have gradually diverged

Between 2016 and 2018, Kyiv City's share of investment spending as part of its total expenditures rose from 33% to 40% (SKL International, 2019[25]). This was accompanied by an increase in investment per capita[5] (Figure 5.12). In the same period, however, the share of investment spending as part of the total expenditures of "cities of *oblast* significance" and amalgamated municipalities fell. "Cities of *oblast* significance" witnessed a decrease of 3 percentage points (from 26% to 23%), while their per capita investment spending stayed the same. The share of investment as part of total spending by amalgamated municipalities decreased more drastically, from 33% to 19% (SKL International, 2019[25]). One possible explanation is related to the size of the Local Infrastructure Subvention (Annex Box 5.A.2). This fund was created in 2016 to encourage municipal mergers, which meant that only amalgamated municipalities were eligible to receive funds. The increase in the number of amalgamated municipalities between 2016 and 2020 appears to have been greater than the increase in available funds over the same period, reducing the available funds per municipality (SKL International, 2019[25]). The Local Infrastructure Subvention was eliminated in 2020 due to COVID-19 budget cuts.

Figure 5.12. Investment as part of total expenditures of selected subnational governments, 2016-2018



Note: Data in this figure varies from the subnational investment data collected by the IMF. This can be explained by the fact that although the IMF looks at total investment made by all subnational governments combined (including *oblasts,* Kyiv City, *rayons* and municipalities) the SKL study focuses specifically on Kyiv City, "cities of *oblast* significance" and amalgamated municipalities. Also, in the SKL study expenditures exclude social welfare transfers as local governments have little control over the allocation of these funds.
Source: Author's elaboration with data from (SKL International, 2019[25]).

To boost the investment capacity of smaller municipalities, the government could consider several aforementioned policy interventions. For example, they could be provided with a block grant to fund investment linked to their local development plans. This would likely be welcomed at the local level, as 58% of surveyed municipalities indicated that reinstating the Local Infrastructure Subvention is among the most urgent subnational finance and investment reform areas (Annex Figure 5.B.1). The government could also consider expanding the municipal power to set the tax base and rates for own-source taxes, possibly within a nationally determined range to avoid too much variation among municipalities, and an excessive tax burden on citizens. This would not only improve their fiscal capacity and give them more flexibility to address local needs, it could also bolster public accountability. Over 40% of all municipalities that responded to the OECD online survey indicated that increasing their powers to set the base or rate of local taxes is a particularly urgent area of reform (Annex Figure 5.B.1).

A closer look at the investment capacity of "cities of *oblast* significance" showed that the decrease in investment capacity went hand-in-hand with an increase in their spending on wages and other operational costs (SKL International, 2019[25]). As commented before, this may be in part due to the minimum wage increase that reduced the revenue that subnational governments were free to spend. While it is widely considered that many municipalities are facing challenges in attracting and maintaining skilled staff, in part because of low wages, any measure aimed at improving the financial remuneration for public officials may reduce the scope for investment. Thus, urgent efforts to attract and maintain skilled staff would therefore have to be accompanied by an increase in revenue generation.

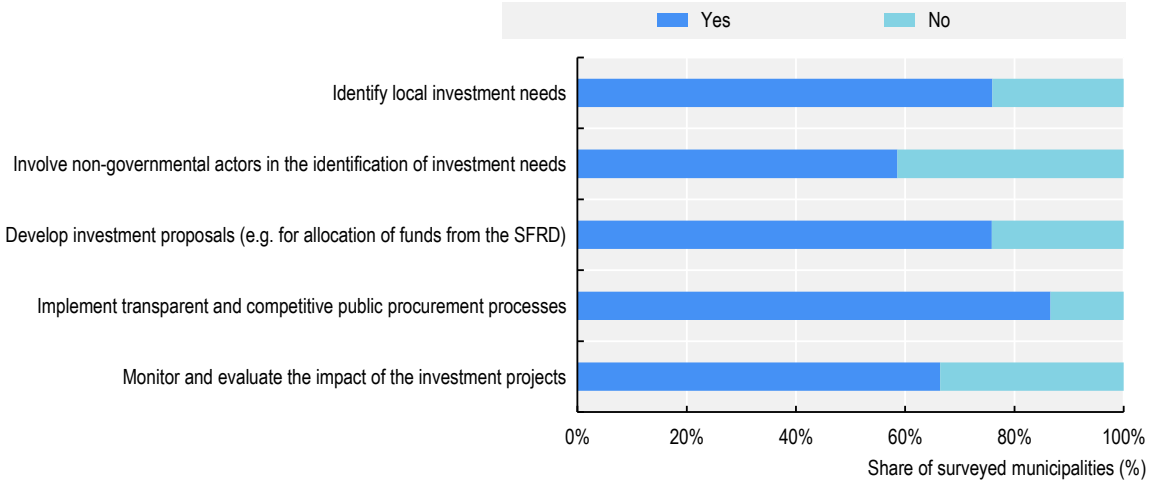
Building skills is crucial to improve the effectiveness of local investment

Ensuring sufficient and qualified human resources at the subnational level is key to effectively carrying out public investment tasks, improving public service delivery and supporting local economic development. There is evidence that the decentralisation reforms have had a relatively positive impact on municipalities' local investment capacity. At the same time, however, skills need to improve across a range of topics,

including developing frameworks to monitor investment projects, as well as engaging with non-governmental actors throughout the life-cycle of investment projects.

Analysis from the OECD's online survey (Figure 5.13) shows that while a sizeable majority (74%) of surveyed municipalities reported having sufficient human resources to identify local investment needs, 24% indicated that they lack such expertise. This could negatively affect the ability of those municipalities to develop quality investment projects that match local development needs and capacities, thus jeopardising the effectiveness of their investment. In addition, 24% of municipalities reported that they lacked the human resources to develop investment proposals. As many regional and local development subventions in Ukraine are competitive, this may imply that municipalities could miss out on funding opportunities. This particularly applies to those municipalities that were administratively amalgamated in 2020 and have received less capacity building support than their peers (OECD, 2021[8]).

Figure 5.13. Availability of human resources to effectively carry out public investment tasks



Note: Question: Indicate whether you believe that your municipal government has the human resources (including expertise) to effectively carry out the following public investment tasks: Identify local investment needs; Involve the private sector, civil society or academia in the identification of investment needs; Develop investment proposals (e.g. for allocation of funds from the SFRD); Implement transparent and competitive public procurement processes with appropriate internal control systems; Conduct periodic M&E exercises to determine the impact of the investment projects. Response options per task: Yes, No. The questionnaire was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

Regarding monitoring and evaluation, 34% of surveyed municipalities reported that they lack the human resource capacity (including expertise) to conduct periodic monitoring and evaluation exercises that could determine the impact of the investment projects. This suggests that certain municipalities may not have developed important mechanisms for accountability and learning. Ensuring effective monitoring capacity can enable municipalities to keep tabs on the implementation of investments, make mid-course adjustments when necessary and communicate the results of their investments to relevant stakeholders. Ex-post evaluation can help determine whether intended outcomes were achieved and inform the development of future investment proposals.

Engaging with non-governmental actors is a key challenge for municipalities

With regard to involving the private sector, civil society or academia in the identification of investment needs, it is notable that 41% of municipalities reported that they lack the human resources (including expertise) to do so. As set forth in the OECD's *Recommendation of the Council on Effective Public*

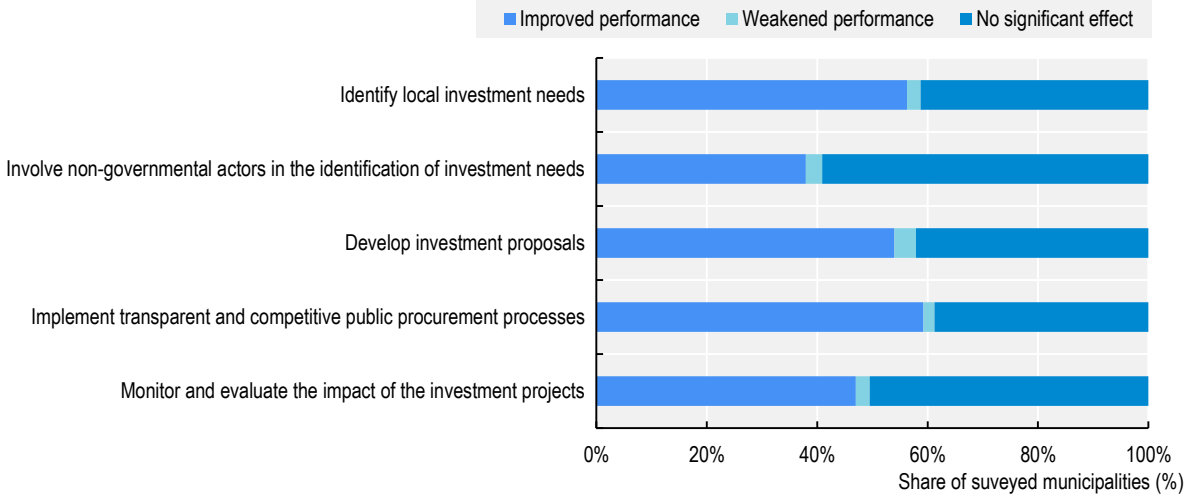
Investment Across Levels of Government[6], engaging with private sector and civil society stakeholders when designing and implementing public investment strategies is fundamental for enhancing the social and economic value of investment and ensuring accountability (OECD, 2014[9]).

All levels of government should involve stakeholders at an early stage of the investment cycle, starting with identifying investment needs and designing an investment strategy. At later stages, a balanced group of stakeholders should be involved in monitoring and evaluation. Information on public investment plans, expenditures, and results should be exposed to some level of public scrutiny to promote transparency and accountability. In addition, municipalities need to have the capacity to balance the incorporation of stakeholders' views and their contributions to the investment process, taking steps to prevent a disproportionate influence by special interest groups.

The decentralisation reform process has improved municipal performance in some aspects of investment planning

Many municipalities find that the decentralisation reform has had a predominantly positive effect on their investment planning capacity. A majority of municipalities (57%) reported that the decentralisation reform process (including amalgamation) improved their ability to identify local investment needs. Furthermore, 59% reported that it had improved their capacity to implement transparent and competitive procurement processes with appropriate internal control systems (Figure 5.14). In addition, 54% of municipalities indicated that the decentralisation reforms had improved their capacity to develop investment proposals for competitive grants, such as the SFRD. At the same time, over 40% of municipalities indicated that the reforms either had no significant effect on or had weakened their performance in other public investment-related areas. This includes involving non-governmental actors in identifying investment needs, where 62% reported that capacity had either decreased or remained unchanged; and the ability to conduct periodic monitoring and evaluation exercises to determine the impact of the investment projects, where 53% reported a decrease or no change

Figure 5.14. Impact of the decentralisation reform on municipal performance related to public investment



Note: Question: What effect have the decentralisation reforms and amalgamation process had on the performance of your municipal government in the following fields related to public investment? Identify local investment needs; Involve the private sector, civil society or academia in the identification of investment needs; Develop investment proposals (e.g. for allocation of funds from the SFRD); Implement transparent and competitive public procurement processes with appropriate internal control systems; Conduct periodic monitoring and evaluation exercises to determine the impact of the investment projects. Response options: Improved performance; Weakened performance; No significant effect. The questionnaire was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

National-level institutions that manage subventions for regional and local development should ensure that municipalities receive sufficient training and advice to better execute their tasks and responsibilities throughout the investment cycle. These efforts can be supported by the different local government associations. Methodologies should be developed and shared on how to identify regional and local development and investment needs given the scarcity of territorially-disaggregated data, and how to effectively engage with governmental and non-governmental actors.

The government should also use its international donor co-ordination mechanisms to identify which municipalities and municipal staff have already received capacity building support for investment planning in the past and which topics have been covered in the training initiatives. This information could generate a database that would allow ministries to identify capacity building needs. In case the turnover of local civil servants is very high, the training database might become outdated quickly. An alternative could be to develop a register that presents the skills and capacity building support received by (local) civil servants. However, such a registry would be more complex to manage and keep up-to-date.

A training database could also serve as a critical input for the selection of municipalities to be targeted in future (international) development projects. The Territorial Portal (*Portal Territorial*) developed by the National Planning Department of Colombia could provide an example (Box 5.9). In Ukraine, such a portal would greatly contribute to the accessibility of relevant training material.

Box 5.9. Colombia's Territorial Portal

The Territorial portal of Colombia was created by the National Planning Department to support municipalities in their efforts to improve municipal planning, administration and service delivery. It features an interactive map that provides information on the municipalities that have received training by governmental and non-governmental actors. The portal also functions as a one-stop-shop for:

- Information on municipal planning and budgeting regulations and procedures.
- E-learning packages on topics such as: public investment, spatial planning, financial management, design of local development plans, and monitoring and evaluation. These packages include manuals, training videos, recommendations, examples of good practices, etc.
- Excel and PowerPoint formats related to the abovementioned topics that can be adjusted by the local governments.
- Contact information of territorial advisors located in different parts of the country.
- Information on relevant national government policies implemented at the local level.

Source: Author's elaboration, based on (Departamento Nacional de Planeación, 2021[63]).

Misuse of investment funds may reduce trust in regional and local development policies

The capacity of subnational governments to use regional and local development funds according to official regulations is another area of concern. The misuse of public funds, a failure to follow procurement guidelines and a lack of transparency in investment spending could undermine the effective and efficient use of scarce resources. It could also reduce trust in government and in regional and local development policies.

An audit conducted by the Accounting Chamber of Ukraine revealed significant outstanding issues related to the implementation of the SFRD, including misuse of budget funds, violation of legislation in the field of planning and budgeting and a significant number of unfinished construction projects (CabMin, 2021[5]). These issues are not solely applicable to the SFRD but appear to be systemic. For instance, a State Audit

Service assessment of the legal and efficient use of communal resources totalling UAH 872 billion during 2018-2020 and the first five months of 2021, revealed violations and shortcomings totalling UAH 141 billion. In addition, a procurement monitoring exercise that looked at UAH 119.7 billion of local expenditures, identified violations of procurement legislation related to almost 80% of the reviewed costs (CabMin, 2021[5]).

The capacity of the government to conduct a more thorough assessment of the adequate use of funds by subnational governments has been significantly curtailed. In recent years, the staff of the State Audit Office was reduced from 14 000 auditors to 3 000, and departments in charge of auditing in *rayons* and cities were closed. In light of these developments, the State Audit Office has advocated for an increase in the territorial presence of auditors and allocation of additional funds (CabMin, 2021[5]). To improve the legal and efficient use of financial resources by subnational governments, the government is advised to prioritise boosting the capacity of municipal authorities to conduct internal audits. Conducting internal audits should be an obligation set by regulations for all municipal governments. This would have to be coupled with financial and capacity building provided by the national government to allow municipalities to equip themselves with a specific team or external support (consultants) and set up an adequate information system (OECD, 2018[14]).

Simultaneously, the government should ensure effective communication between the municipalities and the State Audit Service to identify common challenges and bottlenecks in the field of financial management and procurement. This will allow the State Audit Service to provide MinFin and MinRegion, as well as other relevant ministries, with data regarding the type of funds that are most often misused, as well as the budgeting or procurement regulations that tend to be violated. This would facilitate decision making regarding budget modifications, procurement regulations and the training of local governments in the fields of procurement and investment management. Actions such as these would help align Ukraine with the eleventh principle of the OECD's *Recommendation of the Council on Effective Public Investment across Levels of Government*, i.e. "promote transparency and strategic use of public procurement at all levels of government" (OECD, 2014[9]).

Subnational debt represents a small part of all public debt

Given the fiscal constraints that many subnational governments face, debt financing can be an attractive way to help them carry out the necessary investment projects. However, guardrails need to be in place to ensure that those subnational governments that are allowed to borrow—all except for settlement and rural municipalities—do not assume excessive risks, especially given the capacity challenges many municipalities face.

Between 2019 and 2020, local debt increased by 38.6%, reaching UAH 25 billion (Accounting Chamber of Ukraine, 2021[64]). This increase can be explained, in part, by the devaluation of the hryvnia. In fact, when controlling for inflation, in 2020, subnational debt was about the same as in 2015. Moreover, subnational debt continued to represent only a very small part of all public debt (approximately 1%) (IMF, 2022[11]).

Between 2019 and 2020, local domestic debt increased by 41.7%, to UAH 20.8 billion. This increase was primarily caused by the issuing of bank loans to different city councils (e.g. Odessa and Zaporizhzhia), which used the funds to finance various projects including the reconstruction of municipal utilities and housing projects. Another important factor behind the increase is the issuing of new securities by several cities to finance the reconstruction of social and cultural facilities, transport infrastructure and roads.

Prior to Russia's large-scale aggression against Ukraine, it was expected that the gradual economic recovery from the COVID-19 pandemic would support a rebound in the 2021-2022 tax revenue of Ukrainian cities, enabling them to service their growing debt (Fitch Ratings, 2021[65]). In order to improve the capacity of municipalities to finance local development projects, the right to borrow could be extended to mid-sized municipalities that meet certain fiscal criteria, subject to prior approval by MinFin.

In addition, the government should consider establishing a working group on local debt (management) that includes central government entities such as MinFin and MinRegion, as well as representatives from local government associations. This group could help identify to what extent the current borrowing framework favours public investment in the context of post-war reconstruction and recovery, without jeopardising economic stability and sound fiscal management. Long-term measures to be assessed in such a working group include developing a credit market for subnational borrowing (i.e. creating a more diversified local debt market). One particular area of attention could be the creation of a municipal bond agency to lower the costs of financing investment projects (Box 5.10), thereby making borrowing more accessible to more municipalities.

Box 5.10. Finland's Municipality Finance Public Limited Company

In many countries, helping smaller municipalities gain access to capital markets to finance investment is a key challenge. As their investment projects are often small and municipalities do not pool their resources, they do not obtain very competitive lending conditions from commercial banks. OECD member countries such as Denmark and Finland have dedicated financial agencies that specialise in municipal lending. As these local government financing agencies provide better conditions, municipalities rarely opt for commercial loans.

In 1989, Finland created the Municipality Finance Public Limited Company (MuniFin), which is a credit institution that is specialised in financing the local government sector and government-subsidised social housing production. MuniFin pools municipal risk and provides loans to Finnish municipalities drawing on resources from financial markets. MuniFin is jointly owned by:

- Municipalities, joint municipal authorities and companies owned by municipalities (53%).
- A local public sector pension fund (31%).
- The national government (16%).

Its funding is guaranteed by a separate institution—Municipal Guarantee Fund—which has access to the entire tax base of the Finnish population. Finnish municipalities, all of which are all members of the Municipal Guarantee Fund, have unlimited right to levy PIT, which provides sufficient collateral for MuniFin funding. Around 80% of municipal debt is financed through MuniFin.

Source: Author's elaboration, based on (OECD, 2021[66]; MuniFin, 2021[67]; OECD, 2021[68]; André and García, 2014[69]).

The government should also consider using the wealth of information on subnational debt presented on the Open Budget Portal and the Register of Local Loans and Local Guarantees to build a public monitoring dashboard to detect the municipalities at risk. This would improve transparency and facilitate decision making on corrective measures. MinFin and MinRegion should also explore the option of providing training to municipal administrators on debt management. Finally, it is important to recognise that, when asked what they consider the most urgent areas of financial reform, only 3% of municipalities mentioned legal adjustments to facilitate borrowing (Annex Figure 5.B.1). As such, any reforms to facilitate local borrowing should be considered complementary to, for example, adjusting the PIT allocation system or increasing the ability of local governments to raise own-source revenue.

Public distrust and lack of know-how hamper the potential of public-private partnerships

Under certain conditions and strict control mechanisms, public-private partnerships (PPPs) can be a mechanism for diversifying funding for regional and local development projects, particularly when a government is faced with funding constraints. However, PPPs are subject to the same fiscal or willingness-

to-pay constraints as public projects. In both cases, a strong institutional capacity is required for the effective delivery of projects.

PPPs are complex and sometimes risky arrangements that require capacity to design, negotiate and implement. This capacity is not always available, particularly at the subnational level. Despite widespread excitement about the potential of PPPs for generating additional resources for investment projects, there continue to be relatively few Ukrainian municipalities that have embarked on such partnerships (Box 5.11).

Box 5.11. Public-Private Partnerships in Ukraine

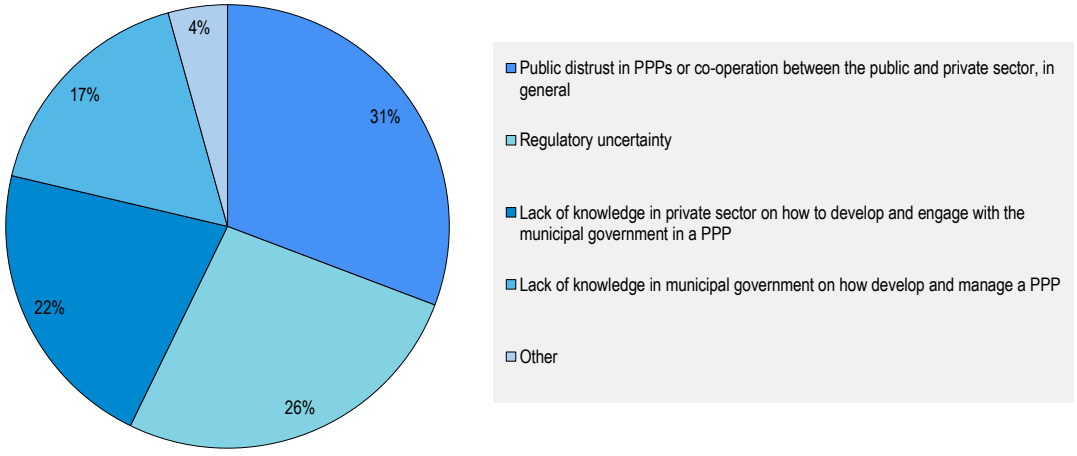
The first Law "on Public-Private Partnerships" was passed in 2010 and considerable hope was placed on it as a tool to attract investment. However, it did not live up to expectations for a variety of reasons. To improve the legal framework, a new PPP Law entered into force in 2016 introducing amendments to "Some Laws of Ukraine to Eliminate Regulatory Barriers for Development of Public-Private Partnership and to Stimulate Investments in Ukraine". The PPP Law better defined the scope of a PPP project.

In 2019, a new Law on Concessions was passed to resolve inconsistencies between the laws regulating concessions and PPS, and to increase private investment, particularly in the field of infrastructure. In addition, in 2018, the State Agency on Support to Public-Private Partnership was established, which provides training to national and local authorities in the field of PPP. More specifically, it offers assistance in the preparation of necessary documentation and supports PPP contract management processes. There are concerns, however, that it mainly focuses on major national level PPPs and does not have the requisite human resources to support the establishment and management of partnerships at the subnational level.

Source: (OECD, 2018[14]) (OECD, 2021[8]) (CabMin, 2021[5]).

According to the results of the OECD online survey, only a fraction of municipalities (10%) reported that they are engaging with the private sector in PPPs. Sixteen percent indicated that they are not sure if they do, and the remaining 74% of municipalities reported that they are not part of any PPP (OECD, 2021[42]). Of those municipalities that have a PPP, a number of them (30%) mentioned that the partnership targets waste management, followed by education (27%) and water and sanitation management (25%). Municipalities are reluctant to set up PPPs for a variety of reasons. For example, 31% of municipalities consider that the lack of public trust in public-private collaboration is the greatest obstacle to setting up a PPP (Figure 5.15). This may be related to the public's perception that corruption is widespread. Furthermore, 26% of municipalities consider that regulatory uncertainty is the biggest obstacle to setting up PPPs. This is followed by a perceived lack of knowledge on the part of the private sector (22%) or the municipality (17%) on how to develop and manage a PPP.

Figure 5.15. Greatest obstacle to the successful co-operation with private sector organisations through PPPs



Note: Question: What do you think is the greatest obstacle to the successful co-operation between your municipality and private sector organisations through PPPs? Response options: Public distrust in PPPs or co-operation between the public and private sector, in general; Regulatory uncertainty; Lack of knowledge in private sector on how to develop and engage with the municipal government in a PPP; Lack of knowledge in municipal government on how develop and manage a PPP; Other. The questionnaire was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

The government could consider improving outreach to municipalities and the private sector—for example via local business or regional chambers—about the potential of PPPs, and its regulatory framework, as well as emphasise the multiple risks involved in establishing and managing such partnerships. This should be coupled with the development of training material for municipalities on how to assess the value added of PPPs, manage partnerships, and establish a transparent system to track the use of public funds and determine its effectiveness. The latter is of singular importance as it could increase public trust in collaboration between the public and private sectors. Related to this, the *OECD Principles for Public Governance of Public-Private Partnerships* stress the importance of having a clear and transparent regulatory framework that is duly enforced and which all parties involved can trust (OECD, 2012[70]). Such a framework needs to foster competition, while helping governments minimise the risk of conflicts of interest, regulatory capture and corruption.

Ukraine's State Agency on Support to Public-Private Partnership could also assess the experience of the PPP Centre in the Philippines (Box 5.12). For example, it could promote the dissemination of the practical experience that larger cities, in particular, have gained in managing PPPs. Municipalities tend to approach larger cities, though on an *ad hoc* basis, for insights and recommendations on how to set up a PPP (OECD, 2021[8]). The State Agency on Support to Public-Private Partnership could share succesful practices, but also those where the national or subnational authorities involved were unable to adequately manage the financial risks involved.

Box 5.12. The PPP Centre in the Philippines

The 1991 Local Government Code of the Philippines devolved the provision of local infrastructure to local governments, stipulating the institutional mechanisms for formulating and implementing local plans. The PPP Centre was created to assist local governments in preparing projects, clarifying procedures, and evaluating PPP projects, as well as providing training.

The Centre launched a PPP strategy for local governments including the preparation and dissemination of a PPP manual. It also helped prepare action plans and strategies for the implementation of PPP projects at local levels. In addition, local governments have access to the Local Government Unit Guarantee Corporation, which offers guarantees for municipal bonds as a private risk guarantor for PPP projects.

Source: Adapted from (OECD, 2021[71]).

Municipalities should use PPPs with great caution, as across the OECD there are many recent examples of PPP failures or misuse. The *OECD Principles for Public Governance of Public-Private Partnerships* outline that when deciding whether or not to use a PPP, governments should "carefully investigate which investment method is likely to yield most "value for money" and consider "key risk factors and characteristics of specific projects" (OECD, 2012[70]). Moreover, benefits, costs and risks of PPPs need to be considered against other project funding and financing models (OECD, 2019[72]; OECD, 2022[73]).

Value for money should be the primary objective in PPP design. Value for money refers to what a national or subnational government "judges to be an optimal combination of quantity, quality, features and price (i.e. cost)", calculated over the complete life-cycle of a project (OECD, 2021[74]). A PPP project generally yields higher value for money compared to traditional procurement or government in-house production when it provides better features, higher quality or lower whole-of-life cost. Higher value for money is mainly obtained through risk transfer, competition and the use of private sector management skills and innovation (OECD, 2021[74]).

Fiscal risks related to the use of PPPs by subnational governments are especially critical to consider. In some cases, PPPs risk being improperly used to circumvent public financial management controls, which can create long-term fiscal risks for national and subnational governments (World Bank Group et al., 2017[75]). A desire to bypass fiscal constraints should not be considered a valid reason to opt for a PPP over traditional public procurement (IADB, 2018[76]). It can also pose a threat to sound project preparation and value for money, while creating an "affordability illusion" (Eurostat, 2016[77]). The latter particularly holds true when national and/or subnational governments lack a long-term perspective on public finances, which may mean that PPPs look affordable due to their delayed budget impact while, at the same time, long-term payment obligations are overlooked (World Bank, 2020[78]). Risks specific to subnational governments relate to institutional capacity and fiscal and regulatory frameworks (OECD, 2022[73]). Substantial institutional expertise is required for subnational governments to successfully harness PPP projects. This includes the capacity to properly assess the potential benefits, costs and risks of a PPP, and to manage the subsequent development, approval, procurement, award and contract management elements, while ensuring transparency (OECD, 2018[79]). This implies that PPPs should be used primarily by larger cities and regional jurisdictions that are more likely to have the fiscal and institutional capacities needed to manage them, under certain conditions, and framed by strict control mechanisms. In addition, PPPs should not be "off-budget" (i.e. when costs and revenues are not included in subnational budgets) nor should they be adopted only to attract finance, as other mechanisms may be available (e.g. bond issuance and loans from multi-lateral development banks).

Subnational governments should consider PPPs if gains from these factors outweigh the costs of private finance and risks associated with such partnerships, such as the ones mentioned above, and offer significant value for money (OECD, 2021[80]). Moreover, they should primarily be directed towards large-scale projects in priority infrastructure sectors.

In general, PPPs are not appropriate for small projects, which, despite their appeal to local governments, do not necessarily represent value for money. Moreover, small PPP projects do not necessarily portend small liabilities, underscoring the need to also consider the full extent of contingent liabilities created through guarantees to PPP projects (OECD, 2022[73]). In addition, small PPPs are not always commercially viable. To overcome this challenge, some countries have introduced provisions for bundling PPPs across sectors or jurisdictions to encourage economies of scale or attract operators (Box 5.13).

Box 5.13. Example of bundling subnational public-private partnerships

A practice highlighted by PPP practitioners is the bundling of smaller projects into larger ones in order to improve scale and viability thus making them more attractive to larger players in infrastructure, and enabling better financing options, including PPPs. In some cases, governments in multiple jurisdictions are involved. An example of bundling is the programme designed by the Pennsylvania Department of Transportation that aggregated the construction and maintenance of a few hundred small bridges into a single PPP project under its old bridges rehabilitation programme. This helped manage the limited viability of individual PPP projects given that the average cost of the individual bridges was as low as approximately USD 2 million.

Source: Author's elaboration, based on (OECD, 2021[71]).

In Wales, the Mutual Investment Model (MIM) is an example of how to set up a PPP to support subnational investment. In a MIMs, the Welsh government pays a fee to the private partner to cover the cost of the project's construction, maintenance and financing. In return, the Welsh government becomes a direct investor in the project, able to take an equity stake of up to 20% in the holding company established to deliver the project and to appoint a director to the holding company's board. At the end of the contract, the asset is transferred into public ownership (OECD, 2020[4]).

Though not technically a PPP, Ukraine could draw inspiration from the Scottish Futures Trust (SFT). This initiative provides an interesting example for strengthening local governments' capacity and expertise in the fields of investment financing and implementation. The SFT works with Scottish local authorities to reinforce capacity by transferring knowledge and carrying out independent expert reviews at various stages of investment projects. In particular, the SFT's "Hub" programmes seek to improve the planning, procurement and delivery of smaller public infrastructure projects that support community services across Scotland. It operates through joint venture arrangements between local public sector organisations and the private sector in each territory. Their objective is to increase efficiency and reduce the cost of building community infrastructure.

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Notes

[1] The Budget Code of Ukraine defines subventions as inter-governmental transfers of funds to be used for specific purposes through procedures defined by the authority that decides to provide the subvention (Verkhovna Rada, 2021[81]).

[2] Exceptionally, during the winter of 2021-2022, municipalities received 64% of PIT to ensure that they could cover utility covers (Verkhovna Rada, 2022[15]).

[3] The convergence effect was measured as the total revenue of the poorest cohort of each level of subnational government, as a share of the total revenue of the wealthiest cohort of the same level.

[4] These figures exclude grants and subventions for which no funding was allocated in a given year.

[5] When calculating the per capita investment spending as a share of total expenditure, social welfare transfers, over which subnational governments have little control, were excluded.

[6] In 2018, Ukraine adhered to the OECD's *Recommendation of the Council on Effective Public Investment across Levels of Government* (OECD, 2014[9]).

Annex 5.A. Regional and local development subventions

Annex Box 5.A.1. Subvention for the Implementation of Measures aimed at the Development of the Healthcare System in Rural Areas

The Subvention for the Implementation of Measures Aimed at the Development of the Healthcare System in Rural Areas ("Rural Healthcare Subvention") is a competitive, regional and local development grant that is managed by MinRegion. Launched in 2017, its annual spending has fluctuated, from a high of UAH four billion in 2017 to a low of UAH one billion in 2018-2019. The rural healthcare subvention is the only large grant (over UAH five billion) that is aimed solely at developing healthcare at the subnational level, although healthcare also falls within the Socio-economic Subvention's cross-sectoral remit.

Funds from the Rural Healthcare Subvention are allocated for the development of the healthcare system in rural areas. This includes action such as including: 1) construction or modernisation of public health facilities; 2) purchases of medical equipment; 3) development of telecommunications infrastructure (including broadband and IT systems for electronic healthcare and telemedicine); and 4) housing and vehicles for medical workers. The grant is open to *oblast* state administrations, which submit proposals in consultation with municipalities. Projects are selected by a commission chaired by MinRegion and that includes representatives from the Ministry of Health. The commission selects projects based on their compliance with the priorities of state health policies and the specifications of the grant.

Key pre-conditions for receiving the grant include: a) that the realisation of proposed projects should take no longer than four years; b) that the needs of persons with disabilities and other low-mobility groups should be taken into account in the proposal; and c) that projects are subject to co-financing of at least 10% from local budgets (except for purchases of official vehicles for public health workers in rural areas). After projects have been selected by the commission, MinRegion distributes the funds to *oblast* state administrations, which in turn distribute them to municipalities.

Source: Author's elaboration, based on (CabMin, 2017[38]).

Annex Box 5.A.2. Local Infrastructure Subvention

The Subvention from the State Budget to Local Budgets for the Formation of Infrastructure of Local Hromadas (Local Infrastructure Subvention) was a non-competitive, regional and local development fund managed by the MinRegion. It was launched in 2016 and annual spending rose steadily in subsequent years, from under UAH one billion in 2016 to over UAH two billion in 2019, before the fund was scrapped in 2020 due to COVID-19 budget cuts. It is the only major grant (over UAH five billion during the 2015-2019 period) to date in Ukraine that has exclusively targeted the municipal level of government.

The Local Infrastructure Subvention was intended to fund projects contributing to the formation and development of communal property infrastructure, specifically: 1) establishing and modernising administrative service centres; 2) building or upgrading streets, roads, bridges; 3) building or modernising water supply and sewage facilities; 4) purchasing vehicles for transporting educational institutions; 5) purchasing special purpose vehicles for fire, rescue and medical institutions; 6) refitting buildings with energy efficient technologies; and 7) modern community management technologies.

The Local Infrastructure Subvention was non-competitive, however, only amalgamated municipalities were eligible. To apply for the fund, municipalities had to first submit project applications to *oblast* state administrations, who would issue an opinion on the compliance of the proposals with the grant's objectives. Following this, a MinRegion commission would review the proposals for compliance with requirements. They would either approve it or provide comments to be addressed by municipalities before resubmission. Funding allocations were made according to a formula that took into account both the population and territory of individual municipalities. After a list of proposals had been approved, the funds would be paid out directly by MinRegion to the municipalities.

Source: Author's elaboration, based on (CabMin, 2016[39]; U-LEAD, forthcoming[1]).

Annex Box 5.A.3. Socio-Economic Subvention

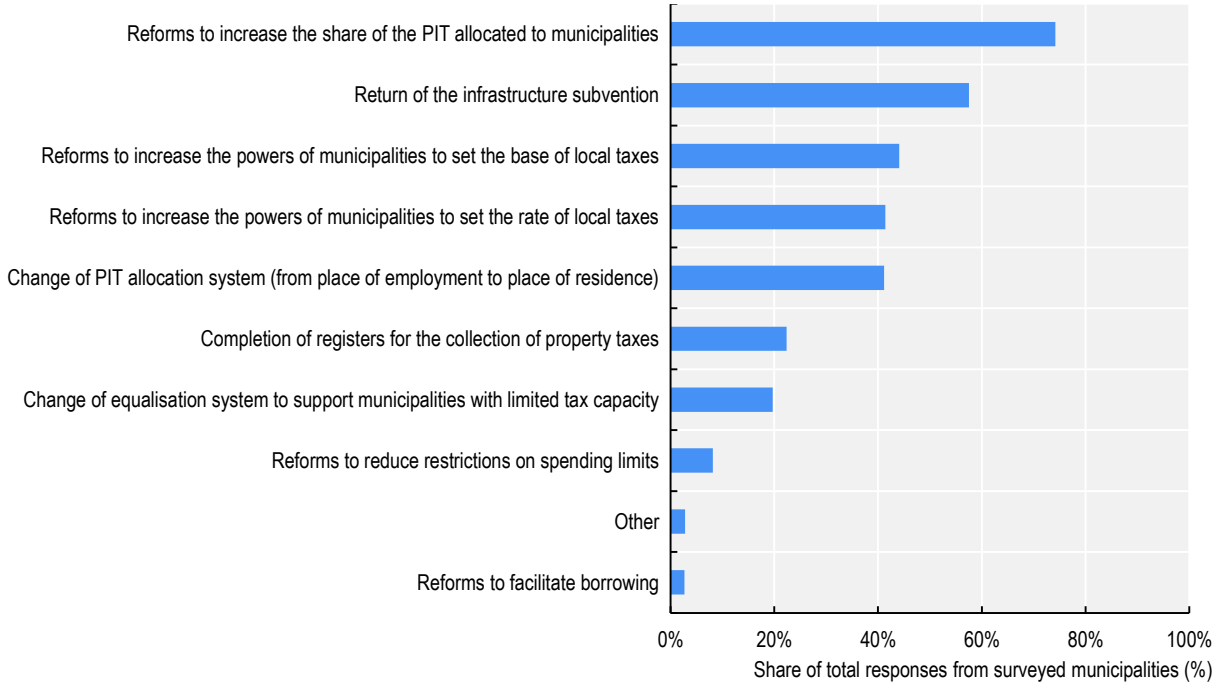
The Subvention for the Implementation of Measures for Socio-economic Development of Certain Territories (socio-economic subvention) is a competitive, regional and local development grant managed by MinFin. It was launched in 2012 and annual spending in subsequent years has fluctuated significantly, from a low of UAH 700 million in 2015 to a high of UAH 6.2 billion in 2017. Overall, between 2015-2019 spending on the socio-economic subvention was broadly comparable to spending on the State Fund for Regional Development (UAH 17.7 billion compared with UAH 17.4 billion respectively).

The socio-economic subvention is allocated for the implementation of measures designed to promote socio-economic development at the subnational level in Ukraine. The grant is open to *oblast* state administrations, which submit proposals in consultation with municipalities. Projects are selected by a commission consisting of members of parliament (MPs) of the Verkhovna Rada Budget Committee, as well as representatives from MinFin. By law, at least 50% of the commission's membership must be comprised of Budget Committee MPs.

Source: Author's elaboration, based on (CabMin, 2012[36]).

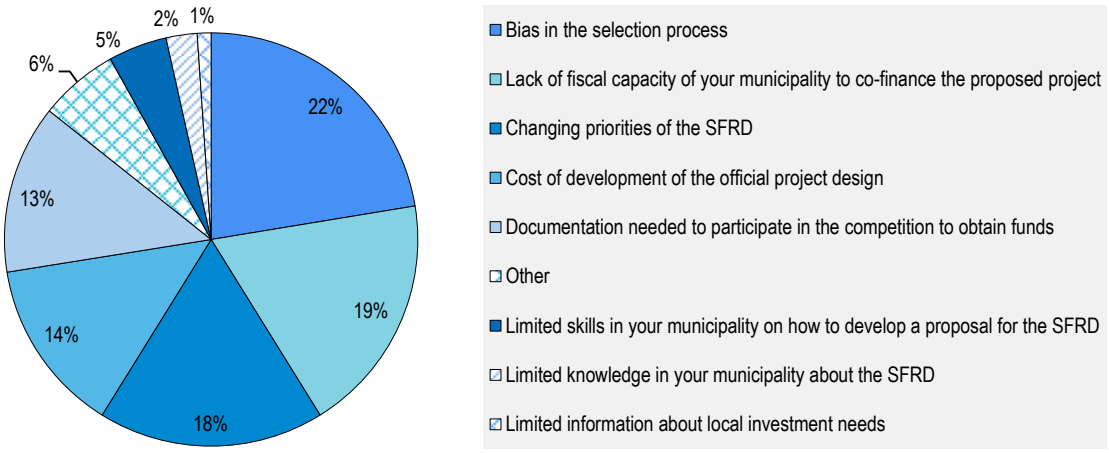
Annex 5.B. Results from the OECD survey

Annex Figure 5.B.1. Urgent areas of reform in the field of subnational finance and investment



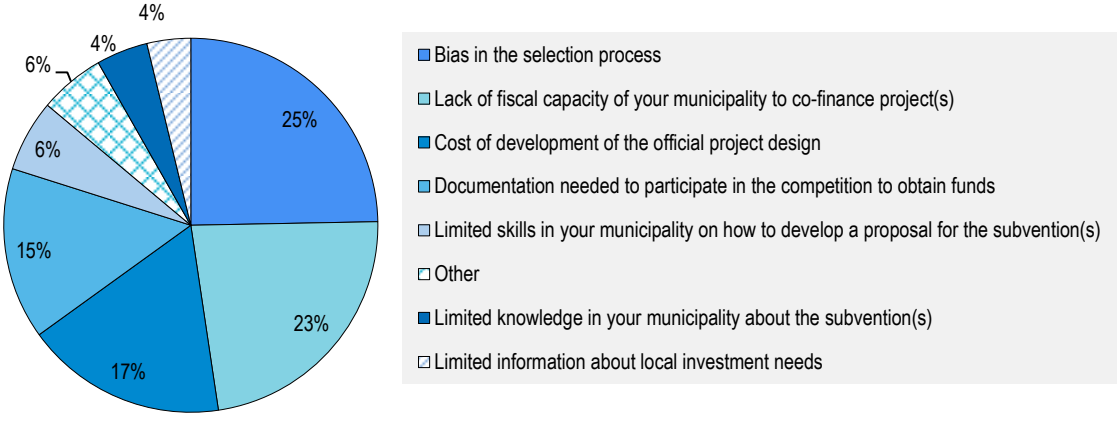
Note: Question: Which of the following areas of reform related to subnational finance and investment do you consider most urgent? You can select more than one option. Response options: Reforms/revisions to facilitate borrowing; Reforms/revisions to reduce restrictions on spending limits; Reforms/revisions to the equalisation system to increase support to those municipalities that have a limited tax capacity; Completion of registers for the collection of property taxes; Reform to change the PIT allocation mechanism from the place of employment to the place of residence; Tax reforms/revisions to increase the powers of municipalities to set the tax rate of local taxes; Tax reforms/revisions to increase the powers of municipalities to set the tax base of local taxes; Return of the infrastructure subvention; Reforms to increase the share of the PIT allocated to municipalities; Other. The questionnaire was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

Annex Figure 5.B.2. Main challenge to receiving funding through the SFRD



Note: Question: What do you think is the main challenge or obstacle to receiving funding through the State Fund for Regional Development? Please select only one option. Response options: Limited knowledge in your municipal government about the SFRD; Changing priorities of the SFRD; Limited skills in your municipal government on how to develop a proposal for the SFRD; Cost of development of the official project design; Documentation needed to participate in the competition to obtain funds; Limited information about local investment needs; Lack of fiscal capacity of your municipality to co-finance the proposed project; Bias in the selection process; Other. The questionnaire was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

Annex Figure 5.B.3. Main challenge to receiving funding through subventions from sources other than the SFRD



Note: Question: What do you think is the main challenge or obstacle to receiving funding through subventions from sources other than the State Fund for Regional Development? Please select only one option. Response options: Bias in the selection process; Lack of fiscal capacity of your municipality to co-finance project(s); Cost of development of the official project design; Documentation needed to participate in the competition to obtain funds; Limited skills in your municipality on how to develop a proposal for the subvention(s); Limited knowledge in your municipality about the subvention(s); Limited information about local investment needs; Other. The questionnaire was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

Part II Making the most of decentralisation for post-war recovery

6 Advances in Ukraine's decentralisation reform process since 2014

This chapter explores advances in Ukraine's decentralisation reform between 2014 and Russia's large-scale aggression in February 2022. First, it provides a recap of developments as part of the country's efforts to strengthen local self-governments, improve public service delivery and strengthen local democracy during the period. Second, it considers the challenges that have arisen during the reform process, including the discrepancies in existing legislation regarding the tasks of different levels of government, as well as the need to strengthen multi-level governance arrangements, and improve municipal fiscal and administrative capacity. Lastly, it reflects on how the government can leverage the success of the decentralisation reforms in the forthcoming post-war period, in order to support place-based recovery and improve local well-being in all territories.

Introduction

By February 2022, when the Russian Federation launched its large-scale invasion of Ukraine, the Government of Ukraine had made significant progress towards consolidating key elements of its territorial and decentralisation reforms. Starting in 2014, the government passed a large array of laws with wide-reaching implications for the country's territorial-administrative structure and which advanced administrative, fiscal and political decentralisation. In particular, the administrative and fiscal capacity of amalgamated municipalities was strengthened and municipal leaders were further empowered to directly support the development of their local communities.

As a result of the reforms, many municipalities reported improvement in the quality of local public services by 2021 (e.g. administrative services and education), alongside a consolidation of their administrative capacity. These advances, which were achieved despite the absence of a constitutional amendment to institutionalise the adjusted government structures, are highly relevant in the context of the current war. They have provided municipalities with experience, tools and skills to meet the challenges of the war, and positioned them to more effectively support place-based reconstruction and recovery in the medium to long term.

Building on earlier findings from the OECD's 2018 report *Maintaining the Momentum of Decentralisation in Ukraine*, this chapter briefly discusses the main developments in Ukraine's decentralisation reform process since 2018. Subsequently, it highlights challenges to the reform process in greater detail, and explores how these challenges may affect the current war effort and future reconstruction and recovery initiatives. In particular, it considers the legislative discrepancies in the assignment of tasks and responsibilities among different levels of subnational government, as well as institutional and economic challenges that stem from the decentralisation reforms. It also addresses the need to further update legislation pertaining to local democracy and accountability. The chapter concludes with a set of recommendations to place the current territorial-administrative structure and decentralisation reforms on a more solid footing in the post-war context.

Box 6.1. Recommendations to strengthen institutional capacity at the subnational level in Ukraine

The following recommendations should be considered in a timeframe that is appropriate to the current context of war and post-war reconstruction and recovery.

To improve the oversight of amalgamated municipalities, Ukraine is advised to:

- Adopt amendments to reinforce municipal oversight, for example by:
  - Adopting a constitutional amendment[1] that replaces *oblast* and *rayon* state administrations with a system of prefects, in order to provide local administrative supervision and facilitate the co-ordination of national-level priorities at the local level, or:
  - Amending the Law "On Local State Administrations" to circumscribe the function of *Rayon* State Authorities as being related to local administrative supervision (*a posteriori*) and the co-ordination of national-level priorities at the district level.
- Specify, in either case, that while the oversight entity has the power to appeal suspected legal violations by municipalities in court, municipal laws can only be suspended and/or annulled by court ruling.
- Verify that appointments are made on the basis of a competitive and transparent selection process.

To strike a better balance in territorial reform and ensure the conditions for successful decentralisation, Ukraine is advised to:

- Harmonise the legislative framework to remove duplication and provide clarity on the allocation of responsibilities in sectors where it is lacking (e.g. public transport and roads).

To further strengthen vertical and horizontal co-ordination mechanisms, Ukraine is advised to:

- Reinforce the Congress of Local and Regional Authorities through the creation of a separate municipal chamber, and ensure a transparent and equitable process that enables municipalities to participate on a rotating basis.
- Reinforce the Inter-Departmental Co-ordination Commission for Regional Development by granting municipalities a permanent seat in its official sessions.
- Consider creating a national conference of local government associations, in order to improve the strength and coherence of municipal lobbying and advocacy at central government level.

To consolidate subnational strategic planning capacity, Ukraine is advised to:

- Develop and implement training modules on areas of local administrative performance where municipalities are lagging (e.g. citizen engagement, performance monitoring).
- Support national and international peer-to-peer exchanges between municipalities on issues of local administrative performance, in order to promote the sharing of best practices, innovative methodologies, etc. The support provided through these exchanges should be equitably spread among different types of municipalities (rural, settlement urban), and have built-in dissemination mechanisms to ensure that relevant knowledge, practices and tools are being shared more widely.

To strengthen subnational human resource capacity, Ukraine is advised to:

- Develop and periodically update a subnational strategy for human resource management, including an expanded list of standardised training programmes with improved mechanisms for quality control of teaching content.
- Conduct local needs assessments and encourage municipalities to prepare training plans based on those assessments.
- Amend the Law "On Service in Local Self-government" to require local civil servants to be politically neutral and to ensure open and merit-based recruitment and performance management, while also setting out effective mechanisms for professional development.
- Harmonise the remuneration of national and local civil servants in order to improve the recruitment and retention of skilled staff by municipalities.

To improve subnational fiscal and investment capacity, Ukraine is advised to:

- Ensure that poorer municipalities and those with limited technical and financial capacities can compete with their wealthier and more capacitated peers for regional development funding, for example by:
  - Linking co-funding requirements to the fiscal capacity of municipalities.
  - Providing municipalities with more clarity on eligibility criteria.
  - Boosting their technical skills to develop competitive proposals.
  - Promoting the development of joint project proposals (i.e. by multiple municipalities). This can help them to pool resources and address shared development challenges.

To increase the uptake of inter-municipal co-operation arrangements, Ukraine is advised to:

- Provide municipalities with additional support materials on inter-municipal co-operation (e.g. on relevant legislation, good practices, draft co-operation agreements, etc.).
- Develop guidance for municipalities on how to set up and manage inter-municipal co-operation, particularly in sectors where uptake has been weaker in the past.
- Integrate this guidance into the official decentralization.gov.ua portal, in order to enable municipalities to better familiarise themselves with inter-municipal co-operation and identify its benefits and challenges.
- Encourage or even temporarily require increased inter-municipal co-operation whereby subnational governments share staff and expertise or the provision of services.

To strengthen the capacity of municipalities to support local business, competitiveness and job creation, Ukraine is advised to:

- Provide guidance to municipalities on the policy options available to them to stimulate local economic development and to reduce the administrative burden on businesses.
- Develop training modules for municipalities on aspects of local governance that require effective engagement with the local private sector (e.g. identifying investment needs or co-designing local investment projects).
- Create new or modify existing regional development subventions[2] to facilitate the implementation of projects to support small and medium-sized enterprises.
- Provide capacity building support to municipalities on how to develop and manage local public-private partnerships.

To strengthen local democracy and accountability, Ukraine is recommended to:

- Amend the Electoral Code to allow citizens living abroad temporarily to vote in local elections.
- Develop clear standards for *starosta* performance and training modules on their core functions.
- Consider increasing the basic salary of *starostas* to align financial incentives with their expected performance.

Brief overview of decentralisation developments and reforms

The vision guiding Ukraine's amalgamation and decentralisation process was originally set out in the 2014 "Concept of Reforming Local Self-Government and Territorial Organisation of Power", which called for a number of territorial challenges to be addressed. These included an adjustment to the high number of local councils (more than 10 000), many of which had small populations and lacked the administrative and/or financial capacity to fulfil their tasks and responsibilities effectively; local-level spending characterised by strong deconcentration and limited decentralisation; and a heavy reliance on central government transfers, due in part to a lack of municipal own-source revenues (CabMin, 2014[1]).

In response to these challenges, the Concept set objectives for broad political, administrative and territorial restructuring by:

- Altering the political power structures at the *oblast* and *rayon* government levels to make room for stronger democratic governance;
- Differentiating mandates and supporting decentralised administration and public service delivery by municipalities;
- Simplifying the territorial administrative structure into three subnational tiers, with only one category of local self-government units;
- Clarifying and adjusting the responsibilities assigned to each level of government (OECD, 2018[2]).

The Concept Framework has served as the foundation for all subsequent decentralisation reforms, including those related to the amalgamation of local self-governments. Key legislative steps in the reform process included the adoption of the Law "On Co-operation of Territorial Communities", the Law "On Voluntary Amalgamation of Territorial Municipalities", and amendments to the Budget Code of Ukraine (Table 6.1).

Table 6.1. Overview of key laws governing decentralisation reform in Ukraine

Law	Key elements
2014 Law "On Co-operation of Territorial Communities"	This law allows municipalities to co-operate with one another on a formal basis with a view to: a) supporting the social, economic and cultural development of their territories, and b) enhancing the quality of services provided.
2015 Law "On Voluntary Amalgamation of Territorial Municipalities"	The 2015 law established the right of small cities, villages and rural communities to amalgamate on a voluntary basis. 2020 amendments to the law suspended the voluntary principle, and gave the Cabinet of Ministers new powers to merge municipalities.
Amendments to the Budget Code of Ukraine	The 2016 Amendments to the Budget Code made amalgamated municipalities eligible to receive 60% of the Personal Income Tax (PIT) revenues that were levied on their territory, and allowed them to enter into direct budget negotiations with *oblasts* (while bypassing the *rayon* level).
2020 Law "On Amendments to Certain Laws of Ukraine on Streamlining Certain Issues Regarding the Organisation and Activity of Local Self-government Bodies and District State Administrations"	The 2020 law ordered the transfer of public property held by *rayons* to the communal ownership of municipalities.

2020 Resolution "On the Formation and Liquidation of *Rayons*"	The Resolution reduced the number of *rayons* from 490 to 136.
Amendments to the Law "On Local Self-Government"	Amendments to the Law since 2015 have progressively reassigned key responsibilities away from *rayons* to municipalities, in areas such as healthcare and education (although most healthcare financing was recentralised in 2017).

Source: Author's elaboration, based on (Verkhovna Rada, 2014[3]; Verkhovna Rada, 2015[4]; OECD, 2018[2]; Verkhovna Rada, 2020[5]; Verkhovna Rada, 2020[6]; WHO, 2021[7]).

Amalgamation in two stages: voluntary and mandatory

In the first stage of the amalgamation process (between 2015 and 2020), municipal mergers took place on a voluntary basis. Following the passage of the 2015 Law "On Voluntary Amalgamation of Territorial Municipalities", most municipalities were afforded the right to amalgamate (merge) with one another (with the exception of cities of *oblast* significance, which received the same rights following amendments to the law in 2018 (Verkhovna Rada, 2015[4]). In addition, financial incentives to amalgamate were provided in the form of expanded own-source revenues, the right to negotiate annual municipal budgets with the *oblast* state administration, and access to regional development funding through the State Fund for Regional Development (SFRD) (OECD, 2018[2]). Amalgamated municipalities also received budget transfers directly from the state budget, avoiding the *rayon* level, and were eligible to receive funds from the Local Infrastructure Subvention. While the reforms led to a large number of voluntary municipal mergers—with over 4 882 municipalities merging to form 1 070 amalgamated municipalities by mid-2020—a minority of municipalities did not voluntarily elect to do so (CabMin, n.d.[8]; Vox Ukraine, 2020[9]). Reasons for this included a lack of understanding by some local leaders of the potential benefits of amalgamation, challenges faced by leaders in convincing neighbouring municipalities of these benefits, as well as local leaders' fears of losing influence in their communities (OECD, 2021[10]).

The result was a second, mandatory stage of amalgamation. A 2020 Amendment to the Law "On Voluntary Amalgamation of Territorial Municipalities" superseded the principle of voluntary association by giving the Cabinet of Ministers (CabMin) the power to form amalgamated territorial communities in all regions of the country (Verkhovna Rada, 2015[4]). In June 2020, on the basis of this law, the CabMin issued 24 orders (one for each region) to approve the creation of 1 469 amalgamated municipalities throughout the country. This included municipalities that had voluntarily merged prior to 2020 (Table 6.2) (CabMin, 2020[11]).

Table 6.2. Administrative units at the subnational level in Ukraine, 2017-2021

Tier/level of subnational government		Administrative unit	Number of units	
			2017	2021
First tier	Regional	*Oblasts*	24	24
		Autonomous Republic of Crimea	1	1
		Cities (Kyiv & Sevastopol)	2	2
Second tier	Intermediate	*Rayons* (districts)	490	136
		Cities of *oblast* significance	186	-
Third tier	Self-governments	Amalgamated municipalities	665	1 469
		Other cities (of *rayon* significance)	235	-
		Other (rural, urban and district councils)	10 000+	-

Source: Author's elaboration with data from (CabMin, 2021[12]; OECD/UCLG, 2022[13]).

Amalgamation as a platform for political, administrative and fiscal decentralisation

Ukraine's voluntary municipal amalgamation process had a series of built-in incentives revolving around political, administrative and fiscal decentralisation[3]. This resulted in reported improvements in the quality

of local democracy, administrative and public services delivered by municipalities, and an increase in their budget capacities (Freedom House, 2022[14]; Chatham House, 2019[15]; DESPRO, 2021[16]). It also led to some unforeseen challenges, such as an exacerbation of territorial inequalities.

Political decentralisation strengthened local democracy and accountability in Ukraine

One objective of Ukraine's decentralisation reform was stronger local democracy and greater accountability to citizens by subnational governments. In order to harmonise the election cycle, following the creation of the 1 469 amalgamated municipalities a first and then second round of local elections were held in October and November 2020 in all amalgamated municipalities (OSCE, 2021[17]). Local democracy was then bolstered by different amendments to the Electoral Code in December 2019 that simplified electoral voting and registration. For example, they allowed unregistered voters to vote in a community's local election, as long as they proved residence in the locality at the time of voting (UNDP, 2019[18]).

Local accountability was consolidated by further institutionalising the *starosta*. *Starostas* are local community officials that represent the interests of residents of so-called *starosta* districts (districts consisting of at least 500 inhabitants) in the municipal council and for liaising among them (Verkhovna Rada, 2021[19]). While *starostas* were previously elected by citizens, the rules were changed in 2020 requiring them to be appointed by the municipal council. At the same time, an element of local democracy is preserved in the current appointment process, as any *starosta* candidate must first be nominated by a certain percentage of the local resident population (the exact percentage depends on the size of the municipality). *Starostas* are responsible for a number of tasks, such as participating in the preparation of proposals for the draft local budget and providing administrative services. The type and number of administrative services is determined by the local council and depends, among other elements, on the *starosta's* experience and qualifications, as well as on whether the municipality has an administrative service centre. Examples of administrative services include registration of place of residence, birth, death and marriage. In the context of Russia's war against Ukraine, *starostas* have also started providing services for internally displaced persons (Zamfir, 2022[20]). In addition, *starostas* monitor local development projects and the use of public property and provide periodic reports on these issues to the local council. In October 2021, the government made the presence of *starostas* in all municipalities mandatory (Verkhovna Rada, 2021[19]). Amendments to the Law "On the Development of the Institute of *Starostas*" in 2021 increased the rank of *starostas* within the local government hierarchy. The law also enabled them to serve on local executive committees if approved by local council members, as a means to improve the accountability of local decision-making (Verkhovna Rada, 2021[21]).

Administrative decentralisation focused on improving service quality and access

The administrative decentralisation process included transferring responsibility for key public services—such as administrative services, education and health—from the *rayon* level of government to newly amalgamated municipalities. Municipalities that chose to amalgamate moved from being primarily executors of central administration policy to local self-government units responsible for managing, maintaining and financing infrastructure, and a wide range of local public services. These included all levels of education, primary, secondary and tertiary healthcare[4], social services, waste, water and sanitation management, cultural institutions, public safety services (e.g. fire departments) and local public housing (Verkhovna Rada, 2021[19]).

In addition, several administrative tasks were delegated to municipalities including the registration of businesses, property or residence, and passport issuance and renewals (Verkhovna Rada, 2020[22]). This was accomplished by introducing administrative service centres (ASCs) in municipalities across the country. The result was a simplification of administrative transactions by creating a space for citizens to manage these services in their municipality. Prior to the ASCs, many people needed to travel long

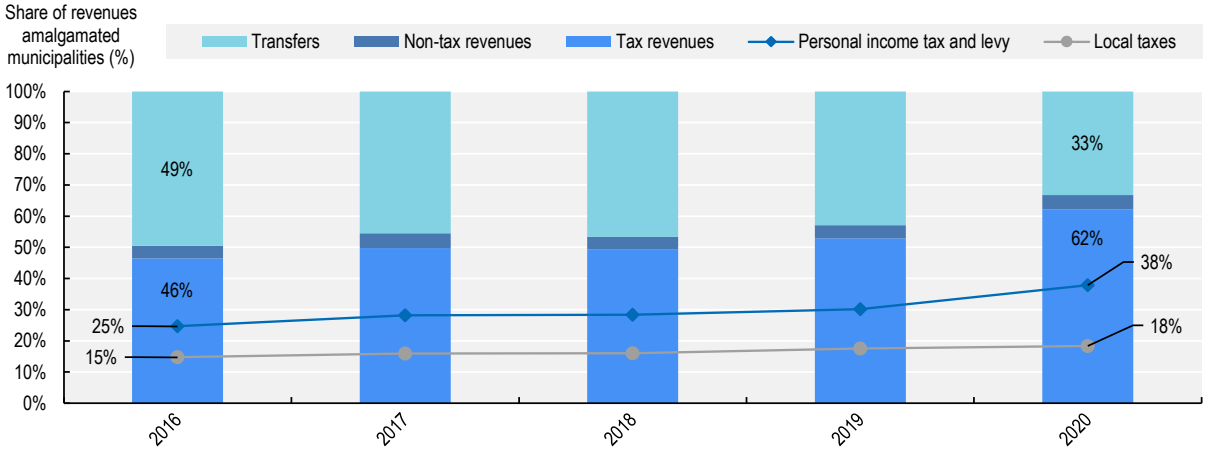
distances to regional hubs in order to accomplish the same tasks. Prior to Russia's war in Ukraine, the intention was to have an ASC in each municipality by 2024 (OECD, 2021[10]).

To further encourage administrative decentralisation and support municipalities in their need for administrative infrastructure, the decentralisation reform transferred objects of common property, which were previously held by *rayon* state administrations, to the communal ownership of municipalities, per the 2020 Law "On Amendments to Certain Laws of Ukraine on Streamlining Certain Issues of Regarding the Organisation and Activity of Local Self-government Bodies and District State Administrations". This transfer of local state property served to align communal ownership with the current municipal responsibilities for local infrastructure maintenance (Verkhovna Rada, 2020[5]).

Fiscal decentralisation increased local budgets, as well as local spending

Between 2016 and 2020, in nominal terms, local revenues increased substantially from just over UAH 7 billion in 2016 to over UAH 86 billion in 2020 (UAH 51.5 billion, when correcting for inflation) (CabMin, 2021[23]; World Bank, 2021[24]). Over this five-year period, the breakdown of municipal revenues changed substantially, with tax revenues becoming a growing share of municipal income, and intergovernmental transfers representing a reduced share. This reflects the fact that, as part of 2016 amendments to the Budget Code, amalgamated municipalities were rewarded with a 60% share of locally-levied PIT. A large part of the reduction in the share of intergovernmental transfers to total municipal revenues came between 2019 and 2020 (from 43% to 33%) (CabMin, 2021[23]; OECD, 2022[25]). This reflected the government's decision to cut the size of several regional and local development funds, including the SFRD, to create the COVID Stabilisation Fund, as well as to changes in the mechanisms for funding healthcare and social services. Since 2019, a significant share of expenditures in both areas has been funded directly from the national budget.

Figure 6.1. Components of municipal revenue, 2016-2020



Note: The table presents disaggregated local revenue data for amalgamated municipalities over the 2016-2020 period. No information on non-amalgamated local self-governments was available. The table excludes sources of revenues that contributed less than 1% of total subnational revenues. Besides PIT and local taxes, the category "tax revenues" includes: rent and payment for the use of other natural resources; internal taxes on goods and services; separate taxes and fees credited to local budgets; and other taxes and levies.
Source: Author's elaboration, based on information provided by (CabMin, 2021[23]).

In 2020, Personal Income Tax (PIT), which is shared among the central government, *oblasts* and municipalities, made up 38% of total municipal revenues (up from 25% in 2016) (CabMin, 2021[23]). Between 2016 and 2020, there was only a modest increase in the share of local taxes as part of total

municipal revenues: from 15% in 2016 to 18% in 2020. In 2020, PIT, subventions and local taxes (e.g. property tax, tourist tax and certain user charges and fees) were the three most important sources of municipal revenue.

Decentralisation reforms not only generated an increase in local revenue, they also increased local expenditures, given the assignment of new responsibilities, as presented in the previous section. Local expenditures of amalgamated municipalities increased significantly in nominal terms between 2016-2020, from just over UAH 6 billion in 2016 to nearly UAH 87 billion in 2020 (UAH 51.9 billion, when controlling for inflation) (CabMin, 2021[23]; World Bank, 2021[24]). During this period, the number of amalgamated municipalities also increased drastically, which may account for part of the rise in expenditure.

Unlike local revenues, however, the composition of local expenditures did not change much over time (Table 6.3). Education has remained by far the largest component of local expenditures, accounting for over half of municipal spending (53%) in 2020 (CabMin, 2021[23]). This reflects both the importance placed on education throughout the reform process and the increased responsibilities attributed to municipalities for its provision. Municipalities are responsible for delivering primary, secondary, vocational and higher education services, including the maintenance of educational institutions through their local budgets and paying teachers under the educational subvention provided by the government (Ministry of Education, 2022[26]). Regarding higher education at the municipal level, expenditures only include payments for the training of specialists, scientific and scientific-pedagogical staff of higher education institutions established by municipal councils. Other important components of expenditure in 2020 included general public services (16%), economic affairs (10%) and utilities (8%), the latter two both decreased in the same period (CabMin, 2021[23]).

Table 6.3. Municipal expenditures by functional classification, 2016-2020

Functional expenditures	2016		2020		
	UAH billion	Share of total expenditure	UAH billion	UAH billion, corrected for inflation	Share of total expenditure
General public services	0.7	12%	13.9	8.3	16%
Defense	0.0	0%	0.0	0.0	0%
Public order, safety and judiciary	0.0	1%	0.4	0.3	1%
Economic affairs	0.9	15%	9.0	5.4	10%
Environmental protection	0.0	0%	0.3	0.2	0%
Utilities	0.5	9%	6.8	4.1	8%
Health	0.3	5%	3.9	2.3	5%
Recreation, culture and religion	0.3	5%	3.9	2.3	5%
Education	2.9	48%	46.1	27.5	53%
Social protection and security	0.3	5%	2.6	1.5	3%
Total	6.0	100%	87.0	51.9	100%

Note: The table presents disaggregated local revenue data for amalgamated municipalities over the 2016-2020 period. No information on non-amalgamated local self-governments was available.
Source: Author's elaboration with data provided by (CabMin, 2021[23]; World Bank, 2021[24]).

When assessing expenditures of amalgamated municipalities by economic classification for the period between 2016 and 2020, important changes can be identified. The most significant increase has been in the share of remuneration and payroll expenditures as part of total municipal expenditures; from 43% in 2016 to 59% in 2020. Conversely, share of capital expenses declined from 31% to 15% over the period (CabMin, 2021[23]). This likely reflects the fact that the national minimum wage increased annually over the period, without a commensurate increase in the revenue-raising capacity of municipalities or in the

education subvention to cover teacher salaries, which put a substantial strain on the financial resources of municipalities (SKL International, 2019[27]).

Despite the advances and the unquestionable success of Ukraine's decentralisation reforms, a number of challenges remained at the start of the war, which are examined in the following sections. These centre around various aspects of the country's multi-level governance system, and include legal discrepancies in the assignment of tasks and responsibilities among the *rayon* and municipal levels of government. Furthermore, there is a need for greater co-ordination among levels of government, for example in dealing with overlapping assignments in areas such as the maintenance and construction of roads. Reinforcing vertical co-ordination is also necessary to ensure that municipalities are properly informed about relevant legislative and regulatory changes that may affect them, and can effectively communicate their needs and priorities to higher levels of government. Additional challenges include: the need for improved municipal planning; greater human resource, fiscal and investment capacity; a potential deepening of local inequalities; and the need to better support municipal economic development.

Addressing the tensions between *rayon* and municipal levels of government

Ukraine's amalgamation and decentralisation processes favoured the development of local self-government over that of the intermediate (*rayon*) level in order to fulfil the core aims of the decentralisation process. These included improving access to good-quality public services through a more optimal distribution of sub-national government powers, based on the principle of subsidiarity (CabMin, 2014[1]). Furthermore, the amalgamation and decentralisation reforms created territorially larger municipalities that are responsible for a core set of public services while empowering them to manage their own budgets, which was a clear break from the 2015 reforms (OECD, 2018[2]). Originally, the establishment of municipalities as local self-governments, the shift in responsibilities from *rayon* governments to municipal governments, and the system of territorial administration was to be enshrined in a constitutional amendment. Despite various attempts, however, the amendment has remained elusive. The impact is threefold there is a need to: i) manage legislative inconsistencies governing subnational government responsibilities; ii) address the question of how to ensure oversight of municipalities in a way that does not stifle local decision making processes; iii) resolve the open question as to the role of *rayon* state administrations as government units.

Managing legislative inconsistencies governing rayon versus municipal responsibilities

Today, there are inconsistencies between the Constitution of Ukraine and various pieces of legislation on the respective functions of municipalities and *rayon* state administrations. These inconsistencies present a risk not only to local democratic governance, but also to the functioning of government as a whole. A lack of clarity in the assignment of responsibilities could undermine the effective and efficient use of valuable resources supporting the war effort and in the subsequent recovery.

On the one hand, certain legislation grants municipalities broad powers and funding to directly manage service delivery tasks on behalf of their local communities. According to the Law "On Local Self-Government", municipalities are now responsible for the infrastructure and funding and financing of administrative services, education and healthcare, which were formerly under the remit of the *rayon* level (Verkhovna Rada, 2021[19]). Meanwhile, Budget Code amendments have transferred locally-levied PIT income and ownership of state property from *rayon* state administrations to municipalities, providing them with additional funding and assets with which to manage their new responsibilities (Verkhovna Rada, 2020[28]; Verkhovna Rada, 2020[5]). These laws drastically reduced the responsibilities and funding of *rayon* state administrations for delivering local public services.

On the other hand, the Constitution and the Law "On Local State Administrations" have not been updated since the decentralisation reform process began. Among other elements, the Constitution describes the general mandate and functioning of the different subnational government units (e.g. *oblasts, rayons*, cities, city districts, settlements and villages*)*, some of which have been subject to profound changes as part of the decentralisation reforms. The Law "On Local State Administrations", by contrast, specifies the general competences of *oblasts* and *rayons*, as well as their sectoral responsibilities. For example, the law indicates that *rayons* are responsible for socio-economic development in their territories, as well as for science, education, culture and healthcare, among other areas (Verkhovna Rada, 2021[29]). However, as indicated earlier, many of these tasks have been transferred from *rayons* to amalgamated municipalities through a series of legislative and regulatory reforms (Table 6.1). This legislative discrepancy undermines the local democratic governance principle that is set out in the Concept Framework, which presupposes, that a simplified territorial administrative structure should be based on subsidiarity and a clear assignment of responsibilities among levels of government.

Another area of legislative ambiguity is related to the legal status of local self-governments, and whether they have legal personality. Currently, legal personality is attributed to various local government institutions, and not to a local community per se, which puts Ukraine in contrast with many European countries (CoE, 2021[30]). The fact that municipalities do not possess explicit legal personality creates ambiguity about their status. There have been concerns that this could, for example, give way to the creation of "fake municipalities" to manipulate local state property, try collecting taxes, or more broadly, to promote destabilisation (Rabinovych, 2020[31]). At the same time, a 2021 report found that "there is apparently no major obstacle for guaranteeing the rights of citizens, the integrity of the local public property system, or against having functional budgets, although the conflicts of competences between institutions in the same municipality remain a possibility" (CoE, 2021[30]). There are, however, several potential benefits to granting municipalities legal personality through legislative reform. These include simplifying the relation between the local mayor and municipal council. Moreover, it could contribute to preventing the possible mismanagement of funds, as there would no longer be numerous legal persons within municipalities who may be looking after their own interests (CoE, 2021[30]).

The allocation of different tasks among levels of government should be further clarified

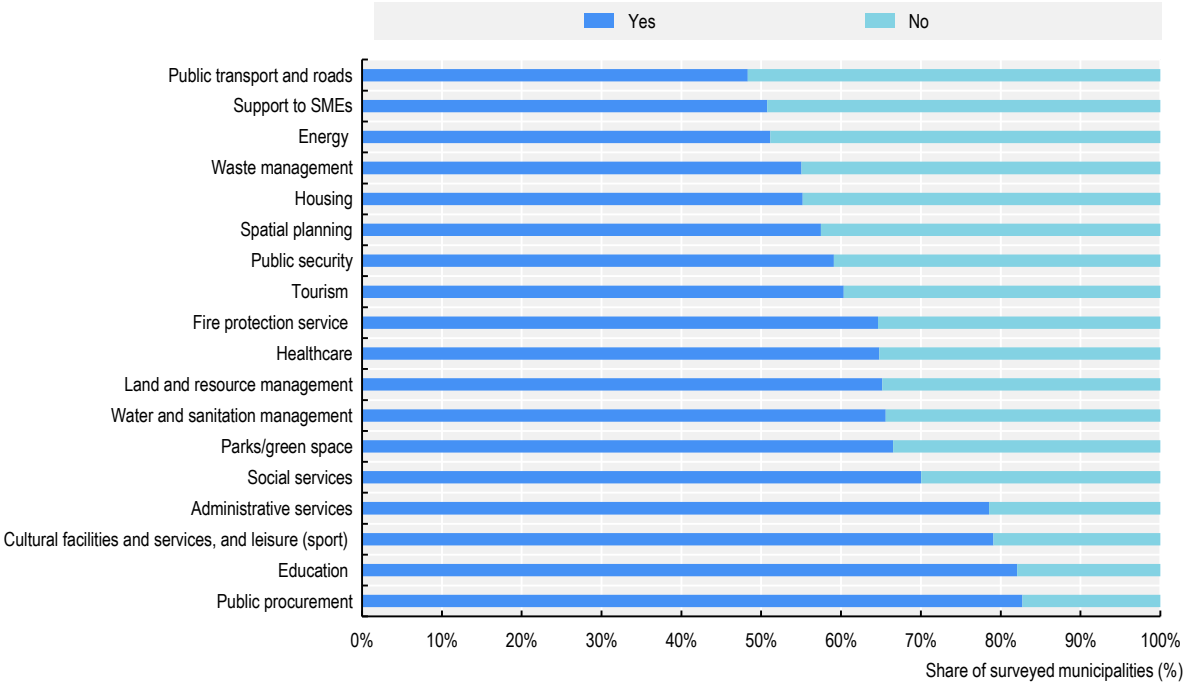
With the decentralisation reform, communities saw significant improvements in service delivery. In terms of administrative services, for example, 79% of municipalities that were surveyed by the OECD in 2021 reported an increase in local service quality since 2014 (OECD, 2021[32]). The investment in establishing ASCs throughout the country has been particularly relevant in the context of Russia's large-scale aggression in Ukraine, as the centres have demonstrated flexibility by taking on new tasks such as registering internally-displaced people, and co-ordinating humanitarian aid distribution (Prosto, 2022[33]).

A majority of surveyed municipalities also felt that the decentralisation reforms led to significant improvements in the quality of social services (71%) and education (70%) (OECD, 2021[32]). Since the transfer of social care responsibilities to local self-governments in 2019 and 2020, data from the Ministry of Social Policy indicate a significant rise in the number of smaller municipalities that are providing social care services for the elderly and families. This suggests that local access to social care has improved (OECD, 2021[10]; Verkhovna Rada, 2022[34]). Educational outcomes are reportedly better but remain more difficult to quantify. This is due to the challenges in identifying a direct link between the scores and grades of students in a particular municipality and the overall decentralisation process. Yet, results from the 2021 OECD survey of municipalities suggest that many amalgamated municipalities are satisfied with reform outcomes in this area. Indeed, 70% reported an increase in service quality since 2014 (OECD, 2021[10]).

Effective local service delivery also depends on sufficient clarity in the assignment of responsibilities among levels of government. A clear division of tasks enhances policy and service effectiveness, spending efficiency, and greater accountability (OECD, 2019[35]). Clarity in the assignment of responsibilities among

Ukraine's subnational governments has been elusive. For example, over 82% of the 741 municipalities surveyed by the OECD in 2021 reported that they have sufficient clarity in the division of tasks and responsibilities with other levels of government in the field of education (Figure 6.2). This high share reflects a relatively clear legal framework. The central government is a funding provider, regulator and standard-setter for education, as well as a source of capacity building support. Meanwhile, municipalities have the power to directly manage educational institutions (OECD, 2021[32]).

Figure 6.2. Clarity in the division of tasks among levels of government



Note: Question: Do you consider that there is clarity in the division of tasks and responsibilities in the following fields between your municipal government and other (local) governments: other municipal governments, *rayons*, *oblasts* and central government)? Full response options: Waste management; Water and sanitation management; Public procurement; Housing; Healthcare; Social services (e.g. support for families, children, elderly, etc.); Public transport and roads; Education; Cultural facilities and services, and leisure (sport); Tourism; Parks/green space; Public security; Fire protection service; Spatial planning; Land and resource management; Support to SMEs; Energy; Administrative services; Other. The questionnaire was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on responses to the OECD project survey.

In contrast to education, a majority of surveyed municipalities felt that clarity for responsibilities in public transport and roads was lacking. This reflects the sector's complex and overlapping legal framework. For example, the Law "On Roads" states that *oblast* state administrations are responsible for maintaining public roads of local importance, the Law "On Local Self-Government" maintains that such responsibility lies with municipalities, and the Law "On Local State Administrations" assigns this particular responsibility to the *rayon* level of government (Verkhovna Rada, 2021[36]; Verkhovna Rada, 2021[29]; Verkhovna Rada, 2021[37]). At best, the differences between the different laws can create uncertainty as to which level should act, for example in the construction or maintenance of local public roads. At worst, it undermines the effective delivery of public services and accountability as actors may avoid taking responsibility by "passing the buck" to other levels of government. It also risks contributing to inefficiency in service provision, for instance through a duplication of activities. Local road repairs will play a particularly prominent role in post-war reconstruction. As such, the government should urgently look to harmonise the legislative framework in order to provide clarity on the responsibilities of different levels of government and ensure an effective and efficient allocation of recovery funding. To assess and improve the effectiveness of the assignment of

responsibilities among levels of government, policy makers should consider applying a subsidiarity framework (see Chapter 2, Box 2.7). More specifically, Ukraine could be guided by article 4.3 of the European Charter of Local Self-Government, which stipulates that "[p]ublic responsibilities shall generally be exercised, in preference, by those authorities which are closest to the citizen. Allocation of responsibility to another authority should weigh up the extent and nature of the task and requirements of efficiency and economy" (COE, 1985[38]).

A key challenge that lawmakers identified early on in the decentralisation process was the lack of clarity regarding the way in which decisions by subnational governments in general, and municipalities in particular, would be overseen by higher levels of government. This is problematic given the vast increase in administrative and service delivery responsibilities of amalgamated municipalities. In addition, representatives from Ukraine's national and subnational levels of government, as well as non-governmental stakeholders signalled the importance of clarifying and updating the role of *oblast* and *rayon* levels of government (OECD, 2021[10]).

In order to address these challenges, in November 2021, the government prepared draft amendments to the Constitution that proposed replacing the o*blast* state administrations and the *rayon* state administrations by prefectures. The intention would be to appoint a prefect at the *Oblast* level, with sub-prefectures at the *Rayon* level, to oversee—not control—the legality of municipal decision making. At the same time, *Oblast* and *Rayon* councils would see their own executive committees, which are elected by the councils, empowered to execute council decisions in lieu of *oblast* and *rayon* state administrations, as is currently the case (Office of the President of Ukraine, 2021[39]). This would result in a shift from state administrations playing a direct territorial management role, as is currently stipulated in the Constitution, to a role focused on representing central government interests at a subnational level. This would ensure the legality of municipal decisions through legislative oversight and greater co-ordination among the various levels of government.

The constitutional amendments did not garner sufficient political support to be brought up for a vote prior to Russia's large-scale invasion of Ukraine, and any actual constitutional reform is banned while the country remains under martial law. However, the proposed prefecture system has acquired even greater salience in light of the war and forthcoming recovery period[5]. Ensuring oversight of municipalities and strengthening co-ordination among different levels of government will be particularly important given the expected vast inflow of recovery funding and pressure on municipalities to allocate resources swiftly, efficiently and effectively.

The proposed constitutional amendment would see Ukraine's territorial-administrative structure shift further away from a deconcentrated model to a mixed system that fuses elements of both deconcentration and decentralisation. In this regard, it would mirror, to some extent, the current system in France, where prefects are appointed by the President as heads of regions, and work together with democratically-elected regional and local councils. While the councils both adopt and execute decisions at regional and local levels, prefects are tasked with overseeing the legality of subnational decision-making and ensuring effective co-ordination between different levels of government.

Similar to France, the Constitutional reform proposed in 2021 in Ukraine would give prefects the power to appeal legal violations by subnational governments in court *a posteriori.* However, whereas under French law, only the courts can suspend or annul a subnational law, under Ukraine's proposed constitutional amendments, the prefect would have the power to temporarily suspend legislation that it deemed inconsistent with Ukrainian law even before the courts had ruled on the legality of such legislation. This would provide prefects with broad powers to disrupt local decision making in the short term. In order to avoid this, any legislation that deals with municipal oversight should ensure that the power to suspend or annul local decisions is left to the courts. Moreover, as indicated in the recommendation of the Committee of Ministers of the Council of Europe "on supervision of local authorities' activities", any law or statute on supervision of municipalities should provide the possibility of effective recourse to judicial remedies against

improper use of supervisory powers (COE, 2019[40]). Moreover, Ukraine is advised to ensure that any efforts to strengthen oversight of municipal decision making follows the principles of proportionality and subsidiarity.

A key challenge to institutionalising a prefect system in Ukraine is the need for a constitutional amendment that requires a two-thirds majority vote to be approved by the Verkhovna Rada. Given that past draft constitutional amendments were not passed due to a lack of political support, the government has explored the possibility of amending the Law "On Local State Administrations", and enable *rayon* state administrations to play a prefect-like role in overseeing the legality of municipality decision making (Verkhovna Rada, 2021[29]). This would be consistent with the legislative approach to decentralisation that the reform process has taken to date. Subsequent draft amendments to the Law "On Local State Administrations" were presented to the Verkhovna Rada, with a final draft that had been pending approval when the war started (CabMin, 2021[41]).

A key difference between the first and second drafts of the bill relates to the proposed appointment system for heads of *rayon* state administrations. In the initial draft, heads of *rayon* state administrations would come from the civil service, and be appointed based on a competitive selection process that complied with national civil service legislation. In the more recent version of the bill, however, such elements are absent (CabMin, 2021[41]). This modification could open the way for a politicisation of the prefects. In addition, the appointment of an oversight actor that is not seen as vocationally impartial could lead to tensions between prefects and amalgamated municipalities. Policy makers should consider revising the bill to ensure that the appointment of prefects is based on a transparent and competitive selection process. In the same vein, in 2021, the G7 Ambassadors Support Group for Ukraine called for a constitutional reform that makes prefects accountable only to the Cabinet of Ministers and not to the President of Ukraine (Box 6.2). This follows an earlier statement by the G7 made in June 2021, which also emphasised the need to ensure that "any supervision from central authorities is proportionate and defined by law" (G7 Ambassadors, 2021[42]).

Box 6.2. Statement of G7 Ambassadors on Ukraine's decentralisation reform

In December 2021, the G7 Ambassadors Support Group for Ukraine, which is comprised of Canada, France, Germany, Italy, Japan, the United Kingdom and the United States, released a statement underscoring their support for the implementation of decentralisation reforms in Ukraine. They also provided a list of priorities for the country to consider in the context of the proposed constitutional reform, which could help to align Ukraine with European good practices. These recommendations have become even more relevant given that Ukraine was granted EU candidate status in June 2022.

1. The Constitution of Ukraine should be aligned with the European Charter on Local Self-Government, including on safeguarding the role of municipalities, providing adequate funding for delivering their responsibilities, defining their rights and powers and introducing a structured system of supervision;
2. Municipalities should be granted the status of legal entities;
3. Prefects should be accountable only to the Cabinet of Ministers (rather than doubly accountable to the President and the Cabinet of Ministers), and;
4. The central government, political parties, local government associations, civil society and other stakeholders should all be engaged in consultations on the draft Constitution of Ukraine.

Source: Author's elaboration based on (G7 Ambassadors, 2021[43]).

Revisiting co-ordination mechanisms for municipal governance

In the context of Ukraine's post-war reconstruction and recovery process, it will be important to further strengthen its vertical and horizontal co-ordination mechanisms. Effective co-ordination and communication among and across levels of government will be necessary to ensure that the design, funding and implementation of reconstruction initiatives meet territorially-differentiated needs and build on local assets, while also contributing to national priorities. Since 2015, different co-ordination bodies have been created and there is *ad hoc* consultation of municipalities and non-governmental actors. However, there are various opportunities for improvement.

Co-ordination and communication challenges among levels of government are both top-down and bottom-up (see Chapter 4) (OECD, 2021[10]). On the one hand, many municipalities have a relatively poor understanding of changes in the rapidly evolving legal framework that they are bound by, and are not always systematically consulted on matters of relevant laws, as is required by Article 4 of the European Charter of Local Self-Government, which Ukraine ratified in 1997 (COE, 1985[38]; OECD, 2021[10]). On the other hand, municipalities often struggle to communicate their development needs and challenges to higher levels of government, which could limit their access to much-needed support (OECD, 2021[32]). These challenges reflect the way in which existing mechanisms have been established for the co-ordination and implementation of regional and local development policy and decentralisation reforms between national and subnational governments.

A first example relates to the Inter-departmental Co-ordination Commission for Regional Development (ICC), which aims to co-ordinate the design and implementation of the State Regional Policy at national and subnational levels. Several of its tasks relate to the design, implementation and monitoring of Ukraine's regional development policy at the municipal level. However, whereas the ICC's regulations indicate that municipalities may be involved in the commission's work, their participation is not guaranteed, only that of several ministries, CabMin, the Office of the President, and the Verkhovna Rada (CabMin, 2015[44]).

The Congress for Local and Regional Authorities presents a second example. The Congress was created in 2021 and serves as an advisory body that is convened and chaired by the President of Ukraine. Its purpose is to represent, protect and advance the interests of regional and local authorities, for example by promoting effective vertical and horizontal co-ordination between state and local government bodies. OECD interviews with local stakeholders indicated that municipalities' participation in meetings of the Congress has, at times, been minimal and *ad hoc* (e.g. based on the invitations extended to a few select municipalities by the national government and *oblast* state administrations). There are also concerns that the Congress acts less as a forum for upward communication and two-way exchange, and more as a platform for the central government to present its national priorities to subnational governments (OECD, 2021[10]).

Ukraine's multiple local government associations play an important role in supporting communication and co-ordination among levels of government. They are commonly set up to facilitate exchange between their members, identify common needs and priorities and advocate these at the central government level. They also support local authorities in implementing new legislation and regulations. However, the overlapping memberships in certain Ukrainian local government associations (e.g. the Association of Ukrainian Cities and the Association of Amalgamated Territorial Communities) have created competition among them, which risks fragmenting the strength and coherence of their advocacy to the central government (OECD, 2021[10]). Given that the government has been closely consulting with local government associations in the development of a national recovery plan, an approach that enables them to speak with one voice should be adopted as soon as possible.

Vertical and horizontal co-ordination mechanisms should be adjusted to promote more effective cross-government communication

With regard to strengthening vertical co-ordination and communication, the government could consider different actions. For example, it could provide municipalities with a permanent seat in the ICC's sessions in order to strengthen multi-level communication about progress in implementing local development strategies, as well as challenges faced by municipalities. This would be particularly valuable during the reconstruction and recovery process given that municipalities may likely play a major role in defining and/or implementing reconstruction projects, making effective co-ordination even more important than usual.

Bottom-up communication between municipalities and higher levels of government could also be improved by the Congress of Local and Regional Authorities. While the Congress clearly has the potential to serve as a useful forum for municipal consultation, steps should be taken to ensure that consultations are more systematically carried out. This could be done by ensuring that two chambers are established, as envisioned when the Congress was created: one for municipalities and another for regions. This would enable more active and systematic municipal participation and exchange. In order to ensure that all municipalities can participate in the Congress on a rotating basis, an equitable process for selecting subnational representatives would be needed. At the same time, bottom-up communication could be improved by avoiding the fragmentation of municipal lobbying and advocacy (OECD, 2021[10]). In this regard, the different local government associations could consider creating a national conference of local government associations, which could facilitate exchanges between them and enable them to speak with one voice to the government when needed.

It should be noted that co-ordination between MinRegion and the donor community has been carried out by the Decentralisation and Regional Development Working Group, which is headed by MinRegion and co-chaired by the European Union (EU) and the Government of Canada. The Working Group enables MinRegion and international partners to exchange on updates to their work programmes, while providing a forum for feedback and learning, and enabling stakeholders to align their respective work and projects (MinRegion, n.d.[45]). However, the workstreams underpinning this co-ordination body may have been partially disrupted by the current war.

Strengthening municipal capacity to meet administrative, financial and investment-related challenges

The differentiated process by which municipalities received their responsibilities through amalgamation has compounded differences in municipal planning, administrative, fiscal and investment capacities. Addressing these challenges effectively will be critical to supporting the post-war recovery so that all municipalities are able to deal with local challenges and improve local wellbeing. Broadly speaking, three relevant groups of municipalities can be identified.

- **Amalgamated municipalities that were formerly categorised as cities of *oblast* significance**, which already had extensive responsibilities at the outset of the reform process. Many of these cities had a well-developed administrative capacity by the time the reform process had begun (OECD, 2021[10]).
- **Former local communities that amalgamated voluntarily at the outset of the reform process,** and that received new tasks and responsibilities on a relatively incremental basis (OECD, 2021[10]). This gradual transfer of responsibilities afforded these municipalities time to develop their administrative capacities accordingly.
- **Communities that were amalgamated administratively in 2020** received all of their administrative responsibilities at once. These municipalities had the least amount of time to develop the various capacity dimensions necessary to effectively manage and execute their new

responsibilities. In addition, they were not eligible for some the financial incentives that their peers who amalgamated voluntarily received (e.g. access to the Local Infrastructure Subvention) (OECD, 2021[10]).

This reform context should be kept in mind when developing policy solutions to strengthen municipal capacity. In particular, municipalities in the third reform group may require additional time and support, in order to ensure that they are able to meet their responsibilities effectively and benefit from the reform process.

Strategic planning capacity at the municipal level could be further consolidated

Capacity to manage all phases of the strategic planning cycle—from developing a diagnostic and designing a plan, to implementing it and monitoring and evaluating progress—helps municipalities identify development priorities, set clear targets and guide public investment. It can also enable municipalities to contribute more effectively to regional development strategies, ensuring that these strategies reflect local needs and capacities. In the post-war recovery, a robust strategic planning capacity will be critical for making sure that recovery initiatives are coherent with local realities and capacities, while building on local assets. Results from the OECD project's online survey suggest that there may be a disparity in the strategic planning capacity of municipalities, which could weaken a place-based approach to the recovery process. By the end of 2021, half of the municipalities did not have an officially approved local development strategy, hampering their ability to guide local development efforts towards clear objectives and monitoring progress. (OECD, 2021[10]). In 2022, the Verkhovna Rada approved amendments to the Law "On the Principles of State Regional Policy". This law specifies, among other elements, that municipalities are required to develop local development strategies (Verkhovna Rada, 2022[46]).

One strategic planning capacity gap identified by the OECD survey relates to monitoring. Forty percent of surveyed municipalities indicated they do not have the necessary expertise to develop a monitoring and evaluation framework with clear objectives and indicators (OECD, 2021[32]). This reflects OECD interviews with local stakeholders, in which it was suggested that many municipalities lack the capacity to set appropriate indicators and define realistic targets (OECD, 2021[10]). Another capacity gap identified by the OECD relates to the involvement of non-governmental actors in preparing the municipal development strategy. Among surveyed municipalities, 39% indicated that they lacked the capacity to involve public or private non-governmental actors when preparing a local strategy (OECD, 2021[10]). This suggests that the development priorities identified by municipalities may not reflect the needs and/or capacities of other local stakeholders, such as the private sector and academia, which could ultimately lead to a poor allocation of municipal investment resources.

In order to address these strategic planning capacity gaps and ensure municipalities can make a substantial contribution to the post-war recovery, the government and other development actors should, among other measures, provide systematic capacity building support to municipalities in all phases of the strategic planning life-cycle, especially in the fields of citizen engagement and performance monitoring. This could take the form of training modules or guidance from MinRegion, the local government associations or the regional development agencies. A more systematic facilitation of peer-to-peer exchanges by local government associations and/or international development partners could also help municipalities to learn from the strategic planning good practices of other local governments at the national or even international level. These exchanges should be available to all types of municipalities (rural, settlement, urban), and include dissemination mechanisms to ensure that relevant knowledge, practices and tools are widely shared.

A more professionalised system for training municipal civil servants could strengthen human resource capacity

The need for further support of local capacity building in key areas like strategic planning raises broader questions about the quality of Ukraine's municipal human resource training system. While municipalities have some access to vocational training programmes through the National Civil Service Agency, the programmes are not standardised and quality control mechanisms remain limited (Goncharuk, Kurniewicz, A and Swianiewicz, P, 2020[47]). In addition, with priority topics chosen by the National Civil Service Agency, local civil servants are unable to request the development of new training programmes that better meet their human resource needs (OECD, 2021[10]). OECD interviews with local stakeholders indicated a decline in the number of civil servants who have completed training courses in recent years, including at the municipal level. This may be attributed to a growing dissatisfaction with or disinterest in the training provided by the civil service training system (OECD, 2021[10]).

In connection with the post-war recovery and Ukraine's EU candidate status, the need for building municipal expertise in key areas such as strategic planning, economic development, public financial management and donor relations will become increasingly urgent. In order to cater to this demand, and to enhance the professionalism of the local civil service and its capacities, the government, in collaboration with the different local government associations, could support municipalities by developing a subnational strategy for human resource management. This could include establishing an expanded list of standardised training programmes, with teaching content that is subject to effective quality control. It could also include conducting local civil service needs assessments and encouraging municipalities to prepare training plans that reflect their local needs. Training needs will likely change as the reconstruction and recovery process advances, which makes it necessary to review and update the human resource management strategy periodically, based on input from public servants and citizens (OECD, 2019[48]).

To improve municipal human resource and administrative capacity, the government also should prioritise updating the 2001 Law "On Service in Local self-government" (Verkhovna Rada, 2001[49]). In particular, it should make political neutrality a requirement for local civil servants, introduce mechanisms for professional development and ensure open and merit-based recruitment, performance management and appraisal processes. The latter is particularly relevant as many municipalities will likely receive significant funds for local reconstruction projects. Finally, concerns have been raised about an increasing gap in the remuneration of national versus local civil servants, which undermines the ability of municipalities to attract and retain skilled staff. Several of these elements were addressed in the draft Law "On Service in Local Self-Government Bodies" that was prepared by the National Agency of Ukraine for Civil Service. In August 2022, the law did not receive sufficient votes to pass the first reading in the Verkhovna Rada (MinRegion, 2022[50])

Strained municipal fiscal and investment capacity may call for adjustments to the fiscal and public investment frameworks

Municipalities face formidable fiscal and public investment challenges, which undermine their ability to effectively fund service delivery and support local investments. The first is the inequitable distribution of fiscal incentives for amalgamation. The second is the impact of the decentralisation reform period on municipal investment capacity. The third is the metastasis of Russia's war against Ukraine in February 2022, which, while having put the financial stability of all local governments under serious pressure, has affected some municipalities more than others. Because of these elements, in the forthcoming post-war recovery, municipalities will face strained revenues, while also being expected to respond to increased demand for service delivery (e.g. clearing debris, building temporary or permanent housing for internally-displaced people and repairing damaged infrastructure).

With regard to fiscal capacity, as fiscal incentives for amalgamation were gradually scaled back, municipalities that merged relatively late in the process received fewer resources than their peers to meet their new service delivery needs and boost their administrative capacity. For example, as part of 2016 Amendments to the Budget Code only municipalities that voluntarily merged were rewarded with a 60% share of locally-levied PIT. Municipalities that did not amalgamate voluntarily were ineligible to receive this contribution until they were mandatorily merged in 2020. In addition, only municipalities that merged before 2020 were able to receive funding from the non-competitive Local Infrastructure Subvention, which was allocated to fund municipal infrastructure projects (OECD, 2021[10]). This subvention was scrapped in 2020 due to COVID-19 budget cuts.

The fiscal capacity of municipalities has been shaken by the recent dynamics of the war (and prior to that by the COVID-19 pandemic). On the one hand, the demands on municipalities are increasing as new tasks that are specific to meeting the challenges of the war are added. On the other, particularly in the first months of the war, municipalities faced large drops in local budget revenues (Chatham House, 2022[51]; World Bank, 2022[52]). This "scissor" effect on municipal public finance, i.e. an increase in expenditure and a decline in revenue, could lead to increased deficits and municipal debt, which will limit municipalities' ability to fund recovery activities (OECD, 2019[35]).

With regard to public investment, there are indications that municipal public investment capacity was weakened over the voluntary amalgamation period. Between 2016 and 2020, the share of capital expenses in total spending by amalgamated municipalities declined from 31% to 15% (CabMin, 2021[23]). As mentioned earlier, this may be explained, in part, by hikes in municipal spending on staff salaries due to increases in the minimum wage (SKL International, 2019[27]). Moreover, evidence suggests that the decentralisation reform period has either had no significant effect on (or even weakened) the capacity of municipalities to carry out key public investment-related tasks. For example, less than half of municipalities surveyed by the OECD felt that the reforms had improved their ability to a) involve non-governmental actors in the identification of investment needs and b) monitor and evaluate the impact of investment projects. Moreover, certain characteristics of competitive investment funds that are available to all municipalities (e.g. SFRD), such as a 10% co-funding requirement for municipalities, have hampered the ability of municipalities with weaker fiscal capacity to obtain the funding necessary to fulfil their investment needs (MinRegion, 2019[53]).

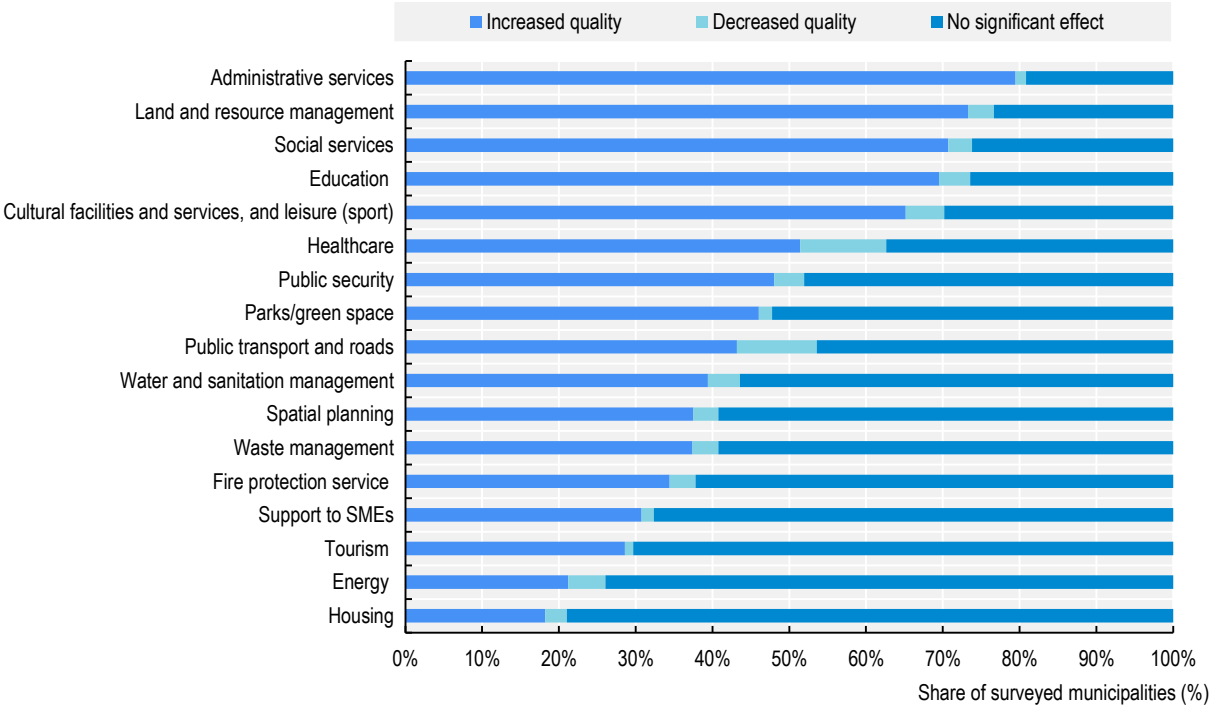
In the post-war period, the government could consider multiple complementary policy interventions to improve local capacity to fund service delivery and finance subnational public investments. First, to improve the access of less affluent municipalities to central government funding for local development, the selection criteria of funds such as the SFRD could be modified, for example by linking (or better matching) co-funding requirements to local fiscal capacity. Municipalities with the weakest fiscal capacity could be exempt from providing co-funding or, barring this, they should be eligible for a reduced co-funding rate. This could be coupled with measures to improve the efficacy of regional and local development spending. This could be done, for example, by promoting projects that are designed by multiple municipalities and have a cross-jurisdictional focus to achieve economies of scale (see Chapter 5). Second, the government could support further outreach to and capacity building for municipalities to improve access to the multiple competitive subventions for regional and local development. This could include providing municipalities with greater clarity on eligibility and application procedures, while strengthening their ability to develop competitive proposals.

Rebuilding service delivery capacity after the war may depend on additional inter-municipal co-operation

How to rebuild and further improve service delivery capacity will be an additional challenge facing municipalities in the post-war recovery period. Results from the OECD project's online survey indicated that, prior to Russia's recent and large-scale territorial aggressions, the decentralisation reforms had had

an uneven impact on local service quality. While a large majority of municipalities reported that the reforms led to improvements in the delivery of administrative services (79%) and social care (71%), in other key service delivery areas, such as waste management, they reported no effect (59%) or decreasing quality (3%) (Figure 6.3). It should be noted that there is a general scarcity of territorially-disaggregated data that can objectively measure local service quality.

Figure 6.3. Effect of the decentralisation reforms on service delivery in selected areas



Note: Question: What effect have the decentralisation reforms (including the amalgamation process) had on the quality of service delivery by your municipality in the following areas? Full response options: Increased quality; Decreased quality; No significant effect. The questionnaire was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the responses to the OECD project's online survey.

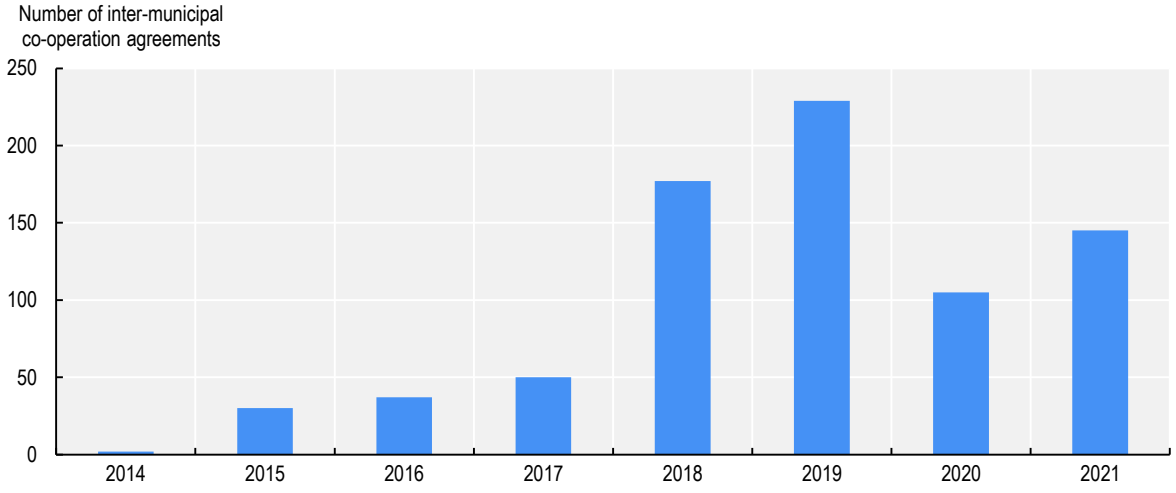
One solution to rebuild infrastructure and further improve public service delivery capacity, especially if further amalgamation is not a desired path, is through greater inter-municipal co-operation. Sharing responsibility for providing public services can help alleviate chronic public infrastructure shortages, particularly in those municipalities where critical public infrastructure (e.g. schools and hospitals) has been destroyed or badly damaged. It is also a cost-effective action that local governments—especially those with limited fiscal resources—can use to deliver the services they are required to provide (OECD, 2019[35]). The use of inter-municipal co-operation arrangements was a key concept underpinning the 2014 Concept Framework given the arrangements' ability to generate economies of scale and improve cost-efficiency in the delivery of municipal functions.

Alongside the municipal amalgamation process, which increased economies of scale and municipal capacity to provide public services, there has been a gradual increase in the number of inter-municipal co-operation agreements signed between two or more municipalities (Figure 6.4). Between 2014 and 2021, 769 inter-municipal co-operation agreements were signed, with over 200 in 2019 prior to a drop during the COVID-19 pandemic. In 2021, there was a slight uptick in the number of inter-municipal co-operation agreements signed. This might reflect the fact the amalgamation process concluded in 2020 and that

municipalities were increasingly turning to inter-municipal co-operation agreements to improve economies of scale.

There appears, however, to be room for improvement. Over half of municipalities surveyed by the OECD in 2021 indicated that the amalgamation process had either had no noticeable effect or a negative effect on their co-operation with other municipalities (OECD, 2021[32]). Research indicates that, in general, the complexity of the procedure for concluding agreements, limited awareness of inter-municipal co-operation by municipal staff, as well as reluctance among mayors to co-operate with other municipalities are all factors contributing to the slow take-up (OECD, 2018[2]; Wright and Slukhai, 2021[54]). This corroborates findings from analysis in different OECD countries, such as Poland, where a lack of knowledge by local authorities of inter-municipal co-operation agreements and the risks involved may have also slowed uptake (OECD, 2018[55]; OECD, 2021[56]). In the case of Ukraine, many municipalities reported a lack of understanding of the benefits of inter-municipal co-operation or the capacity to organise these arrangements (OECD, 2021[10]).

Figure 6.4. Total number of inter-municipal co-operation agreements signed by Ukrainian municipalities (per year)



Note: The bar chart denotes how many inter-municipal co-operation agreements were signed in a given year. As such, it also includes co-operative agreements that have either subsequently expired or been made redundant through further municipal amalgamation between two or more partner municipalities.
Source: Author's elaboration, based on data from (MinRegion, 2022[57]).

In the post-war recovery period, improving knowledge and awareness of inter-municipal co-operation arrangements could boost local service delivery and help financially strained municipalities free up funding for other investment priorities. In this regard, the government could consider providing municipalities with additional support material (e.g. on relevant legislation, good practices, draft co-operation agreements, etc.) and advice on how to set up and manage inter-municipal co-operation, particularly in service delivery areas that have not been targeted much in the past. In the context of the war, the national government could encourage or even temporarily require increased inter-municipal co-operation, whereby subnational governments share staff and expertise or the provision of public services to support those municipalities that saw their human resource and service delivery capacity severely reduced due to the war. There is some precedent in OECD countries for making inter-municipal co-operation mandatory in municipalities under certain conditions. In Greece, for example, smaller municipalities are required to enter into inter-municipal co-operation arrangements in order to meet their town planning and welfare benefits service

responsibilities (OECD/UCLG, 2018[58]). However, mandating inter-municipal co-operation can be politically sensitive and legally challenging to establish.

Strengthening municipal capacity to support economic development

The purpose of territorial economic development is to build the capacity of an area to improve its economic prospects and contribute to the well-being of its inhabitants. It can reduce disparities between more and less affluent communities, add to the stock of locally generated jobs and firms, while increasing private sector investment (OECD, 2014[59]). To support economic development, municipalities need a wide range of skills and capacities, for example for identifying and engaging with local businesses, as well as developing and implementing economic development and investment strategies and projects.

While the decentralisation reform process appears to have led to important improvements in the delivery of local public services, there are indications that it has not significantly reinforced municipal economic activity. This was already a salient issue before the war, given the large and growing economic disparities between Ukraine's territories and the need to promote growth across all regions (see Chapter 3). For example, a 2021 survey by the European Business Association found that companies in many Ukrainian regions continued to face difficulties doing business. There was some regional variation to this trend, with surveyed entrepreneurs in Lviv *Oblast* rating the regional business climate as "satisfactory", compared with "difficult" in the other surveyed regions. Overall, however, the survey results reflected a lack of improvements to the local business environment (European Business Association, 2021[60]). Empowering municipalities to more effectively support economic development will be key to rebuilding local communities and encouraging displaced residents to return. It will also help in improving the long-term economic potential of affected territories and in increasing Ukrainian's well-being.

Many municipalities currently lack the knowledge and skills to effectively support municipal economic development. Among municipalities surveyed in 2021, 68% indicated that the decentralisation reforms had had no significant effect on support to small and medium-sized enterprises (SMEs) within their municipality (OECD, 2021[32]). This may reflect the fact that municipalities continue to have only limited explicit responsibilities for their economic development, with local leaders viewing the delivery of social services as their most important task (OECD, 2021[10]). Moreover, as is also the case in many OECD countries, some municipalities consider that there is a lack of clarity with respect to the division of responsibilities for supporting SMEs among levels of government—about 50% of municipalities in the case of Ukraine (OECD, 2019[35]) (OECD, 2021[32]). Furthermore, collaboration with the private sector to support economic development activity is extremely limited. Only 10% of the 741 surveyed municipalities indicated that they work with private sector organisations in public-private partnerships (PPPs). Regulatory uncertainty (26%) and lack of knowledge by municipal staff of how to develop and manage a PPP (17%) were cited as two important constraints to setting up and managing PPPs at the local level (OECD, 2021[32]).

There are a number of measures that the government should take to strengthen the mandate and capacity of municipalities to support territorial economic development. First, the government, together with the different associations of local governments, could provide guidance to municipalities on the policy options available to them to stimulate economic development and reduce the administrative burden on businesses. For example, municipalities could support collaboration between local academic, professional or vocational educational institutions and the private sector, in order to ensure that educational and training programmes meet the needs of local businesses. The effects of the war made this issue even more salient, as widespread population displacement caused by Russia's aggression is likely to exacerbate territorially-concentrated labour shortages for the foreseeable future. The government could also provide training for municipalities to more effectively engage with the local private sector while also maintaining good governance practices (e.g. identifying investment needs or co-designing local investment projects).

Moreover, the government could consider adjusting existing regional development subventions to more actively support SMEs. In recent years, a large share of regional and local development grants have mainly targeted investment in building and maintaining local public infrastructure, rather than supporting territorial economic development or innovation (see Chapter 5). Adjusting this practice could help to spur additional economic activity in war-affected municipalities. Finally, the government could consider providing capacity building support to municipalities on how to develop and manage local PPPs, which could be a valuable financing tool to help local governments shoulder the costs of the post-war reconstruction of local infrastructure. However, such partnerships involve substantial risks, including regulatory capture, conflict of interest and long-term fiscal constraints on local budgets. Typically only larger municipalities possess the requisite fiscal and institutional capacity to establish a PPP. Moreover, PPPs should be undertaken only where they are affordable and produce greater value for money than would be provided by the delivery of public services or investment through traditional means (see Chapter 5). In the light of the post-war reconstruction and recovery period, the government may want to review the existing legislative framework for PPPs, which was updated in 2016, to see if it provides sufficient clarity on how municipalities can establish and manage a PPP, as well as establish the necessary guardrails to avoid misuse.

Updating legislation and regulations on local democracy and accountability

In broad terms, Ukraine's decentralisation reforms improved local democracy and accountability. Yet there are gaps in the legislative framework that risk undermining elements of both. With regard to electoral reform, an issue with particular resonance in the context of Russia's war is the lack of local voting rights for Ukrainians who reside abroad. Currently, these citizens are regarded as not belonging to any municipality and therefore do not have any right to vote in local elections (COE, 2020[61]), despite millions having been displaced from the country against their will as refugees (UNHCR, 2022[62]). Given the situation, the government should consider amending the Electoral Code to allow citizens temporarily living abroad to vote in national and local elections.

With regard to local accountability, while the *starosta* institution provides a promising foundation for improving public engagement in municipal decision making, there are a number of issues that should be addressed to improve its effectiveness. First, there is a lack of data regarding the activities of *starostas.* For example, there is no single *starosta* register, which makes it impossible to know the exact number of *starostas* in the country or what services they provide as per local council decision. This reflects the fact that there is no legislation or guidance stipulating how many *starostas* can be established within a single municipality. Moreover, there are no performance indicators with which to monitor the performance of *starostas.* This means that they operate with little oversight (OECD, 2021[10]).

Second, there are concerns over the expertise and skills of *starostas*, as well as the financial resources allocated to them. According to law, *starostas* do not receive any training for their role. As a consequence, many *starosta* appointees lack the necessary skills to work effectively with municipal governments on solving local issues (OECD, 2021[10]). Moreover, there is significant variation in the financial remuneration for *starostas* and additional financial support that they receive to carry out their mandate. While their basic salary is UAH 11 000, local councils can provide them with an additional salary and equipment (OECD, 2021[10]).

Strengthening the capacity of *starostas* to carry out their mandate (e.g. supporting the development of the local budget, providing administrative services, overseeing local projects) will be important for ensuring that municipalities remain accountable to residents. This is particularly so in light of the volume of programmes, investment, and service delivery that municipalities will be called upon to deliver as part of the reconstruction and recovery process. The government should consider developing clear standards for their role and some core training modules on their key functions as a priority. This would help to set concrete expectations and provide a baseline of knowledge and skills that can be used to accomplish

tasks. To the extent possible, the government should also consider increasing the basic salary of *starostas*. Residents might then find these positions more appealing, which could improve the quality of candidates, while also ensuring that they are less dependent on alternative sources of personal income (e.g. a second job) and can commit to their responsibilities more fully (OECD, 2021[10]).

Post-war considerations for the Government of Ukraine

The escalation of Russia's war in Ukraine has exacerbated municipalities' development challenges. Pre-existing municipal disparities have widened substantially because of the war, as can be seen through the near-total destruction of some local communities. Yet, in others governance structures are emerging relatively unscathed. In addition, the human resources capacity of many municipalities has been severely hampered as local civil servants have fled to safer places in Ukraine or abroad, or joined the armed forces. Moreover, the war's pressure on municipal public finance—increasing municipal expenditures and declining revenues—has compounded the fiscal challenges that many municipalities were facing prior to 24 February 2022.

During the recovery period, policy makers should look to ensure that the reconstruction of war-torn infrastructure goes hand in hand with a strategy of long-term socio-economic development that harnesses the economic potential of all of Ukraine's territories. Failing to do so will not only thwart the rebuilding of local economies and livelihoods, it may also create the impression that reconstruction is not equitable, thus undermining trust in government. In order to prevent this, subnational recovery efforts should, among other elements, account for the territorial socio-economic development trends and governance challenges that municipalities were facing prior to February 2022. These include large differences in regional GDP and local competitiveness, as well as significant divergences in the administrative and fiscal capacity of municipalities.

The government should ensure equitable subnational reconstruction, tailored to local needs and assets

A priority for Ukraine should be ensuring that it adopts a place-based approach to the post-war recovery, at both the regional and municipal levels. Such an approach would take into account the starkly differentiated reconstruction needs of local communities. At the same time, it would enable the recovery process to be tailored to account for the divergent development challenges and capacities facing local communities, while building on local assets. This would support a more equitable reconstruction process, and ensure that all municipalities can share in the fruits of the recovery.

In this regard, as Ukraine moves forward with the implementation of a national recovery plan it should involve subnational governments, including municipalities, in the definition of immediate recovery support schemes, as well as more long-term strategies to strengthen their economic potential. This will help to ensure that recovery implementation and funding mechanisms reflect local needs and assets. In addition, the recovery should build on the skills and experience that municipalities have gained since the launch of the decentralisation reforms in providing citizens with a wide array of public services, as well as managing investment funding. Key in this regard will be developing a more effective civil service training system, in order to further bolster local human resource capacity.

In addition, existing vertical and horizontal co-ordination mechanisms should be reinforced to improve communication among and across levels of government in order to establish how to meet local needs and priorities while avoiding a fragmentation of recovery efforts. Co-ordination bodies such as the Congress of Local and Regional Authorities and local governments associations could be used to promote and facilitate discussion and exchange on prospective legislative reforms impacting municipalities, and/or changes to (reconstruction) funding mechanisms. Furthermore, they could help to identify municipal capacity building

needs on issues that are particularly relevant for the post-war reconstruction period, such as procurement, project appraisal, transparency and donor relations, and promote the development of corresponding training material. Concurrently, in order to streamline reconstruction and recovery processes and ensure policy coherence, further efforts should be made to clarify development and reconstruction planning requirements for the different levels of government.

The recovery could create space to re-evaluate Ukraine's territorial governance structure

The post-war recovery period will also present an opportunity to review Ukraine's territorial governance structure. The need for more effective municipal oversight, which was already apparent prior to February 2022, will increase further due to the large volume of external funding that will likely flow to municipalities in the aftermath of the war, and the need for such funding to be allocated as quickly as possible to recovery initiatives supporting economic development and well-being. Ensuring the legality of local decisions in relation to recovery initiatives will be paramount for corruption to be avoided and recovery funding to meet its stated objectives.

As discussed above, reforming Ukraine's territorial governance structure could help to improve oversight of municipal decisions, as well as strengthen co-ordination and co-operation among levels of government. Preferably, this would take the form of a constitutional reform, which would replace the *oblast* and *rayon* state administrations with a prefecture system. In the absence of a change to the Constitution, the government could consider amendments to existing legislation that would assign municipal oversight tasks to *rayon* state administrations. At the same time, it will be important to ensure that the role of any entity in charge of oversight is impartial, and does not unduly interfere with the day-to-day business of municipalities.

Other reforms related to the country's administrative-territorial structure were also under active consideration prior to the war. For example, legislative proposals to amend the governance model of Kyiv City have been a source of robust public debate. Currently, the positions of elected local mayor and state-appointed head of the Kyiv City state administration are combined in a single role, which creates a confusion of functions and a conflict of interest. The 2021 Draft Law "On the City of Kyiv—the Capital of Ukraine" aims to separate the two positions, with the mayor of Kyiv tasked with implementing a political strategy, organising the work of the city council and implementing municipal decisions, and the head of the Kyiv City state administration tasked with responsibilities such as ensuring that the decisions made by the mayor comply with the law. Debates have arisen in relation to this issue of administrative supervision. For example, previous versions of the draft law did not clearly specify the principle of proportionality (i.e. preventing oversight from becoming disproportionate with regard to the interests being protected) in administrative supervision. If these previous versions of the draft law had been approved, the ability of the mayor to run the city's affairs independently could have been severely limited (COE, 2020[63]; COE, 2022[64]). Policy makers will need to revisit these issues in the post-war recovery period, in order to ensure that an appropriate balance between local democracy and accountability is struck in the capital.

Any reform of the country's territorial-administrative system should be evidence-based

In the context of Russia's further encroachments into Ukrainian territory since February 2022, there is an ongoing debate regarding whether the country's administrative-territorial organisation may need to be further adjusted after the war has ended. The debate has been ignited as the war has: a) transformed the demographic situation across territories and b) wrought widespread infrastructural damage in certain areas. Additional (voluntary) amalgamations could be considered, though such reforms take time to generate results and any decision on additional reconfiguration might be premature as there is insufficient data to determine how performance has changed over time given the recent reform cycle.

Moreover, a sizeable minority of municipalities were only amalgamated in mid-2020, and had less than two years—which coincides with the COVID-19 pandemic—to develop their capacity to meet more

extensive responsibilities before the outbreak of war. Even municipalities that have the potential to meet their responsibilities will likely require additional time to develop their capacity. Increased inter-municipal co-operation may provide an alternative for improving the cost-efficiency and quality of local service delivery that stops short of further municipal amalgamation.

Any future amalgamation decisions made should be evidence-based. However, as discussed above, municipal performance data are currently limited. Particularly challenging is the lack of data to measure access to (or the quality of) various local public services. Based on the data available and a survey of over 50% of the amalgamated municipalities on Ukrainian territory, the OECD conducted an assessment of how Ukraine's municipal performance has changed over the past few years. As discussed in the next chapter, the results of this analysis, which may help to inform the discussion on any future adjustments to the multi-level governance system, identify clear progress in the performance of amalgamated municipalities over the reform period, while highlighting several ongoing and new challenges, including those created or exacerbated by Russia's war in Ukraine.

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Notes

[1] Note: owing to Russia's war and the imposition of martial law in Ukraine, constitutional amendments in the country are currently banned (Just Security, 2022[67]).

[2] The Budget Code of Ukraine defines subventions as inter-governmental transfers of funds to be used for specific purposes through procedures defined by the authority that decides to provide the subvention (Verkhovna Rada, 2020[6]).

[3] Administrative decentralisation focuses on a reorganisation and clear assignment of tasks and functions among territorial levels of government in order to improve the effectiveness, efficiency and transparency of national territorial administration; fiscal decentralisation involves delegating taxing and spending responsibilities to subnational tiers of government. The degree of fiscal decentralisation can depend on the amount of resources delegated and on the autonomy in managing these resources. Autonomy is greater if local governments can decide on tax bases, tax rates and the allocation of spending (OECD, 2017[66]).

[4] While most health facilities are under local government ownership, following the recentralisation of most healthcare financing in 2017, the financing and delivery of public health services are currently a mix of central and local government responsibility (WHO, 2021[7]).

[5] Discussions regarding the necessity of constitutional reform are long-standing in Ukraine. A related issue in this vein includes the possible reform of legal personality at the local level. A 2021 report by the Council of Europe notes that unlike in most European countries, territorial communities in Ukraine currently lack a legal personality, which is instead awarded to institutions of local government (whose personal composition is by nature changeable). Ongoing debates on both constitutional reform and legal personality in Ukraine aim to provide a clear and transparent status for municipalities within the country's territorial-administrative structure (COE, 2021[65]).

7 Amalgamation and its impact on municipal performance

This chapter presents the results of the OECD assessment of how Ukraine's decentralisation reforms have affected municipal performance. First, it sets forth the methodology used to analyse municipal performance. Second, it presents the results of an online OECD survey focusing on how the decentralisation reforms affected various dimensions of municipal performance prior to the large-scale invasion by Russia in February 2022. In particular, it reflects on how municipal administrative capacity, human resources, service delivery, stakeholder engagement, and co-ordination among levels of government have improved, the challenges that remain, and what this means for post-war reconstruction and recovery. Third, the chapter examines municipal efficiency and explores how the combined qualitative and quantitative analysis can inform the debate about the possible need for amalgamations in the future.

Introduction

Decentralisation has been one of Ukraine's most essential and complex reforms of the past decade. The establishment of larger municipalities through mergers has been the cornerstone of the decentralisation process and a basis for strengthening local democracy. The impact of the decentralisation reforms has been far reaching, certainly territorially but also in terms of the quality and accessibility of services delivered, inter-governmental relations and partnerships, and subnational accountability. Amalgamated municipalities perceive progress in their ability to effectively deliver important public services, such as administrative services, education, healthcare and social services. Challenges remain, however. Activities such as strategic planning and stakeholder engagement require further attention, and there are significant differences in the effect that decentralisation reforms have had on rural, settlement and urban municipalities. A robust performance measurement framework, which can help all levels of government to identify where progress has been made and where gaps remain, is always valuable but will be even more so as Ukraine takes stock of its territorial and community needs in its reconstruction and recovery from Russia’s full-scale invasion in February 2022.

This chapter proceeds in three parts. First, it sets forth the methodology used by the OECD to examine municipal performance based on the territorially-disaggregated data available, covering the 2015-2021 period. Second, it discusses the results from an online survey that was completed in 2021 by 51% of Ukrainian municipalities prior to the Russian Federation’s full-scale invasion of Ukraine in February 2022. Third, the chapter examines the results of a Data Envelopment Analysis (DEA) of municipal efficiency.

Box 7.1. Recommendations for the continued progress of the decentralisation reforms

The following recommendations complement the ones included in Chapter 6. They should be considered in a timeframe that is appropriate to the current context of war and post-war reconstruction and recovery.

To improve professional development of municipal civil servants, Ukraine is advised to:

- Establish a reconstruction and recovery training strategy for municipalities that can be adapted to different territorial contexts and needs. The strategy should prioritise capacity building in areas that are particularly relevant for the post-war recovery period, such as strategic planning, project appraisal, procurement, implementation, transparency and stakeholder engagement (including with donors). Legislative amendments should be made in tandem, for example, to ensure that the recruitment and performance management criteria for the local civil service are merit-based.
- Set up train-the-trainer programmes to create and support a highly skilled network of municipal trainers who can effectively localise and multiply the acquired knowledge and skills in their communities. In the short term, such programmes could focus on topics that are particularly relevant to recovery, such as the ones mentioned above.
- Establish peer-to-peer learning initiatives (including coaching and mentoring) to facilitate the exchange of experiences, tools and methodologies related to strategic development planning, public engagement and performance monitoring among Ukrainian municipalities and with local authorities in Europe. Such initiatives should be tailored and targeted to the particular challenges of each type of municipality. Support should be equitably distributed among different types of municipalities (e.g. rural, settlement, urban), and include dissemination components to ensure that relevant knowledge, practices and tools are being shared across municipalities.
- Promote and facilitate administrative and human resource-sharing, for example, through:
  - Temporary secondments or job shadowing among larger and smaller municipalities. These mechanisms should only be applied when, in the post-war period, the basic administrative and human resource capacities of the most affected municipalities have been restored and they are able to send key staff to learn from municipalities, without undermining their own capacities.

To strengthen local accountability and public engagement, Ukraine is advised to:

- Reinforce existing legislation to make public consultation a systematic component of development and investment planning at the subnational level. However, the government should be careful not to overwhelm municipalities with requirements to organise public engagement processes, as this might stifle municipal decision making and lead to consultation fatigue.
- Develop guidelines and provide training on 1) what mechanisms municipalities can use to inform, consult, involve, collaborate and/or empower different stakeholders (e.g. participatory planning and budgeting, petitioning) and 2) under which circumstances those mechanisms should be used, in order to ensure that they are fit-for-purpose.
- Make municipal budget information (including on revenues and expenditures for recovery projects) more easily accessible and understandable to the public (a "budget for citizens") and publish a yearly (or half-yearly report) on budget execution in a friendly format, accessible by the public.

To improve the quality of municipal service delivery, Ukraine is advised to:

- Adopt and/or facilitate flexible and shared public service delivery models, such as co-operation, collaboration, co-production, colocation and flexible service provision.
- Provide additional capacity building support for municipalities to demystify complex legislative and regulatory issues as new legislation that impacts municipalities is introduced. This also applies to existing legislation on sectors for which there is, according to municipalities, limited clarity about the division of tasks and responsibilities among levels of government (e.g. public transportation and roads, support to small and medium-sized enterprises, waste management and housing).
- Ensure that municipalities do not have un- or underfunded mandates, for example by:
  - Increasing the volume of block grants or expanding municipal power to set the tax base and rates for own-source taxes in order to ensure that municipalities have sufficient financial resources and the necessary flexibility to allocate spending to meet particular local needs. This should be based on a comprehensive review of municipal administrative and service responsibilities, and an assessment of the extent to which these responsibilities are currently underfunded.
- Increase outreach to and capacity building of municipal leaders on the value of inter-municipal co-operation and provide financial and functional incentives:
  - Financial incentives could include providing a higher tax-share for delivering joint services and awarding additional points in the selection process of competitive regional and local development grants to project proposals developed by two of more municipalities.
  - Functional incentives could include establishing a condition of population size for the delivery of different services, thereby encouraging co-operation between smaller municipalities.

OECD analytical framework for assessing municipal performance in Ukraine

Assessing the impact of decentralisation reforms (including amalgamation) on the performance of Ukraine's municipalities prior to February 2022 could provide insight into the success factors that will underpin municipal development outcomes in the recovery process. One way to do so is to consider the experience of municipalities that appeared to have significantly improved their performance across a wide range of indicators since amalgamation. Doing so could also shed light on why some municipalities did not appear to benefit as much from decentralisation reforms as others. Ideally, such an assessment could be transformed into a tool to help 'lagging' municipalities 'catch-up' with their more successful peers, and highlight how 'leading' municipalities could continue to strengthen their performance.

For municipalities to fully benefit from such an assessment, however, some data constraints will need to be overcome in the future. For example, while the Hromada Performance Monitoring Portal provides data on the social infrastructure facilities that municipalities have built in their territory (e.g. schools or hospitals), it lacks data that can measure the extent to which local services are being delivered, or time series data that could help evaluate how municipal service performance and quality has changed over time. Furthermore, a misalignment between key datasets across ministries needs to be considered. For example, the Ministry of Finance's Open Budget Portal is not harmonised with the unique territorial codifiers for municipalities used by the Ministry for Communities and Territories Development (MinRegion). This makes it more difficult for policy makers to link datasets and develop an in-depth analysis. Finally, time will be necessary in order to develop a fair assessment of changes in performance. The gradual nature of the amalgamation process (from 2015 to 2020) and adjustments to the decentralisation incentives meant that

municipalities were in different stages of building capacity and received different levels of support from the central level. These considerations were taken into account when undertaking the assessment presented below, resulting in a focus on three main performance areas: economic performance, service delivery and local democracy (e.g. administrative, fiscal, citizen satisfaction and democracy) (Box 7.2).

Box 7.2. Measuring the success of amalgamation reform

To measure the success of municipal mergers in different OECD countries, researchers have often focused on evaluating the effect of amalgamation on three different strands of local government activity: economic performance, service delivery and local democracy.

Economic and efficiency performance measurement

Indicators related to issues such as debt and expenditures per capita consider the extent to which municipal mergers are delivering cost savings. As such, they can help to test the hypothesis that municipal amalgamation improves technical efficiency at the local level by creating economies of scale.

Service delivery performance measurement

Indicators related to institutional capacity, as well as policy and/or service outcomes (e.g. increased access to or quality of water, school enrolment rates) consider the extent to which local governments are able to act effectively as service providers. As such, they can help to determine whether municipal mergers contributed to improved service delivery. Indicators related to citizen satisfaction are another way to examine whether local public service quality improved after municipal amalgamation.

Democratic performance measurement

Indicators related to democratic performance (e.g. voter turnout percentages) consider the extent to which municipal amalgamation has coincided with a change in local democratic participation. Other indicators, such as the number of town hall meetings or other formal interactions that residents have with their elected officials, assess whether municipal mergers have either increased or reduced opportunities for the community to participate in local decision making.

Source: Author's elaboration, based on (Allers and Geertsema, 2016[1]; Bikker and van der Linde, 2016[2]; Buljan, Švaljek and Deskar-Škrbić, 2021[3]; Haček and Bačlija, 2014[4]; Hofmann and Rother, 2019[5]; Roesel, 2017[6]; Miriam and Petríková, 2015[7]; Turley et al., 2018[8]; van Houwelingen, 2017[9]; Miyazaki, 2017[10]).

The OECD analytical framework in the context of scarce data

In order to assess municipal performance post-amalgamation, while also working within the data constraints described above, the OECD developed an analytical framework composed of two complementary elements: i) the responses to an online survey completed by over 50% of Ukraine's 1 469 municipalities, and ii) a Data Envelopment Analysis (DEA) of municipal efficiency. Both elements consider distinct strengths and limitations, and are complementary. The OECD's online survey of Ukrainian municipalities, circulated to all municipalities in 2021 (Box 7.3), measured municipal performance across a wide range of areas, including administrative capacity, local finance and investment, and local democracy. Survey responses enabled the OECD to identify how municipalities assessed their performance across various areas (including strengths and challenges), as well as how they perceived their performance and challenges had changed over time. The survey's multiple-choice format helped disaggregate responses by urban, rural and settlement municipalities[1], enabling a cross-municipal comparison. However, the survey's perception-based nature means that it is inherently subjective, and would therefore benefit from complementary statistical analysis to help assess municipal performance.

Box 7.3. OECD online survey of Ukrainian municipalities

To better understand the results of the decentralisation reforms, the OECD requested that municipalities complete an online survey. The objective of the survey was to assess the impact of Ukraine's amalgamation reform on municipal performance. In particular, it sought to collect perspectives on how decentralisation reforms, including the amalgamation process, affected local service delivery, finance, and co-operation with non-governmental actors, as well as current municipal challenges.

The survey, which was prepared with input from MinRegion, the Cabinet of Ministers of Ukraine (CabMin), as well as international development partners U-LEAD and DOBRE, included sections on the process of amalgamation, the creation of administrative service centres, administrative capacity, local finance and investment, local democracy and public participation, among others. With the support of CabMin and MinRegion and the 24 *oblasts,* the survey was shared with all municipalities. In total, 741 municipalities, covering 119 *rayons*, as well as 24 *oblasts*, and Kyiv City, completed the survey, resulting in a highly representative sample.

Given the perception-based nature of the survey results and the data constraints discussed above, a Data Envelopment Analysis (DEA) of Ukrainian municipalities was also developed. DEA is a management performance assessment tool used by local governments since the late 1990s (De Borger and Kerstens, 1996[11]). It evaluates the relative efficiency with which subnational governments are able to provide local public services. The OECD DEA draws on data from the MinRegion municipal performance monitoring portal, such as total local revenues per capita, and from statistics on local public infrastructure (e.g. number of secondary schools or primary healthcare institutions). It also considers how municipal efficiency varied across *oblasts* and urban, rural and settlement municipalities. On the basis of this information, it used regression analysis to establish the most common drivers of municipal efficiency.

This combined qualitative and quantitative framework enables the identification of national-level trends, including areas where municipalities have improved their performance during the amalgamation process, and areas where local challenges remain significant. It also highlights sizeable differences in the performance of urban, rural and settlement municipalities. Furthermore, it signals the value of a place-based approach in responding to the challenges of Ukrainian territories, and indicates elements that are key to improving municipal efficiency across the country.

Municipal self-assessment of Ukraine's decentralisation reforms

This section presents findings from the OECD online survey of Ukrainian municipalities that was conducted prior to the Russian Federation's large-scale invasion of Ukraine on 24 February 2022. It is divided into five parts, covering: i) administrative capacity and human resources; ii) service delivery; iii) financial capacity, iv) local democracy and engagement with non-governmental actors and; v) co-ordination and co-operation mechanisms. The findings highlight that, across the board, municipalities had experienced, prior to the war, a significant increase in their capacity to carry out budgeting, development planning and public investment-related tasks. In addition, a large share of them reported that the decentralisation reforms had increased the quality of social, healthcare and administrative services, resulting in higher revenues while promoting better co-ordination with higher levels of government (vertical co-ordination). At the same time, the survey results show that the effects of the decentralisation reforms were experienced very differently across rural, settlement and urban municipalities. The same applies to how the different types of municipalities perceived their capacity to effectively carry out their mandate.

Understanding the nature of capacity gaps and development needs faced by different types of municipalities will be useful to national and subnational officials, as well as development partners in the

recovery period. Such insights can make it easier to tailor financial and technical support in order to advance recovery efforts while also serving to bridge specific gaps and/or meet pressing needs. Moreover, the results can also inform the debate about the need for additional legislative, regulatory, fiscal and territorial reforms to support local service delivery and citizen well-being throughout the country.

It is important to note that the devastating impact of the war, the effects of which have varied across territories, as well as the crucial role that municipalities have played to support the war effort, mean that the conditions under which the 2021 OECD online survey was completed have changed substantially. In addition, municipalities are already playing a vital role in supporting reconstruction efforts during wartime and will remain critical development actors in the post-war reconstruction and European integration period. Therefore, throughout this chapter, the impact of the war on municipal functions is considered alongside needs for reconstruction and recovery.

Effects of the decentralisation reforms on administrative capacity and human resources

Administrative capacity can refer both to having an adequate number of employees to deliver the services needed, alongside the necessary training and skills, together with the necessary processes and mechanisms to carry out their tasks. Municipalities surveyed by the OECD generally reported that they were sufficiently staffed across a range of functions such as finance, planning and public investment (OECD, 2021[12]). Since the survey was conducted, however, the war has dramatically changed administrative capacity and human resources in many regions. By July 2022, 5.8 million people had fled the country, and millions more are internally displaced (OHCHR, 2022[13]). The population of some municipalities, predominantly located in the west of the country, has doubled or even tripled since the war began. At the same time, many municipalities that are—or have been—on the frontline have seen a dramatic population decline. Municipal leaders in occupied areas have been abducted, tortured and killed. The war is widening disparities between municipalities, with some facing severe human resources challenges as many civil servants have fled or joined the army, and others facing different pressures due to the influx of internally displaced people. Local governments continue to provide services during wartime while also planning for the types of skills that the labour force will need for ongoing reconstruction efforts. Innovative capacity building models and inter-municipal co-operation take on a renewed importance amidst these challenges.

This section discusses how municipalities perceived the impact of the decentralisation reforms on their ability to carry out tasks related to budgeting, strategic planning and public investment. It also looks into whether municipalities considered they had the necessary experience and skills to effectively carry out their mandate in these three areas, showing marked differences across different types of local governments. Finally, the section provides a series of policy recommendations on how to support municipal administrative capacity for post-war reconstruction and recovery.

Prior to the war, most municipalities felt sufficiently staffed to carry out their responsibilities

Among municipalities surveyed in 2021, 72% reported that they had sufficient staff to carry out their responsibilities (Annex Figure 7.A.1). However, there were differences across types of municipalities: 83% of urban municipalities reported that they had sufficient staff, compared with 73% of settlement municipalities and only 62% of rural municipalities. One reason for this disparity might be that urban municipalities find it easier to attract staff with appropriate qualifications than rural municipalities do, and have larger talent pools than their lower-density counterparts. This might also explain why only 15% of urban municipalities indicated that the decentralisation reforms had made the recruitment of qualified staff more complicated, compared with 28% of settlement municipalities and 40% of rural municipalities (Annex Figure 7.A.2).

Despite the generally positive self-assessment regarding staffing levels, research has pointed to a lack of professional local government managers and high staff turnover as major challenges facing Ukraine's local

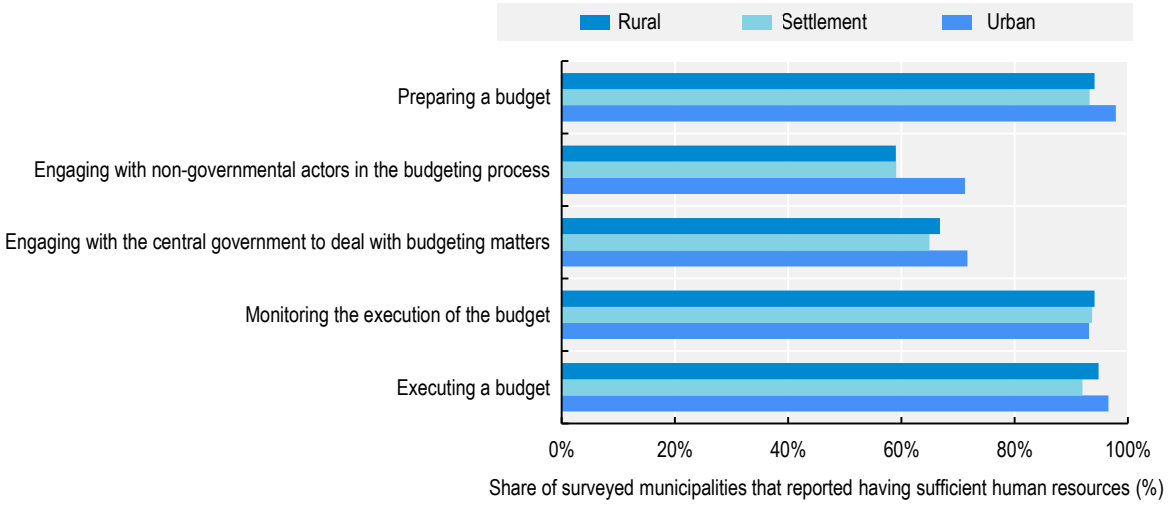
governments (Kolesnik and Samborska, 2020[14]; Vasylieva, 2020[15]; Goncharuk, Orhiiets and Prokopenko, 2021[16]). Ensuring sufficient civil service capacity, in terms of the availability of human resources, experience and skills, as well as mechanisms and structures to guide the work, is crucial for the forthcoming post-war reconstruction period. Municipal civil service capabilities for project appraisal, implementation, transparency and stakeholder engagement (including with donors) will be especially critical as local authorities may play a central role in the execution of local reconstruction projects. In this regard, it is important to acknowledge that staffing levels in the post-war recovery period may look very different from those that were reported prior to February 2022, as municipal staff have fled their communities or joined the armed forces. In June 2022, the government estimated that about 7 000 of the approximately 170 000 national and local civil servants were displaced abroad, and 7 400 were located in the territories occupied by Russian forces (National Recovery Council, 2022[17]; National Agency of Ukraine on Civil Service, 2022[18]). Changes in local population levels as a result of the war may also cause some municipalities to be in greater need of inter-municipal co-operation arrangements in the post-recovery period, owing to the corresponding decrease in financial and human resource capacity that these changes will likely entail. While some municipalities, particularly those located in the west of Ukraine, may still have the necessary staff to carry out most administrative and service delivery tasks, others may not.

To address this challenge, the government could request that municipalities indicate if they are able to, at least temporarily, carry out specific functions. Based on this information, the national government could, for example, encourage or even temporarily require increased cross-jurisdictional co-operation whereby subnational governments share staff and expertise or the provision of services (see Chapter 6). In addition, in heavily damaged areas, non-governmental organisations have been playing a complementary role in supporting service delivery and reconstruction and recovery efforts.

Municipalities have been well equipped to deliver core financial functions

A large share of surveyed municipalities reported having the necessary human resources to: i) prepare a budget, ii) execute a budget and iii) monitor the execution of a budget (Figure 7.1). Differences between urban, rural and settlement municipalities are minimal, with over 90% of each category reporting that they had significant human resource capacity to perform such tasks. This suggests that municipalities were generally well-equipped to cope with the core financial functions that underscore the decentralisation reform process. Such capacities are instrumental in effectively mitigating a “scissor effect” (i.e. increased municipal expenditure and decreased municipal revenue) that the war is having on Ukraine's municipal budgets. Indeed, many municipalities are struggling with rising expenditures and fiscal pressures, as they try to rebuild local infrastructure and maintain their territorial defence. There are examples of municipalities that have developed action plans to cut back on non-essential expenditures, while ensuring the continued provision of key services (U-LEAD, 2022[19]). At the same time, with the support of international donors, local civil servants have generally continued to receive their salary during the war (Atlantic Council, 2022[20]).

Figure 7.1. Availability of human resources to carry out budget-related tasks



Note: Question: Does your municipality have the necessary human resources (including expertise) to effectively carry out the following tasks related to the budgeting process? Full list of tasks: Preparing a budget; Engaging with the private sector, civil society or academia in the budgeting process; Engaging with the central government to deal with budgeting matters; Monitoring the execution of the budget; Executing a budget. Response options: Yes, No. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

Budgeting capacity is also essential for the post-war period, as many municipalities will likely receive funds for local reconstruction projects. A relatively low share of surveyed municipalities reported that they have sufficient human resources to engage with the private sector, civil society or academia in the budgeting process (63%). It is notable that 71% of urban municipalities were more likely to express sufficient capacity in this area, compared to 59% of rural and settlement municipalities. These differences may reflect, in part, the relatively long period of time that many former cities of *oblast* and *rayon* significance have had to develop these capacities, as compared to settlement and rural municipalities. It must be noted, however, that not all urban amalgamated municipalities are former cities of *oblast* and *rayon* significance. Those that are not likely faced similar challenges in building up their planning, budgeting and investment capacity as settlement and rural municipalities, post-amalgamation.

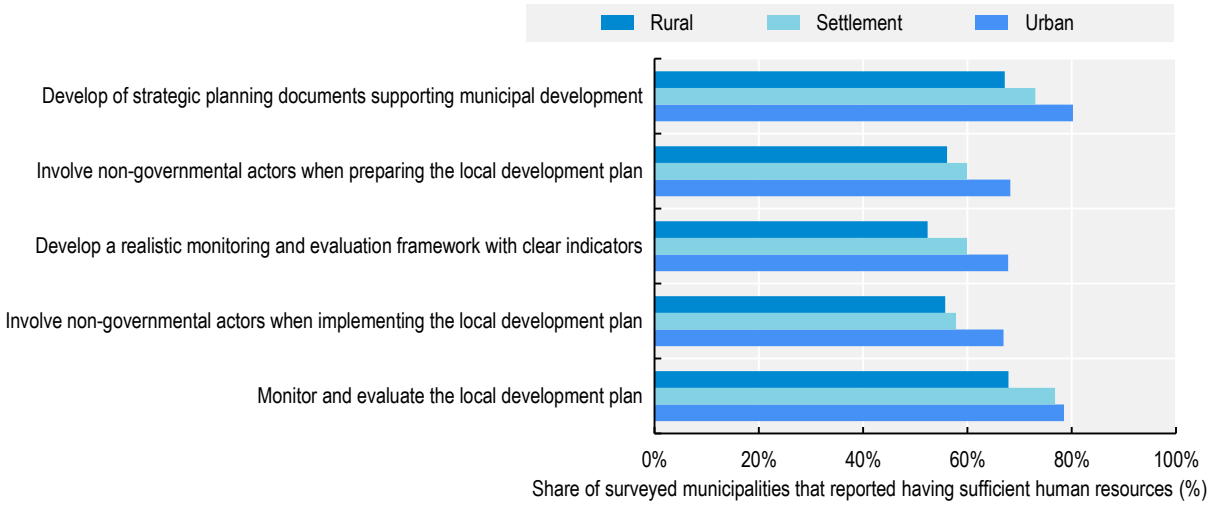
Administrative functions such as engagement with non-governmental actors, co-ordination with donors, and monitoring and evaluation will take on heightened importance for reconstruction and recovery efforts, prompting the need for additional capacity building support. Moreover, municipalities may want to explore engagement mechanisms to help ensure that the reconstruction efforts take into account the specific demands of citizens and that non-governmental actors are provided insight into how (recovery) funds are spent.

Most municipalities have been sufficiently staffed to carry out development planning

Nearly three quarters of all surveyed municipalities indicated that they had the capacity to develop local development strategies (73%) and to carry out monitoring and evaluation exercises (74%). However, fewer rural municipalities report having the human resource capacity for these tasks than urban and settlement municipalities (Figure 7.2). Until 2022, legislation did not mandate municipalities to develop a local development strategy (Verkhovna Rada, 2021[21]). Consequently, in 2021, only about half of all municipalities had an approved strategy, which limited their ability to guide local development efforts (OECD, 2021[22]). Given this, it is not surprising that over one quarter of municipalities considered that they were neither able to develop nor monitor a strategy. Moreover, municipal development planning was

generally limited to the development of one-year plans with a narrow sectoral focus, often dealing with only current, urgent measures while failing to address longer-term objectives and actions (OECD, 2021[22]).

Figure 7.2. Availability of human resources to carry out development planning-related tasks



Note: Question: Does your municipality have the necessary human resources (including expertise) to effectively carry out the following tasks related to the development planning process? Full list of tasks: Develop forecast and program documents of socio-economic development of the territorial community, in particular the strategy of development of the territorial community; Involve the private sector, civil society or academia when preparing the municipality's socio-economic development plan; Develop a realistic monitoring and evaluation framework with clear objectives and indicators; Involve the private sector, civil society or academia when implementing the municipality's socio-economic development plan; Carry out periodic monitoring and evaluation exercises of the municipality's socio-economic development plan. Response options: Yes, No. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

Surveyed municipalities reported that they had less capacity to: a) develop a realistic monitoring framework with clear objectives and indicators (60%) and b) involve the private sector, civil society or academia in the design (61%) and implementation (60%) of the municipality's development strategy. There are also important differences among the different types of municipalities. For example, 52% of rural municipalities considered that they were able to design a realistic monitoring framework, compared with 60% of settlement municipalities and 68% of urban municipalities, a disparity that may reflect the more extensive human resource capacity reported by urban municipalities compared to their peers.

There is a risk that large discrepancies in planning capacities could undermine territorial development in the future. The scale of social, infrastructure and economic development that will be required in many municipalities will necessitate extensive planning capacities and rigorous monitoring and evaluation systems. In July 2022, amendments to the Law "On the Principles of State Regional Policy" were adopted, which formalised a three-tiered strategic planning system and mandated the design of municipal development strategies. These legislative changes make the need to improve municipal planning capacities all that much more urgent (Verkhovna Rada, 2021[23]). MinRegion, together with the various local government associations, regional development agencies and international development partners should support municipalities, particularly rural ones, to improve their capacity to design, implement and monitor local development strategies that reflect local needs and are aligned to national and regional priorities, including those in a national recovery plan. In particular, the government should consider establishing an expanded list of standardised training programmes tailored to municipal responsibilities in the post-war recovery period. More specifically, teaching content should be subject to effective quality control (see Chapter 6). The focus of the training programmes would need to be reviewed periodically as

municipal capacity-building needs will change as Ukraine moves from the immediate post-war reconstruction phase to longer-term recovery. Efforts to boost municipal strategic planning capacity also need to include conducting local civil service needs assessments and encouraging municipalities to prepare training plans that reflect their particular needs for each of the phases of the strategic planning cycle. Similarly, the government should ensure that guidelines for the design of the local strategies emphasise the need for short and adaptable local strategies. This could be achieved by adjusting the official methodology to accommodate for the design of local development strategies.

Peer-to-peer learning initiatives could be set up to facilitate the exchange of experiences, tools and methodologies related to strategic development planning, citizen engagement and performance monitoring among Ukrainian municipalities and with local authorities in Europe. The European Alliance of Cities and Regions for the Reconstruction of Ukraine serves as one such example. International networks, such as the Partnership for Local Economic Development and Democratic Governance project implemented by the Federation of Canadian Municipalities, can also contribute to this work (Box 7.4). Policy makers and donors should ensure that such initiatives are tailored and targeted to the particular challenges of each type of municipality as their specific needs will likely be different. They should also ensure that the support flowing from these initiatives is equitably spread among different types of municipalities (e.g. rural settlement and urban), and includes built-in dissemination components to ensure that relevant knowledge, practices and tools are being shared across municipalities. Ukraine could also benefit from the EU's twinning instrument that enables institutional co-operation between public administrations of EU member states and beneficiary or partner countries. This instrument, of which Ukraine has become a beneficiary, aims to upgrade the administrative capacities of the public administration of beneficiary or partner countries by training civil servants. It also provides support to bring national laws, regulations and quality standards more in line with those of EU member states, which is particularly relevant as in June 2022 the European Council granted Ukraine EU candidate status (European Commission, 2022[24]).

Box 7.4. Partnership for Local Economic Development and Democratic Governance

Since 2015, the Partnership for Local Economic Development and Democratic Governance project—implemented by the Federation of Canadian Municipalities—has supported the design and implementation of development strategies in 16 cities across four regions of Ukraine. It developed a handbook to support strategic planning development and implementation alongside case studies of successful plans. They outline six stages of the strategic planning process:

1. Organising work on strategic planning.
2. Analysing the environment and the factors of territorial community development.
3. Defining the mission, vision, scenarios, and directions of community development.
4. Developing a strategy implementation plan.
5. Public hearing followed up by the official approval of the strategy and its implementation plan.
6. Monitoring and implementing the strategy.

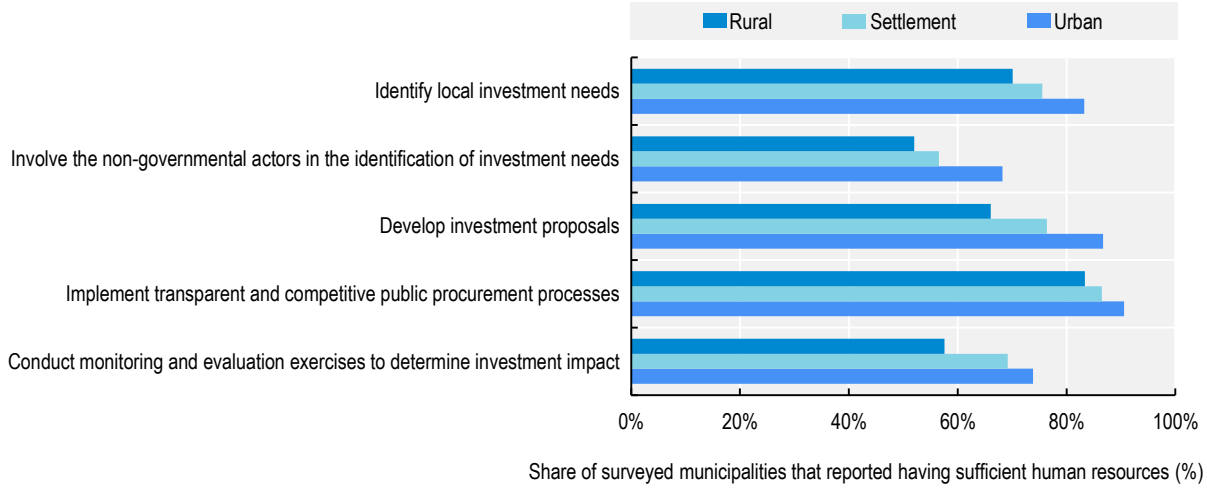
Source: Author's elaboration, based on (FCM, 2019[25]; Verkhovna Rada, 2021[21]).

Strategic planning for post-war recovery and reconstruction requires specific considerations. A handbook for municipal policy makers (similar to the one developed as part of the "Partnership for Local Economic Development and Democratic Governance") that is focused on the measures they can take to support reconstruction and recovery planning would be a useful resource, alongside training in areas such as monitoring and evaluation, and stakeholder engagement. The volume of investment that will be needed in many communities highlights the importance of strengthened strategic planning capacities.

A majority of municipalities reported having the necessary human resources to carry out public investment responsibilities

A large majority of municipalities (87%) considered that they have sufficient human resources to implement transparent and competitive public procurement processes with appropriate internal control systems. There was limited variation between types of municipalities (Figure 7.3). This may reflect the ease of use of the ProZorro electronic procurement platform through which state and municipal customers can organise tenders for the purchase of goods and services. When the ProZorro system was launched, many training sessions were organised on procurement regulations, and a training manual was developed. These actions may help to explain the confidence that municipalities reported in their ability to execute effective public procurement (OECD, 2021[22]). Municipal procurement capacity will be tested during the post-war reconstruction process as local governments will likely become recipients of national and international reconstruction funds, which have to be spent efficiently and in a transparent manner. As such, continued technical support for municipalities on issues related to local public procurement and transparent decision making is essential. Providing targeted training or developing easy-to-use procurement guidelines could be effective initiatives in this regard.

Figure 7.3. Availability of human resources to carry out investment-related tasks



Note: Question: Does your municipality have the necessary human resources (including expertise) to effectively carry out the following public investment tasks? Full description of tasks: Identify local investment needs; Involve the private sector, civil society or academia in the identification of investment needs; Develop investment proposals (e.g. for allocation of funds from the SFRD); Implement transparent and competitive public procurement processes with appropriate internal control systems; Conduct periodic monitoring and evaluation exercises to determine the impact of the investment projects. Response options: Yes, No. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

More than three quarters of municipalities indicated that they have the capacity to a) identify local investment needs and b) develop investment proposals (e.g. for the allocation of funds from the State Fund for Regional Development [SFRD]). There was, however, also some typological variation to this finding. For example, while 87% of urban municipalities reported having sufficient human resource capacity to develop investment proposals, this was the case for only 66% of rural municipalities. One possible explanation for this variation is that rural and settlement municipalities, particularly those that were administratively amalgamated in 2020, may have had a more limited experience with managing projects funded through Ukraine's multiple competitive funds for regional and local development.

A lower share of surveyed municipalities indicated that they have the human resource capacity to involve the private sector, civil society or academia in the identification of investment needs (59%) and to conduct periodic monitoring and evaluation exercises to determine the impact of public investment projects (66%). Reported human resource capacity in these areas in rural municipalities was lower still (52% and 58%, respectively). Monitoring and evaluation exercises and consultations with non-governmental stakeholders play a critical role in ensuring the effectiveness of local public investments. Improving municipal capacity in these areas through tailored training and coaching can help local governments systematically involve the private sector, civil society or academia throughout the investment cycle. Municipalities can build on the significant contribution of non-governmental actors to support the country's response to the war. In many communities, volunteers have been supporting local authorities, for example by organising the delivery of aid to residents, the military, internally displaced people and temporarily occupied territories (U-LEAD, 2022[19]).

Enhancing municipal administrative capacity in the context of post-war recovery

Municipalities generally perceive they are sufficiently staffed to carry out their core duties. This is a positive assessment, however, typological variations indicate that smaller municipalities (rural and settlement) often have less capacity in this regard. Continued investments that are tailored to the human resource needs of specific types of municipalities will be important. Below, possible interventions to strengthen local government administrative capacity are discussed. They relate to i) strengthening the offer of high-quality and training programmes that are adapted to the territorially-differentiated needs of municipalities and take into account specific recovery challenges; and ii) promoting and facilitating human resources-sharing among municipalities to fill particular capacity gaps.

High-quality, flexible and responsive professional training for local government

Recruitment and talent retention is supported through municipal human resource training and talent management, including the development of competitive subnational employment policies such as attractive remuneration and non-financial incentives (e.g. mentoring). Ukraine's municipalities have typically accessed professional development through vocational and certification training and shorter-term courses, with the National Civil Service Agency annually designating priority training topics (Національне агентство України з питань державної служби, 2022). Moreover, after the National Academy of Public Administration was reorganised by joining Taras Shevchenko Kyiv National University in 2021, the Educational and Scientific Institute of Public Administration and Civil Service was established. The Institute has accredited programmes in public administration, including a programme for civil servants and local self-government officials (Taras Shevchenko Kyiv National University, 2022[26]). At the same time, as the war has affected municipal human resource capacity and altered the demands for municipal service delivery, new training methodologies will be needed, including fast-track courses alongside new degree programmes in specialised subject areas. These can include strategic planning, project appraisal, economic development, project management, donor relations and public procurement. Regarding the latter, the OECD *Recommendation of the Council on Public Procurement* stresses that developing effective human resource capacity is a crucial element of a sound procurement system that delivers efficiency and value for money in the use of public funds (OECD, 2015[27]). As such, strengthening human resource capacity has become a priority in countries' public procurement reforms. Specialised training focusing on the particular challenges associated with procuring goods and services in a reconstruction and recovery context might be particularly relevant for Ukraine, as in 2021, a large majority of municipalities (87%) considered that they had sufficient human resources to implement transparent and competitive public procurement processes (Figure 7.3).

Previous OECD research on decentralisation in Ukraine has noted the importance of designing a subnational strategy for human resource management (OECD, 2018[28]). The OECD recommended to Ukraine that it establish a national consultation platform to reform the training system for local authorities;

request and support (technically and financially) subnational governments with the design of an annual training plan; establish specific training for senior managers in local government; and set up an observatory of local employment, remuneration and competences (OECD, 2018[28]). The OECD had also recommended that the National Academy of Public Administration develop specific training programmes for local governments. These recommendations still hold value for Ukraine. Moreover, the government should consider the following actions:

- Establish a reconstruction and recovery training strategy for municipalities that can be adapted to different territorial contexts and needs;
- Establish a high-quality, flexible and responsive municipal training system for reconstruction and recovery;
- Conduct an assessment of local training needs and prepare municipal training plans;
- Set up train-the-trainer programmes as a cost-efficient way to build capacity within municipalities. Such programmes can help create and support a highly skilled network of trainers who can effectively localise and multiply the acquired knowledge and skills in their communities.

Higher education institutions, the local government associations, regional development agencies, non-governmental organisations, as well as international municipal networks will be critical actors for supporting new and expanded municipal training efforts (Box 7.5). MinRegion plays an important role in quality control, monitoring, assessment and co-ordination for training and capacity building.

Box 7.5. Approaches to local government training

There are a variety of training models for local government administration, from formal degrees including diplomas and certificates to shorter training programmes, one-off courses, and initiatives such as workshops and mentoring. While there are a wide range of short-term courses and workshops, the quality and rigour of these programmes should be assessed.

Association of Ukrainian Cities

Currently, the Association of Ukrainian Cities (AUC)—a non-governmental, non-profit, and non-partisan organisation, which unites a large share of Ukrainian municipalities—supports training and professional development through its AUC Centre. The centre is involved in drafting and implementing training programmes for municipal staff, holding workshops, regional training and schools for municipal employees, while maintaining databases of local self-government experts and training institutions.

Accredited programmes for local government management are critical because they equip civil servants with important skills in local administration and budgetary issues, strategic planning, infrastructure, public services, entrepreneurship, community development and asset management.

Government of British Columbia

As an example of how an accredited programme can be established, the Government of British Columbia (Canada) appoints a Board of Examiners, which offers certification and scholarship programmes to improve and recognise the professional skills and education of British Columbia's local government staff and build their administrative capacity. The Board of Examiners is established by legislation and is comprised of representatives from British Columbia's government, the Local Government Management Association and the Union of British Columbia Municipalities. This model ensures that the training that is offered is robust, meets the needs of local government managers and is co-ordinated across the various institutions that provide training. This could be a useful model of shared governance for training certification for Ukraine to consider.

Training programmes for army veterans

In the post-war period, training programmes for Ukraine's veterans could help them transition into careers in local government. For example, in the United States, the Veterans Local Government Management Fellowship offers a 12-to-25-week programme that provides service members who are leaving the armed forces with management training and hands-on experience in local governments to help them start a career in local public service. The programme matches former service members with local governments based on the skills, level of education, experience, and the preferences of both parties (veterans and local governments). Initiatives such as this could support local government capacity building for reconstruction and recovery in Ukraine, while also facilitating the transition of military personnel to civilian careers.

Source: Author's elaboration, based on (Government of British Columbia, 2022[29]; Association of Ukrainian Cities, 2022[30]; ICMA, 2021[31]).

Reforms to the training system for local civil servants in Ukraine should go hand-in-hand with amendments to the 2001 Law "On Service in Local Self-government". These will be necessary to improve municipal human resource and administrative capacity (Verkhovna Rada, 2001[32]). There is currently no requirement for local officials to be politically neutral, and the recruitment criteria for local civil servants are often not based on merit (see Chapter 6). Both of these elements should be adjusted in order to create the conditions for a more professionalised local civil service that can shoulder the burdens of the reconstruction and recovery phase. Remuneration issues, notably the gap in remuneration between national and local civil

servants, should be reviewed in order to facilitate the recruitment and retention of more highly-skilled local officials.

Sharing administrative and human resources

As described above, rural municipalities often have diminished capacity in the fields of budgeting, development planning and investment than their urban counterparts. With municipalities expected to play a critical role in recovery efforts, effective mechanisms need to be in place to strengthen and support the administrative capacity and human resources in communities most affected by the war, regardless of whether they are categorised as urban, rural or settlement municipalities. Administrative and human resource-sharing is one mechanism for doing so. One option is for the government to establish mechanisms to support temporary secondments and job shadowing among larger and smaller municipalities. However, these mechanisms should only be applied when, in the post-war period, the basic administrative and human resource capacities of the most affected municipalities have been restored and they are able to send key staff to other municipalities without undermining their own capacities (Box 7.6). For secondments and job shadowing to work, incentives need to be in place to ensure that both local civil servants and municipal governments are interested in and can benefit from participating. For example, a grant could be created that provides participating civil servants with funding to compensate travel and accommodation costs. It could also cover part of the salary of the participating civil servant during his or her secondment or job shadowing period. The latter could encourage local leaders to allow their staff to temporarily work in another municipality.

Box 7.6. Secondments and job shadowing for local government capacity sharing

A secondment is the temporary transfer of an employee to another municipality or relevant organisation. Secondees get access to career development opportunities, while municipalities get the chance to develop their skills base. Advantages for secondees include the opportunity for wider career and personal development; the acquisition of valuable project and service experience; and the chance to apply specific skills in a different organisational environment. Municipalities also benefit by gaining assistance with projects and obtaining an external perspective. It is also cost-effective and a network-building opportunity.

Shadowing is similar to a secondment. The primary difference is that the learner acts as merely an observer to the work and the organisation. He/she will assume a secondary role and their contribution to operational functions is likely to be minimal. The learner will observe, record and question aspects of the work being undertaken and will, at the end of the experience, reflect on, analyse and evaluate what has been observed. The arrangements for shadowing are flexible and should be agreed between the learners and the host organisation. Once again, shadowing can be agreed over a set timescale and frequency. Exposure to good working practices will equip the learner with the confidence and skills to return to his/her municipality. They should record the experience in a written report and be ready to make a presentation on the practices observed and use the new skills and experience to train/mentor colleagues.

Source: Author's elaboration, based on (Jackson, Trutkowski and Mururajani, 2015[33]).

A flexible approach to administrative capacity and human resource-sharing could help Ukraine meet urgent needs while simultaneously strengthening relationships with other municipalities and demonstrating the benefits of collaboration. This could increase the attractiveness of possible future amalgamations, which is important because in the past, rural municipalities have sometimes been hesitant to merge because

they felt that it would lead to a loss of influence and control over budgets (Hedikova and Muzychenko, 2021).

Effects of the decentralisation reforms on local public service delivery

Ukraine's decentralisation reforms have promoted subsidiarity by assigning new responsibilities to municipalities, which is particularly true for public service delivery tasks. The attribution of responsibilities is roughly in keeping with international trends in multi-level task attribution at the subnational government level, though fewer functions are assigned to the regional and district levels compared to the situation in other countries (OECD, 2018[28]).

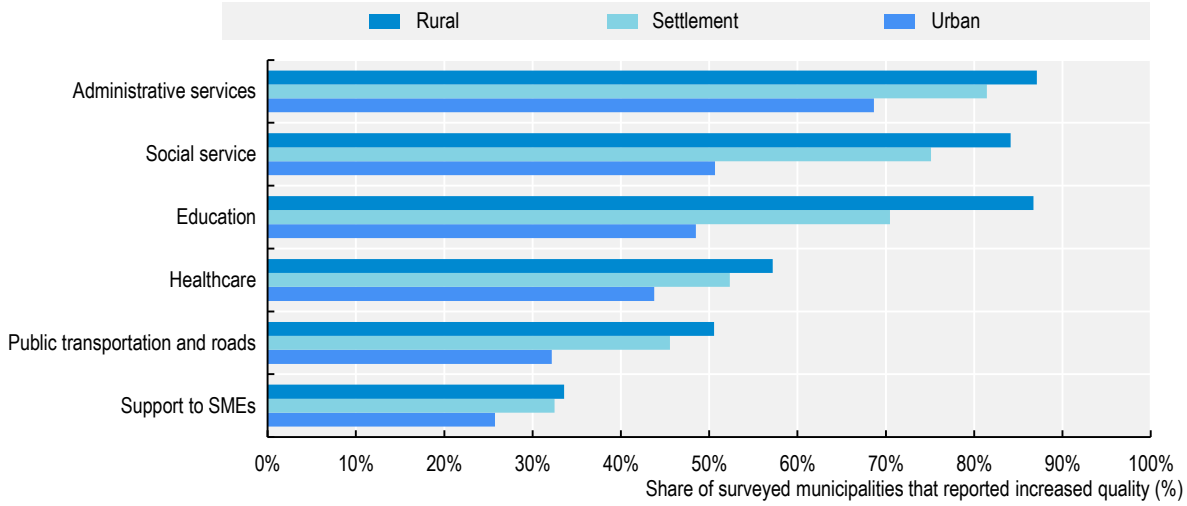
Proponents of decentralisation argue that local and regional governments can provide public services that are better suited to local needs (OECD, 2017, 2019). However, it is important to consider not just which level of government delivers what types of services, but also the context in which they operate, whether the service delivery responsibilities are shared among levels of government, as well as the resources and incentives that they have to perform their duties. Each of these elements can affect the efficiency and effectiveness of subnational service provision. There is growing evidence that 'soft institutions' such as civic culture, leadership and trust in government play an important role in shaping outcomes (Rodríguez-Pose, Tijmstra and Bwire, 2009; Klok *et al.*, 2018).

This section discusses how municipalities perceived the effect of the decentralisation reforms on public service delivery. It also presents how long the different types of municipalities estimate they will need before they can effectively carry out their service tasks and responsibilities and whether there is a need for further amalgamation. It also provides different policy recommendations on how to boost service delivery in the context of post-war reconstruction, for example by adopting integrated service provision models.

Decentralisation reforms were perceived as positive for administrative service delivery

The effect of the decentralisation reforms on local service delivery varies according to the service area. A vast majority of municipalities (79%) reported that the reform process had had a positive effect on the quality of administrative services, including 87% of rural municipalities, 81% of settlement municipalities and 69% of urban municipalities (Figure 7.4). This reflects the recent proliferation of administrative service centres in Ukrainian municipalities, which have made administrative transactions easier and more convenient by allowing residents to deal with administrative issues in their own municipality (Verkhovna Rada, 2020[34]). The relatively low number of urban municipalities reporting that the reform process had a positive effect in this area might be explained by the fact that administrative services were previously handled in regional hubs, which may have meant limited change for the residents of larger cities.

Figure 7.4. Positive effect of the decentralisation reforms on the quality of local service delivery



Note: Question: What effect have the decentralisation reforms (including the amalgamation process) had on the quality of service delivery by your municipality in the following areas? Response options: Increased quality; Decreased quality; No significant effect. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

A large majority of municipalities also reported that the reform process had had a positive effect on the quality of local services, such as social services (71%) and education (70%), while a smaller majority reported a positive effect on healthcare. This was an encouraging finding in the context of improving citizen well-being, not least because research has shown that satisfaction with local public services has a strong impact on citizen trust in government at the local level (Mitsch, Lee and Ralph-Morrow, 2021[35]). There was, however, a significant divergence in the responses by type of municipality. For example, 84% of rural municipalities reported that there had been an increase in the quality of social services, compared with 75% of settlement municipalities and just 51% of urban municipalities. Data from the Ministry of Social Policy indicate that the reform process has led to a large rise in smaller municipalities providing social services for the elderly and families. This may help to explain why the reported improvement was less pronounced in cities, where residents may have already had access to quality social care before the reforms. A similar argument could explain the significant differences between the average responses from urban and rural municipalities regarding the quality of education services.

The education, social services and healthcare sectors have been under particular stress since February 2022. By August 2022, it was estimated that Russia's war against Ukraine had damaged or destroyed 1 435 education institutions, 764 kindergartens, 89 social services facilities and 903 healthcare facilities totalling USD 5.7 billion in damages (KSE, 2021[36]). The widespread destruction of physical infrastructure has limited municipalities' capacity to continue to provide services in these sectors.

The OECD survey also indicated that the reform process had a weaker effect on supporting territorial economic development. Only 34% of rural municipalities, 32% of settlement municipalities and 26% of urban municipalities felt that the reforms had increased the quality of economic development in their communities. This might reflect the fact that decentralisation reforms often take time to generate concrete results. However, there is evidence that municipalities do not consider boosting economic development to be among their key responsibilities, and also find it challenging to support small and medium-sized enterprises. In fact, results from the OECD project's online survey indicate that supporting economic development has not been a high priority for municipalities, compared with other policy areas, such as social services (see Chapter 6) (OECD, 2021[22]). Stimulating territorial economic development is of crucial

importance for rebuilding communities and encouraging residents who have fled to other, safer parts of the country or abroad to return.

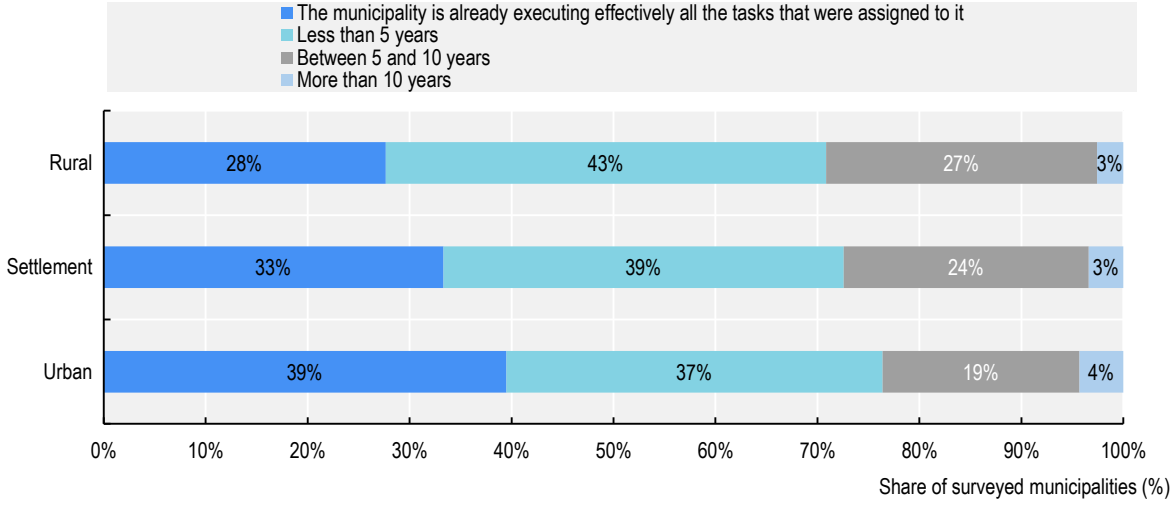
The survey results may also reflect limited municipal capacity to support local development or the impression of municipal leaders that their main priorities are related to social service delivery and not economic development (OECD, 2021[22]). For example, despite having the power to establish PPPs and involve the private sector in the identification of local investment needs, the survey indicated that many municipalities felt they lacked the capacity to do so. These are important considerations for discussion when addressing the next steps in the decentralisation process. Improving guidance on actions that municipalities can take to support the private sector and strengthening their capacity to engage effectively with local businesses are fundamental to boosting subnational economic activity in the recovery period. Besides that, the government could explore increasing financial incentives for municipalities to strengthen their local economy, for instance by increasing the municipal share of the corporate profit tax generated in their territories.

The majority of municipalities believe that they will require more time to be able to effectively execute their mandate

A majority of municipalities believe that they will need at least several additional years before they are able to effectively execute all the tasks and responsibilities assigned to them. Only 33% of all surveyed municipalities considered that in 2021 they were already carrying out all their tasks and responsibilities effectively. Forty percent expected that it would take up to five years of internal reorganisation, while an additional 27% believed that it would take them at least five years.

There were slight variations across municipal typologies, with 39% of urban municipalities reporting that they were already carrying out their tasks and responsibilities effectively, compared with 33% of settlement municipalities and 28% of rural municipalities (Figure 7.5). At the same time, about the same percentage of rural, settlement and urban municipalities (27%, 24% and 29%, respectively) considered that they would need at least 5 years of internal reorganisation before they could fully carry out their mandate.

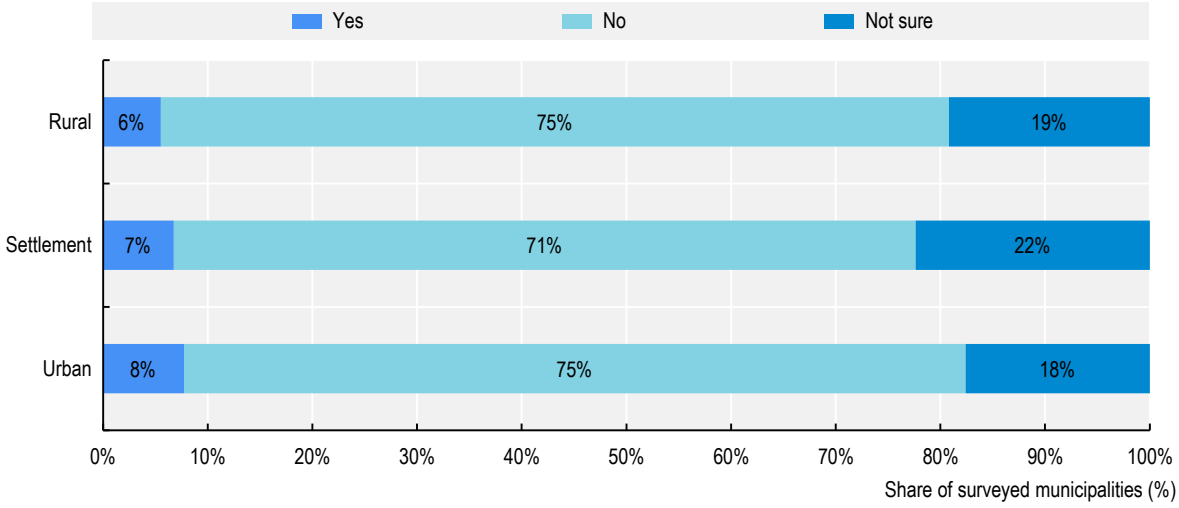
Figure 7.5. Estimated time before municipalities can effectively execute all the tasks and responsibilities that are assigned to them



Note: Question: How many years of internal reorganisation and adjustments do you think it will take before your municipality is executing effectively all the tasks and responsibilities that were assigned to it as part of the decentralisation reforms (including the amalgamation process)? Response options: The municipality is already executing effectively all the tasks and responsibilities that were assigned to it; Less than 5 years; Between 5 and 10 years; More than 10 years. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

The widespread destruction of the war, and its detrimental effects on municipal administrative, human resource and fiscal capacity have increased the likelihood that municipalities will need much more time before they can effectively execute their remit. These are important considerations as policy makers contemplate next steps in the decentralisation process, including further amalgamation, reinforcing inter-municipal co-operation and possible adjustments to the devolution of administrative and service delivery tasks. Regarding further amalgamation, it is worth noting that in 2021, a majority of municipalities (74%) did not consider that they required further amalgamation to effectively provide public and administrative services to their populations. However, a notable minority (26%) reported that either they would or were not sure. This finding was largely consistent across urban, rural and settlement municipalities (Figure 7.6).

Figure 7.6. Perceived need for further amalgamation in the future



Note: Question: Do you think that your municipality may need to be further amalgamated with another municipality to be able to provide basic services to its population? Response options: Yes; No; Not sure. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

These findings are instructive in the context of the current debate on the merits of adjusting Ukraine's territorial administrative organisation after the war ends. The debate has been ignited by the way that Russia's war in Ukraine has transformed the demographic situation across territories and wrought widespread infrastructure damage in certain areas. In the post-recovery period, the government should re-evaluate whether Ukraine's current territorial administrative structure is fit for purpose. This could go beyond, for example, a discussion over the role of *rayon* state administrations and the creation of prefects (see Chapter 6) to include a reflection on the need for further amalgamations in order to ensure effective local public service delivery.

Adopting flexible and shared service delivery models can address gaps in service provision

As shown by the survey results, municipalities have generally reported an increase in local service quality since decentralisation, particularly among rural and settlement municipalities. This is a key achievement of decentralisation reforms. However, there is evidence of territorial inequalities, as some municipalities reported needing more time before they can carry out their all tasks. Many municipalities did not amalgamate until 2020, after which they had to manage the effects of COVID-19 pandemic and Russia's war. These municipalities may need further time to improve their performance. Additional training and greater fiscal capacity could be needed for municipalities that are lagging behind.

Flexible and integrated service provision models could help fill gaps and increase municipal capacity. Co-operation, collaboration, co-production, colocation, and flexible service provision models are relevant in this regard (Box 7.7). These approaches to service provision could help tailor municipal services to user needs and territorially-differentiated circumstances; and in the case of co-production, they could leverage local assets to maintain standards. As an example, Estonia is maintaining hospitals with very small catchment areas through a networking approach, with regional hospitals taking on a leading role in governing general hospitals (Rechel et al., 2016[37]).

Box 7.7. Integrated and flexible service provision models

Integrated service delivery entails combining services for the benefit of users and to improve efficiency in delivery by providers, including costs, quality and access. This can include joint planning, the co-operation or communication among service providers, collaboration among professionals across different sectors, the physical or virtual colocation of complementary services, or a mix.

- **Collaboration** refers to agencies, at the national and/or subnational levels, working together through information-sharing and training, and creating a network to improve service experience for users. This can help to reduce any gaps in service provision. Increased professional knowledge about different services can enhance "needs-based" recommendations. In rural areas, collaboration may be more easily achieved due to the smaller number of individuals involved in service provision.
- **Co-operation** refers to a form of integration wherein professionals communicate and work together, for example on multi-agency teams. Beyond the practitioner level, this can also entail co-operation among or across levels of government (vertical or horizontal). Doing so can help lower the costs of delivering services by reducing duplication, and better identify and respond to service user needs. Often such integration requires facilitation at the regulatory and policy levels in order to, for instance, share resources and other information and pursue joined-up strategies.
- **Co-production** refers to the involvement of community or non-profit groups (i.e. the third sector) in service provision. Some countries have a long history of this tradition—e.g. Germany and the Netherlands where co-production was an essential part of the construction of the post-war welfare state. In some European countries, the term is used to describe the organised involvement of citizens in their own welfare production. In many countries, co-production is increasingly promoted as a cost-effective way of providing services in rural areas. With denser social networks, rural areas may have a competitive advantage over urban ones in pursuing this type of service delivery strategy.
- **Colocation** is a form of (light) integrated service delivery. This practice refers to having different services or agencies being located in one building (e.g. one-stop shops such as Ukraine's administrative service centres). It can provide residents with access to multiple services in one place, while reducing administrative and capital costs.
- **Flexible service provision** can be used to fill the gaps where fixed assets or standard forms of service provision are not possible and/or to improve service accessibility by bringing services to people. It can help to tailor services to different circumstances. Examples of flexible service provision include mobile health services such as blood clinics or medical visits. It can also refer to replacing fixed public transport routes in rural areas with a taxi service, which may be a more affordable option depending on distances/volumes.

Source: Author's elaboration, based on (OECD/EC-JRC, 2021[38]).

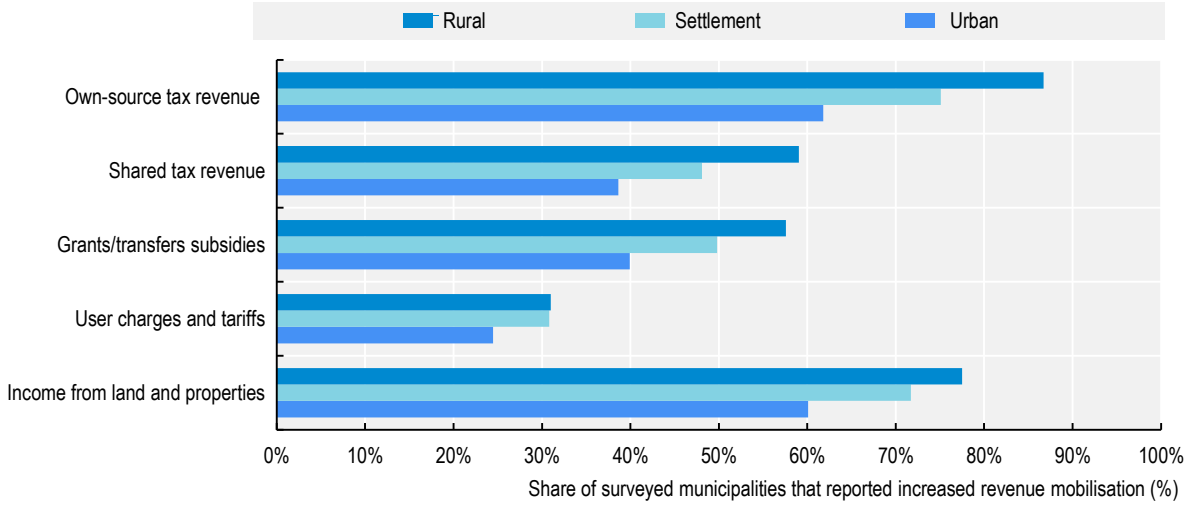
Effects of the decentralisation reforms on sub-regional finance and investment

Fiscal decentralisation has accompanied administrative reforms in Ukraine. Subnational governments have benefit from new revenue sources, tax-sharing arrangements, local taxes and a revised equalisation system (see Chapter 5 and Chapter 6). Fiscal decentralisation processes take time to fully transfer competences and resources from the central government to lower levels of government and as such, this remains an evolving aspect of the decentralisation reform process (OECD, 2018[28]).

Tax revenues increased in the majority of municipalities

A majority (75%) of surveyed municipalities report that the decentralisation reform process increased their own-source tax revenues. There was significant variation among different types of municipalities; with 87% of rural municipalities reporting that their own-source tax revenues had increased compared with 75% of settlement municipalities and 62% of urban municipalities (Figure 7.7). Similar differences can be found with regard to shared tax revenues (e.g. Personal Income Tax). The lower share for urban municipalities may reflect the fact that some were formerly cities of *oblast* significance, which entitled them to a 75% share of Personal Income Tax (PIT), compared to the 60% that they receive today. By contrast, local communities in rural and settlement areas only received 25% of PIT prior to the decentralisation reforms, and therefore saw a significant increase in shared tax revenues. The survey results largely match changes in the distribution of municipal revenues between 2016 and 2020 (see Chapter 6). Over this period, the share of tax revenues of amalgamated municipalities (including shared and local taxes), increased from 46% to 62% of the total revenues of amalgamated municipalities (CabMin, 2021[39]).

Figure 7.7. Effect of the decentralisation reforms on the mobilisation of revenue sources



Note: Question: What effect have the decentralisation reforms (including the amalgamation process) had on the mobilisation of the following sources of revenue of your municipality. Full list of sources of revenue: Tax revenue (own-source); Tax revenue (shared between municipality and other levels of government); Grants/transfers subsidies; User charges and tariffs; Income from land (lease, sales, land value capture) and properties (buildings). Response options: Increase; Decrease; No significant effect. The questionnaire was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD project survey.

In addition, over two thirds of municipalities (70%) reported an increase in income from land/property. This likely reflects the mandatory transfer of "objects of common property" that were previously held by *rayons* (e.g. healthcare and education institutions) to municipalities in 2020, which bolstered the land incomes of the latter. The finding was highest for rural municipalities (77%), followed by settlement and urban

municipalities (72% and 60% respectively), which may reflect the fact that urban municipalities were relatively more likely to own objects of common property prior to the launch of the reform process.

Only half of surveyed municipalities reported that the reforms had increased their revenue from central government transfers. While this may appear striking given that the amount of funding available for municipalities through government grants rose substantially between 2015-2019 (see Chapter 5), the survey results largely correspond with a gradual decrease in the share of transfers as part of the total revenues of amalgamated municipalities (from 49% in 2016 to 33% in 2020) (see Chapter 6). Moreover, the survey results may reflect the fact that municipalities have also seen a substantial increase in tasks since 2015, and may not feel that the net increase in funding has been commensurate with their new responsibilities.

Ensuring territorial equality amidst differences in fiscal capacity for recovery

The OECD project survey indicates that decentralisation has increased own-source revenues, particularly for rural municipalities. There are a number of positive benefits related to this, including municipal ownership over budgets and a stronger connection between the taxes that citizens pay and the services they receive, which can lead to improved public accountability and trust in government. The ongoing war, however, has upended public finance and new mechanisms will evolve to support reconstruction and recovery efforts, including national reconstruction grants and funds from international donors. In this regard, it is essential for the government to periodically assess the fiscal capacity of municipalities and how their public finance needs evolve during the war and post-war reconstruction and recovery period. This should be coupled with establishing transparent monitoring and accountability frameworks that show how recovery funds are spent.

It will be critical that relatively weak municipalities, which tend to lack dedicated finance professionals, do not fall through the gaps in accessing such reconstruction funds. This requires, among other elements, ensuring that the application process for funding is not highly complex or bureaucratic. Moreover, it is important for the government to make sure that information on funding opportunities is widely shared and shared in a timely manner, for example through the local government associations, as well as the Congress of Local and Regional Authorities. In addition, the national and regional governments should track not only which municipalities are applying for funds, but also those that are not applying for them in order to discern whether this is related to a lack of need or a lack of administrative capacity, the latter of which may require intervention.

Effects of the decentralisation reforms on local democracy and public engagement in local decision making

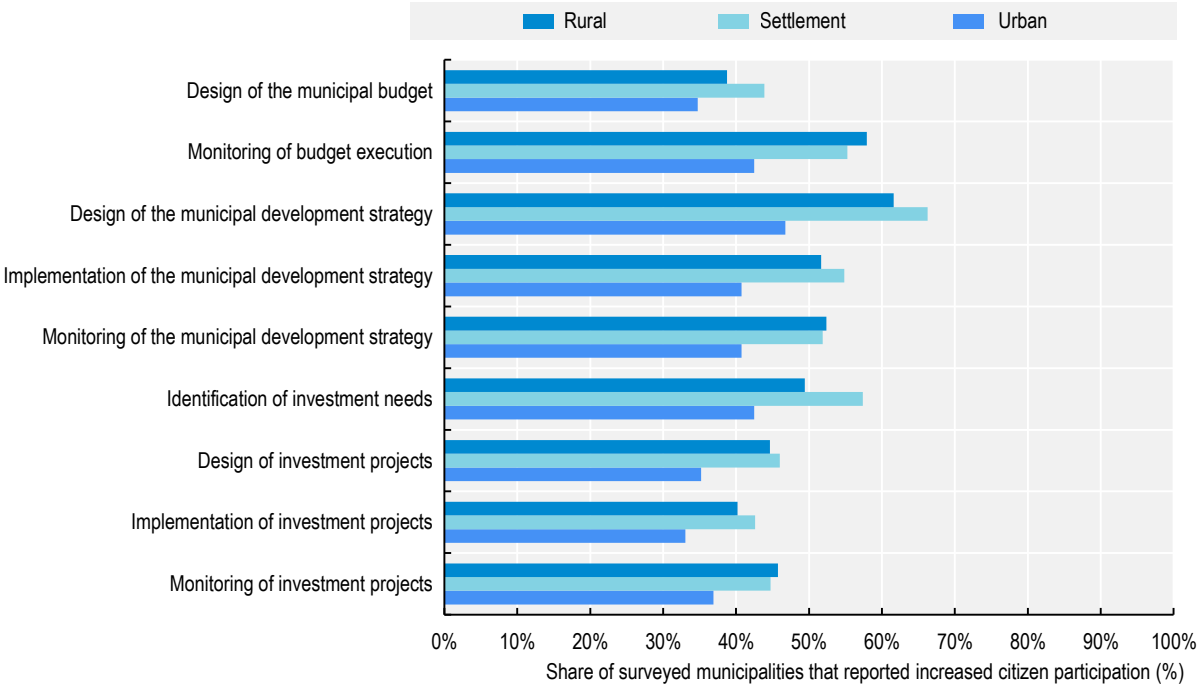
Improving local democracy was one of the goals set out in the 2014 “Concept of Reforming Local Self-Government and Territorial Organisation of Power” (CabMin, 2014[40]). Since then, the decentralisation reforms resulted in the direct election of 1 469 new councils and a further institutionalisation of the *starosta* (see Chapter 6). Moreover, prior to February 2022, civic engagement tools such as electronic petitions were increasingly being used at the municipal level. The same applied to participatory budgeting, particularly in larger cities (Sabadash and Kruglashov, 2020[41]).

This section presents how municipalities perceived the impact of decentralisation on the participation of citizens and businesses in municipal decision making processes. It demonstrates that continued investment in local democratic engagement is needed. The section ends with a discussion of the importance of strengthening public engagement, reporting and accountability, particularly in the context of the post-war recovery period. It also addressed the effect that the war has had on public engagement in municipal decision making.

Few municipalities reported improved participation of citizens and businesses in local decision making

Small majorities of surveyed municipalities felt that the decentralisation reforms had improved citizen participation in the design of a municipal socio-economic development plan (58%); monitoring of budget execution (52%); and identification of investment needs (50%). For all other areas related to citizen participation, a majority of municipalities felt that the reforms had had no effect. There was also a notable divergence between types of municipalities, with less than half of surveyed urban municipalities reporting that the reforms had increased citizen participation across all the different decision making areas, compared to over half of surveyed rural and settlement areas (Figure 7.8).

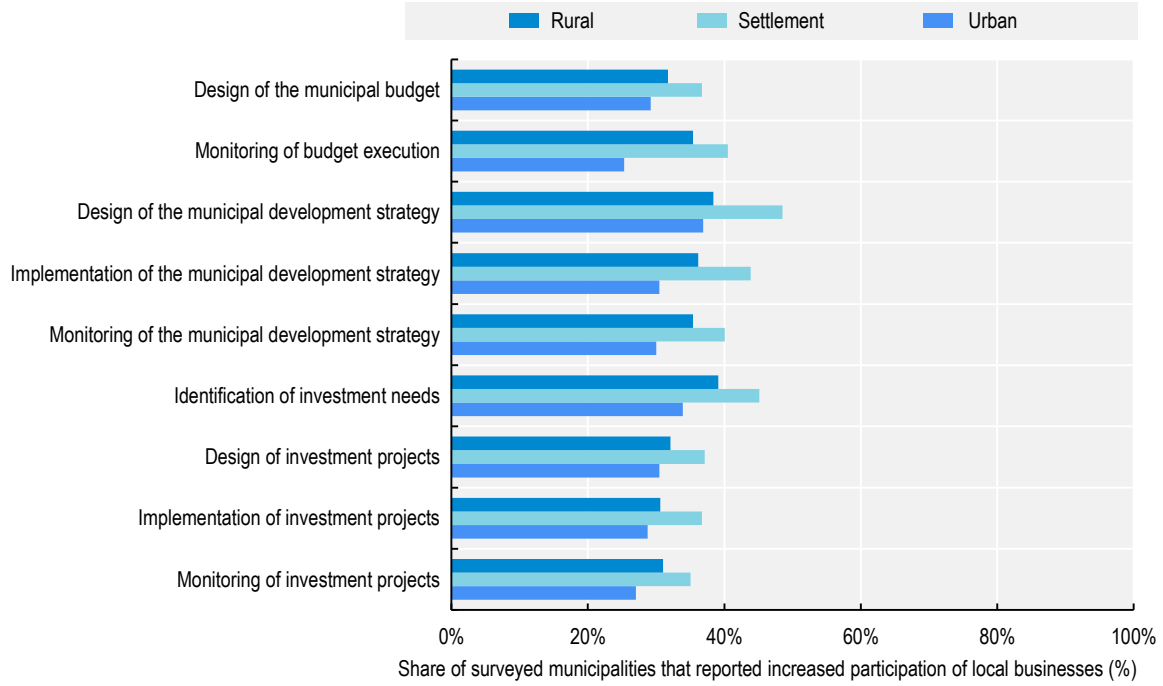
Figure 7.8. Effect of decentralisation reforms on citizen participation in municipal decision making



Note: Questions: What effect have the decentralisation reforms (including the amalgamation process) had on the participation of individual citizens in the following areas of municipal decision making? Full list of areas of municipal decision making: Design of the municipal budget; Monitoring of budget execution; Design of the municipal socio-economic plan (strategy of development of the territorial community); Implementation of the municipal socio-economic plan (strategy of development of the territorial community); Monitoring of the municipal socio-economic plan (strategy of development of the territorial community); Identification of investment needs; Design of investment projects; Implementation of investment projects; Monitoring of investment projects. Response options: Increased participation; Decreased participation; No effect. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

A sizeable majority of municipalities indicated that the reforms had had no effect on the involvement of local businesses in municipal decision making. Overall, this finding was most pronounced in urban municipalities, followed by rural and settlement municipalities. For example, only 25% of urban municipalities felt that the reforms had increased private sector involvement in the monitoring of budget execution, compared with 35% of rural municipalities and 41% of settlement municipalities (Figure 7.9).

Figure 7.9. Effect of the decentralisation reforms on business participation in municipal decision making



Note: Questions: What effect have the decentralisation reforms and amalgamation process had on the participation of local businesses (private sector representatives) in the following areas of municipal decision making? Full list of areas of municipal decision making: Design of the municipal budget; Monitoring of budget execution; Design of the municipal socio-economic plan (strategy of development of the territorial community); Implementation of the municipal socio-economic plan (strategy of development of the territorial community); Monitoring of the municipal socio-economic plan (strategy of development of the territorial community); Identification of investment needs; Design of investment projects; Implementation of investment projects; Monitoring of investment projects. Response options: Increased participation; Decreased participation; No effect. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration based on the OECD online survey.

These findings could be interpreted in different ways. On the one hand, municipalities may feel that they were already adequately engaging with citizens and local businesses in municipal decision making and as such, reforms have not increased engagement. This may, for example, explain the lower number of urban municipalities reporting increased citizen participation due to the decentralisation reforms. As indicated previously, particularly in larger municipalities, tools such as participatory budgeting had been used more frequently in recent years.

What the findings likely reflect, however, is the lack of awareness and/or understanding of the existing legislative and regulatory framework with regard to public participation and consultation at the subnational level (OECD, 2021[22]). For example, in 2020 the Ministry of Finance published methodological guidelines on how to organise public participation mechanisms in the budget process at the local level (Verkhovna Rada, 2020[42]). In addition, as mentioned above, many municipalities reported that they don't have the necessary capacity to involve non-governmental stakeholders in planning, budgeting and public investment processes.

Strengthening public engagement, reporting and accountability

Public engagement is about developing a partnership between public officials and community residents in the governance process. It requires sharing information and managing competing interests. It also requires

trust and acknowledging the contribution that non-governmental actors can make to decision making on development priorities, revenues and spending, among other elements.

Over the course of the war, municipalities have been working closely with civil society, non-governmental organisations and businesses to deliver critical services, co-ordinate humanitarian aid and mobilise recovery efforts. Many have noted how this is transforming the culture of civic engagement and local democracy in beneficial ways (Gumenyuk, 2022[43]). In the reconstruction period and beyond, Ukraine should build on this experience. In order to enhance public engagement in municipal decision making, the government should consider passing new legislation to make public consultation a systematic component of development and investment planning at the subnational level. In particular, it should clearly set out the mechanisms through which municipalities can boost public engagement, such as participatory planning and budgeting, and ensure that public participation tools (to inform, consult, involve, collaborate or empower) are fit-for-purpose. At the same time, the government should be careful not to overwhelm municipalities with requirements to organise public engagement processes, as this might stifle municipal decision making and lead to consultation fatigue on the part of citizens and businesses.

While all municipalities are required by law to present an annual report to their local council on local budget execution, only 59% of surveyed amalgamated municipalities indicated that they had done so (OECD, 2021[12]). There was some variation across types of municipalities, with 65% of rural municipalities reporting having presented such a report, compared to 59% of settlement municipalities and 52% of urban municipalities. A more systematic submission of annual public reports could provide an added measure of transparency and accountability to subnational government activities, particularly as municipalities will be involved in the implementation of recovery projects. This would help municipalities to demonstrate to residents that taxes and donor funding are being spent efficiently and effectively, and show the progress that is being made towards local development objectives.

The government is advised to provide additional resources (e.g. updated methodologies and reporting templates) on how to develop and present annual reports that can inform a wide range of stakeholders about the activities that have been implemented, how funds have been spent and the degree to which local development goals have been met. Moreover, the government could consider making the presentation of an annual report a condition for receiving funds from, for example, the SFRD.

Related to public participation in the field of budgeting, the OECD previously recommended that Ukraine make budget information more easily accessible and understandable to the public (a “budget for citizens”) and develop capacity building meetings with the population in order to develop their financial skills and understanding (OECD, 2018[28]). Moreover, it recommended setting up citizen monitoring committees for fiscal issues and publishing a yearly (or half-yearly report) on budget execution in a friendly format, accessible by the public. Finally, it urged officials to promote the use of participatory budgeting experiences through which citizens can express their demands in terms of budget allocation and prioritisation (OECD, 2018[28]). These recommendations still hold value for Ukraine.

The vast investment that will be needed to support local reconstruction and recovery underscores the importance of robust public engagement in municipal decision making. Non-governmental actors may be able to provide financial, material and human resources to implement reconstruction projects, and to monitor the use of public and donor funding.

Effects of the decentralisation reforms on vertical and horizontal co-ordination and co-operation

Co-ordination and co-operation between and among levels of government is a key element of successful decentralisation reform (OECD, 2019[44]). Co-ordination entails joint or shared information flows among organisations while co-operation implies joint action. The OECD has noted that inter-municipal co-operation is slowly gaining traction, but that there is room for improvement (see Chapter 6). In addition,

existing vertical co-ordination mechanisms face multiples challenges (see Chapter 4 and Chapter 6). A relationship based on partnership among levels of government, as opposed to hierarchy, has become increasingly important as municipalities have gradually received more administrative and service delivery responsibilities.

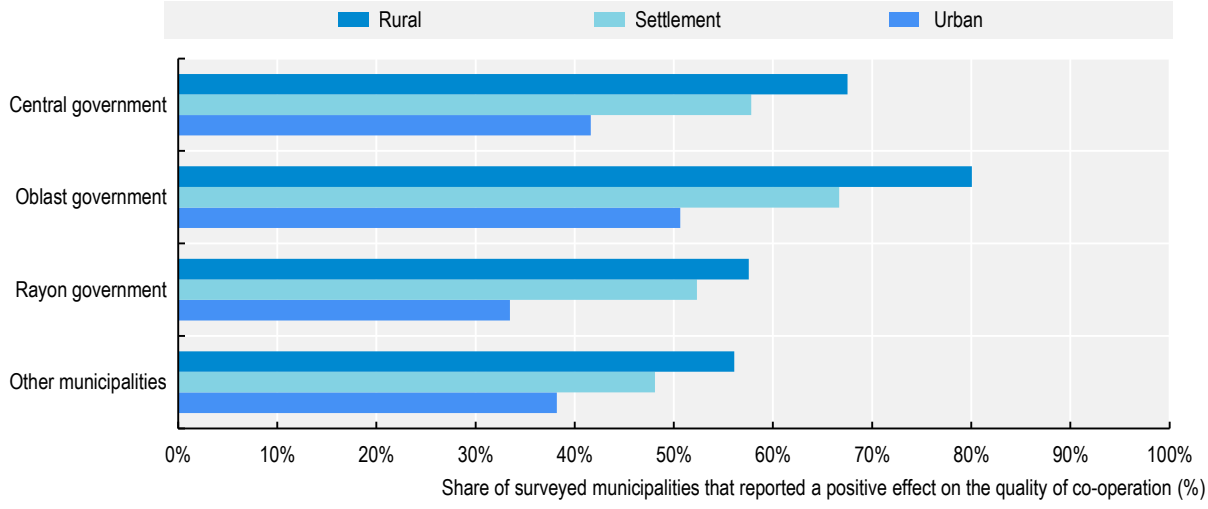
This section discusses how municipalities perceived the effect of the decentralisation reforms on vertical co-ordination, and addresses the issue of clarity in the division of tasks and responsibilities among levels of government. It also reflects on the value of increasing inter-municipal co-operation for post-war reconstruction and recovery.

Decentralisation reforms were perceived to have a positive impact on vertical co-operation

A majority of surveyed rural and settlement municipalities (68% and 58%, respectively) felt that the decentralisation reform process had had a positive impact on their relations with the central government, compared with just 42% of urban municipalities. This may reflect the fact that former cities of *oblast* significance had already had extensive dealings with the central government before the start of the decentralisation reforms. For example, former cities of *oblast* significance were able to issue bonds, subject to the control and co-ordination of the central government, which rural, urban and settlement municipalities were not allowed to do.

By contrast, a majority of rural (80%), settlement (67%) and urban (51%) municipalities all reported that the decentralisation reforms had had a positive impact on the quality of their co-operation with *oblast* governments (Figure 7.10). This likely reflects, at least in part, the way in which the reforms enabled municipalities to negotiate their budgets directly with *oblast* state administrations, thus developing and strengthening their relationship with the *oblast* level. Prior to decentralisation reforms, *rayon* state administrations communicated and managed funding levels to most municipalities. The exception were all cities of *oblast* significance that enjoyed direct fiscal relations with the *oblast* level of government (see Chapter 6). This may explain why urban municipalities were less positive than settlement and rural municipalities about the effect of the decentralisation reforms on the quality of co-operation with other levels of government.

Figure 7.10. Effect of the decentralisation reforms on the quality of co-operation with other levels of government



Note: Question: What effect have the decentralisation reforms (including the amalgamation process) had on the quality of co-operation with the following levels of government? Response options: Positive effect; Negative effect; No noticeable effect. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

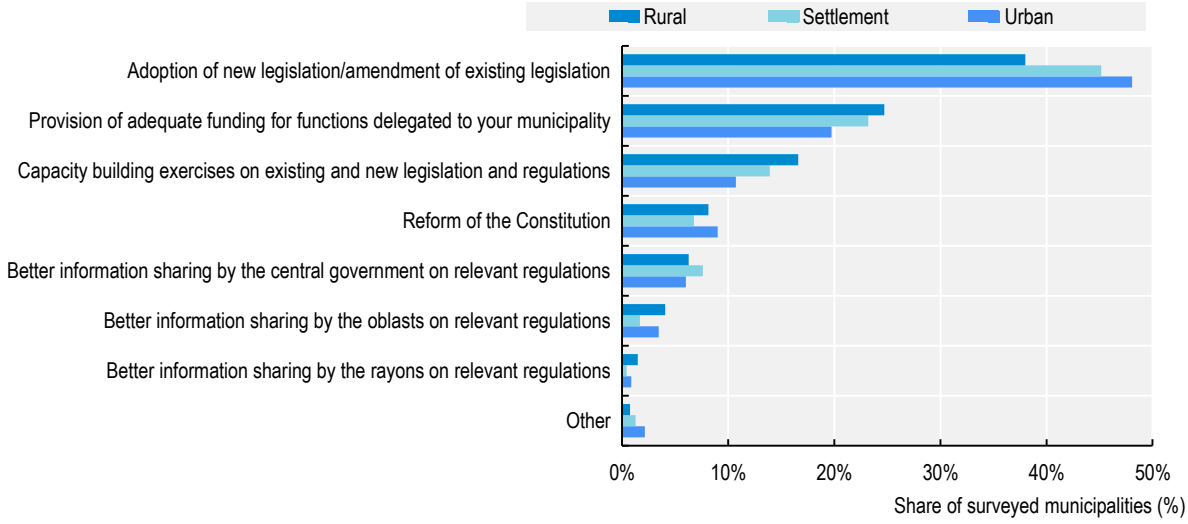
A small majority of surveyed rural municipalities (56%) indicated that the reforms had had a positive impact on their co-operation with other municipalities, compared with only 48% of settlement municipalities and 38% of urban municipalities (Figure 7.10). This may be explained by the fact that not all rural or settlement municipalities have the necessary infrastructure to, for example, provide a wide array of healthcare or education services and therefore need to co-operate with other municipalities that do.

The survey also found that in rural, settlement and urban municipalities alike, the largest share of local authorities indicated that inter-municipal co-operation would be beneficial for improving local waste management services and healthcare (Annex Figure 7.A.3). This may reflect the large amount of investment that is required to develop and maintain physical infrastructure, and a desire to improve the efficiency of public investment by generating greater scale. Other beneficial areas for which a relatively large share of municipalities indicated that inter-municipal co-operation would be beneficial included tourism (particularly among urban municipalities), as well as social and administrative services, signalling a wide range of sectors for which municipalities consider there are benefits to cross-jurisdictional co-operation.

Greater clarity on division of tasks and responsibilities among levels of government is needed

Nearly half of surveyed municipalities (43%) reported that adopting new legislation or amending existing legislation would most contribute to increasing clarity in the division of tasks and responsibilities among levels of government (Figure 7.11). This may reflect the fact that legislation does not set out a clear mandate for municipalities in certain tasks. For example, current legislation does not specify clear mechanisms that municipalities can use to support local economic development. In addition, there is uncertainty about which level of subnational government is responsible for the construction and maintenance of roads (see Chapter 6).

Figure 7.11. Actions that would contribute most to increasing clarity in the division of tasks and responsibilities among levels of government



Note: Question: According to you, which of the following actions would contribute most to increasing clarity in the division of tasks and responsibilities among different levels of government? Please selection one option. Adoption of new legislation / amendment of existing legislation; Provision of adequate funding for functions delegated to your municipality; Training and other capacity-building exercises on existing and new legislation and regulations; Reform of the Constitution; Improved communication / dissemination of information by the central government on regulations affecting municipalities; Improved communication / dissemination of information by the *oblast* administrations on regulations affecting municipalities; Improved communication / dissemination of information by the *rayon* administrations on regulations affecting municipalities; Other. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

Research on inter-governmental relations in Ukraine echoes these findings, indicating that the legal assignment of functions among the levels of government is sometimes unclear (Wright and Slukhai, 2021). This can undermine the effective delivery of public services and accountability as actors may avoid taking responsibility by "passing the buck" to other levels of government. These challenges are especially problematic in the context of a disaster, which requires swift, co-ordinated and decisive action, not to mention clear communication and accountability structures. In order to address this issue, the government could consider a two-pronged approach. First, it could conduct a comprehensive review of municipal administrative and service responsibilities and how these relate to the mandate of higher levels of government. Such a review could help identify services where, for example, responsibilities overlap or where there is limited clarity regarding which level of government is responsible. Second, based on this assessment, the government could identify where introducing new legislation or regulations (or amending existing legislation or regulations) is needed and where other measures might suffice. These include promoting and facilitating vertical and horizontal co-operation, and providing additional capacity building support for municipalities to demystify complex legislative and regulatory issues, particularly as new legislation is introduced. Both of these elements could provide greater clarity for municipalities regarding their tasks and responsibilities within a multi-level governance context.

It is also notable that: a) the provision of adequate funding and b) training and capacity building were the second and third most commonly-cited elements that would contribute to increased clarity regarding the division of tasks and responsibilities among levels of government. The findings suggest that certain municipalities may not feel that their service delivery mandates are being adequately funded. While it is important for municipalities to practice prudent financial management, the government should ensure that local governments have the necessary means to effectively execute their mandate, thereby avoiding un- or under-funded mandates. As part of efforts to increase the stable, predictable and adequate funding of municipalities, the government could consider increasing the volume of block grants or expanding the municipal power to set the tax base and rates for own-source taxes, possibly within a nationally determined range to avoid too much variation among municipalities. This would, however, need to follow the comprehensive review of municipal administrative and service responsibilities mentioned above, combined with an assessment of the extent to which these responsibilities are currently underfunded. These policy interventions would contribute to municipalities having sufficient financial resources and the necessary flexibility to allocate spending to meet particular local needs.

Increasing inter-municipal co-operation

Inter-municipal co-operation is critical for creating economies of scale and improving cost-efficiency in public service delivery. It will be all the more important in light of the vast destruction of public infrastructure in the wake of Russia's war against Ukraine. While Ukraine has formal mechanisms for inter-municipal co-ordination, more needs to be done to encourage these partnerships. The slow uptake of such agreements may be due, in part, to a lack of adequate knowledge about how they work and the risks involved. The national government could play a stronger role by developing incentives for co-ordination and ensuring that municipalities have the right mechanisms in place and the know-how required to take action. For example, it could consider providing local governments with additional support material (e.g. on relevant legislation, good practices, shared service contract templates) and advice on how to set up and manage inter-municipal co-operation, particularly in service delivery areas that may have been overlooked in the past (see Chapter 6) (OECD, 2018[28]). In addition, the share of own-source revenue as part of total municipal revenue may influence the likelihood of municipalities setting up inter-municipal co-operation agreements. When municipal revenue consists mostly of shared taxes (e.g. PIT) and inter-governmental grants, then municipalities tend to feel less pressure to identify expenditure savings, for example by co-operating with neighbouring municipalities to provide services (GIZ/UN-Habitat, 2015[45]). As such, reducing municipal dependence on shared taxes and grants—for instance by increasing the power of municipalities to generate own-source revenue—can work as an incentive for inter-municipal co-operation.

OECD municipal efficiency assessment

The previous sections have highlighted the findings of a self-assessment of decentralisation reforms, providing important insights into how municipalities view the impact of these reforms on internal capacity, inter-governmental relations, and municipal operations. Understanding the impact of the reforms on municipal efficiency provides an additional angle of analysis with which to analyse and understand reform effects. Assessing the relative efficiency with which different municipalities provide public services can be an important metric of municipal performance. It can help to identify how much "bang" local taxpayers are receiving for their "buck".

To determine a municipality's relative efficiency, a Data Envelopment Analysis (DEA) was applied (Box 7.8). This modelling method is commonly used for measuring the cost efficiency of different organisations and institutions in providing similar services, such as primary education, healthcare, access to cultural institutions, sanitation and road infrastructure (Charnes, Cooper and Rhodes, 1978[46]; Cooper, Seiford and Ton, 2006[47]; Lamichhane and Tamang, 2019[48]). In this case, the DEA ranks municipalities according to the relationship between the resources used (inputs) and the public-service goods produced (outputs). A municipality is considered to be relatively inefficient if another municipality, using the same combination of inputs, is able to produce more outputs or is able to produce at the same output level with fewer inputs.

Box 7.8. Data Envelopment Analysis model

To run the Data Envelopment Analysis (DEA) and evaluate the relative efficiency of municipal spending, the OECD identified input and output indicators. The input variable selected was total municipal revenues per capita, which measures how much revenue municipalities have to spend relative to their population. In particular, it refers to the municipal revenues of the General Fund, which is formed by, among other elements PIT. Ideally, the OECD would have used an additional model with municipal expenditure per capita as an input variable. However, the available municipal expenditure data could not be matched with the output indicators presented below.

With regard to output indicators, researchers conducting the DEA typically use variables such as the amount of urban waste collected or the volume of drinking water supplied to citizens in order to measure the provision of public goods. Given limitations on the availability of local-level data indicating policy outcomes (e.g. changes in the quantity or quality of key public services such as education or healthcare), the OECD analysis relied on information presented on the Hromada Performance Monitoring Platform. The DEA model applied by the OECD used the following output indicators:

- Number of preschool institutions
- Number of general secondary education institutions
- Number of institutions providing primary healthcare
- Number of museums
- Number of cultural institutions
- Number of art schools
- Number of libraries

While public infrastructure indicators are not optimal since they do not include information about service delivery quality for example, the range of outputs considered in the analysis is deemed diverse enough to generate robust results that do not vary with the inclusion or exclusion of a particular output.

The DEA used data from 2019-2021, the most recent data available, depending on the indicator. While ideally, the analysis would have only included amalgamated municipalities, the technical difficulty associated with merging datasets with different codes meant that the analysis considered all 1 438 municipalities mentioned on MinRegion's Hromada Performance Measurement Portal. This list included municipalities that did not amalgamate between 2014 and 2020. It also excluded the temporarily-occupied territorial municipalities in Donetsk and Luhansk *oblasts.*

Source: Author's elaboration.

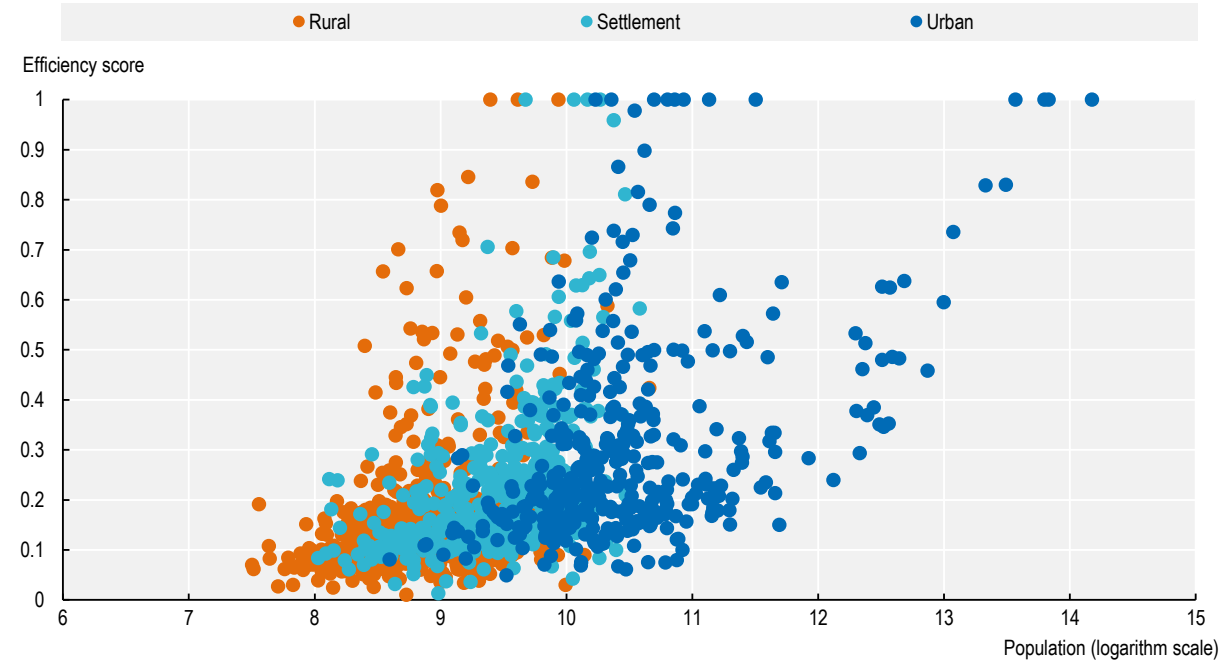
Measures of municipal efficiency, however, should not be viewed in isolation. Equally important is an assessment of effectiveness, including difficult-to-measure objectives such as the quality, equity and accessibility of services, which is discussed in detail in Chapter 8.

Population size and tax revenue-raising capacity are key determinants of municipal performance

The DEA of municipal performance found that only 1% of all 1 438 municipalities were situated at the relative efficiency frontier (i.e. scoring 1 on a range of 0 to 1, with 1 representing the highest level of efficiency) (Figure 7.12) (Annex Table 7.B.1). Large cities such as Dnipro, Kharkiv, Lviv and Odessa were among the most efficient municipalities (i.e. that received the top score of 1), as well as a group of small municipalities, such as Keretsky (Zakarpattia O*blast)*, Solotvyn (Ivano-Frankivsk *Oblast*) and Borynia (Lviv O*blast*) whose population ranged between 14 959 (Keretsky) and 26 033 (Solotvyn) inhabitants in 2021. It is important to stress that the outcomes of the DEA depend on the type and number of input and output indicators used. Moreover, the DEA estimates indicate *relative* and not absolute efficiency. As such, municipalities that obtained an efficiency score of 1 should not be understood to perform at a hypothetical efficiency "maximum".

Overall, the results of the analysis indicate that municipal size (both in terms of population and area), are important determinants of the efficiency of municipal public expenditure, and that this effect is particularly significant in rural and settlement municipalities. The assessment also found that every municipality situated in the bottom 5% of the efficiency index had relatively small populations (less than 10 500 people).

Figure 7.12. Municipal efficiency scores and population size



Source: Prepared by Pedro Camões and Antonio Tavares with data from (MinRegion, 2021[49]).

The role of population size in generating better municipal efficiency outcomes may, in part, be a reflection of Ukraine's pre-2014 administrative-territorial structure. In particular, some of the larger urban municipalities are former "cities of *oblast* significance", which already had an extensive list of tasks and responsibilities prior to the start of the amalgamation process. These municipalities have had significantly more time to build up their administrative capacity than their peers. This, in turn, may help to explain the efficiency of these municipalities relative to those that received additional tasks and responsibilities as part of the post-2014 decentralisation process, and have had to significantly strengthen their capacity to deliver on their expanded mandate. Moreover, as the income per capita of municipalities with relatively large populations tends to be higher than in small municipalities, the former may be more likely to obtain a relatively high share of local taxes as part of their total revenues, which the DEA and subsequent regression analysis identified as a determinant of municipal efficiency.

In most *oblasts*, relatively efficient municipalities derived at least 15% of their revenues from local taxes, which underscores the importance of a minimum level of local financial autonomy in supporting efficient municipal operations (Annex Table 7.B.2). The regression analysis found that municipalities with a higher share of locally-generated revenues were more efficient managers of government funds than their peers. This aligns with OECD work on fiscal decentralisation, notably the fact that municipalities with a higher share of own-source revenues often have a better quality and efficiency of public spending (Asatryan, Feld and Geys, 2015[50]; OECD, 2019[44]). The explanation may lie partly in that municipalities with a relatively high share of own-source revenues, the financial implications of spending decisions are more directly linked to the payment of taxes by local residents, creating public pressure on local decision makers for responsible budgeting and spending. Within the context of the decentralisation process, the findings suggest that additional reforms supporting increased own-source revenue across Ukrainian municipalities could lead to more efficient local government spending. However, the DEA also shows that municipalities that were highly dependent on local taxes (i.e. municipalities whose share of local taxes constituted 60% of their revenues) scored relatively poorly in terms of efficiency (Figure 7.13). This might imply that those municipalities (all rural and settlement municipalities) had relatively low revenues per capita in general, making them highly dependent on PIT.

Figure 7.13. Municipal efficiency scores and own-source revenues



Source: Author's elaboration with data provided by (MinRegion, 2021[49]).

Urban and settlement municipalities are on average more efficient than rural municipalities

The DEA also sought to evaluate the relative efficiency of urban, rural, settlement municipalities at the national level and by *oblast*. The best-performing municipalities overall, as well as the best performing municipalities in the respective rural, settlement and urban categories, are presented in Annex Table 7.B.1; Annex Table 7.B.3;Annex Table 7.B.4 and Annex Table 7.B.5, respectively.

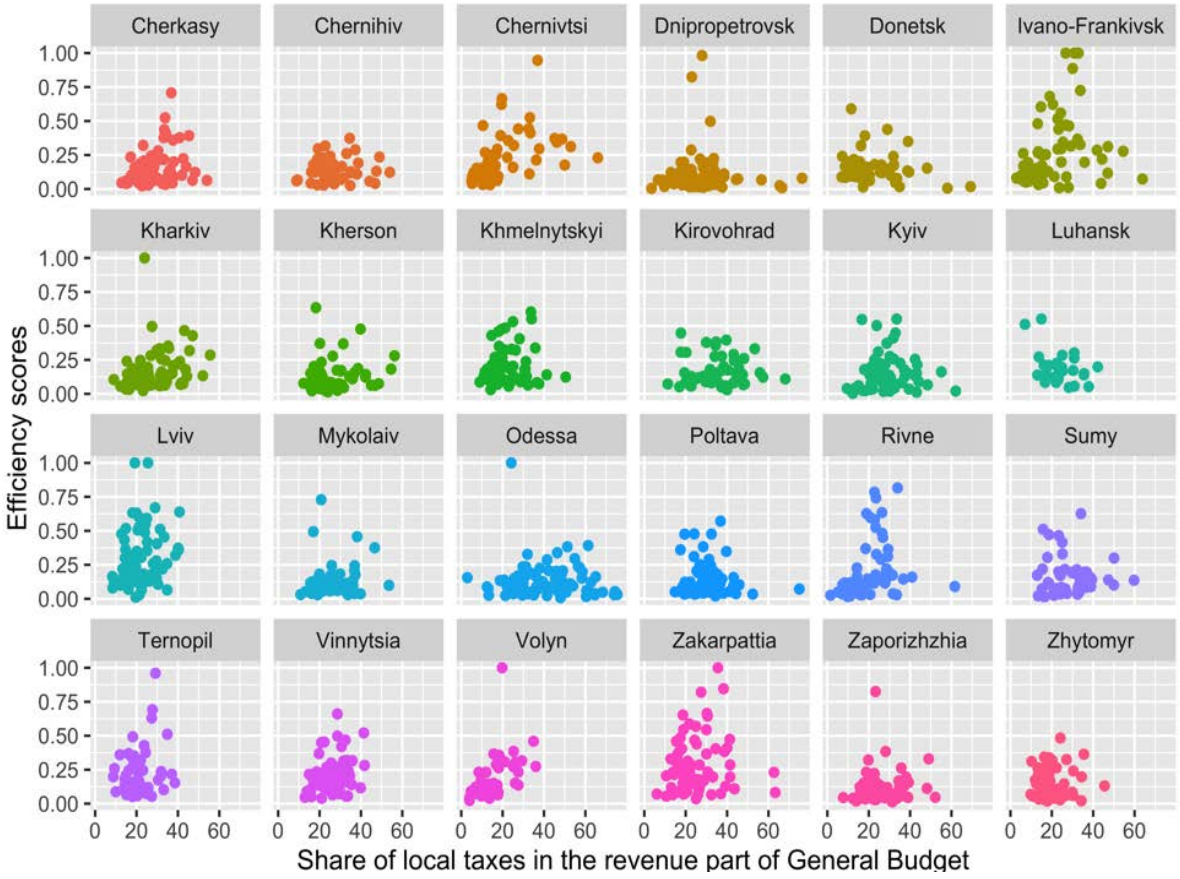
Regression analysis found that urban and settlement municipalities are, on average, more efficient at maintaining public infrastructure outcomes than rural municipalities, with urban municipalities the most efficient of the three. Rural municipalities also tend to have lower efficiency scores, irrespective of their proportion of own-source revenues (Figure 7.13). Moreover, the DEA found that in 19 out of 24 *oblasts,* urban municipalities were relatively more efficient on average than their rural and settlement peers (Annex Table 7.B.2). However, there were a few exceptions, notably in Chernivtsi and Zakarpattia *Oblasts*, where most of the efficient municipalities were rural, and in Donetsk, Luhansk and Mykolaiv *Oblasts*, where most of the efficient municipalities were settlements (MinRegion, 2021[49]).

The relatively low efficiency of rural municipalities may reflect the fact that spending efficiently in rural areas is particularly challenging because of their low density. It could potentially also be related to the fact that, generally, rural municipalities have a relatively high share of elderly population and low levels of productivity, compared to urban municipalities. Another reason might be that rural municipalities have less experience and administrative capacity in managing the construction of public infrastructure than urban and settlement municipalities. The latter point is supported by responses from the OECD project survey, which indicated that a smaller share of surveyed rural municipalities believe that they have the necessary human resources to carry out public investment responsibilities than settlement and urban municipalities (Figure 7.3).

Municipalities in the west tend to be more efficient than peers elsewhere in the county

The OECD also conducted analysis of aggregate municipal efficiency by *oblast* (Figure 7.14). Positive coefficients from the regression analysis indicated that municipalities in certain *oblasts* tend to be, on average, more efficient, particularly Chernivtsi, Ivano-Frankivsk, Khmelnytskyi, Lviv, Rivne, Ternopil and Zakarpattia *oblasts*. This is evidenced by the presence of more municipalities in the upper part of each graph. Notably, the *oblasts* with the most efficient municipalities were situated in the west of Ukraine. By contrast, municipalities in Chernihiv, Donetsk, Kirovohrad, Luhansk, Sumy and Zhytomyr *Oblasts* performed worse as a group, as shown by the significant concentration of units in the lower part of their respective graphs.

Figure 7.14. Municipal efficiency scores represented by proportion of tax revenues, per *oblast*



Note: Each graph constitutes a separate DEA for a different *oblast,* meaning that municipal efficiency scores are only relative to the other municipalities that are located in their *oblast*.
Source: Prepared by Pedro Camões and Antonio Tavarez with data from (MinRegion, 2021[49]).

Preliminary considerations for increasing municipal efficiency

The findings, which underscored the importance of a municipality's size and own-source revenues in ensuring better municipal efficiency, are instructive in the context of the current debate regarding Ukraine's administrative-territorial structure and whether it should be adjusted after the conclusion of Russia's war

against Ukraine. The OECD findings provide some initial evidence suggesting increasing municipal size, particularly in terms of population, and increasing the capacity of municipalities to generate own-source revenues could lead to more efficient local government spending. There are diverse ways to accomplish this, such as educating municipal leaders on the value of inter-municipal co-operation and developing financial and functional incentives. Examples of financial incentives include providing a higher tax-share for delivering joint services and awarding additional points in the selection process of competitive regional and local development funds to project proposals developed by two or more municipalities. An example of a functional incentive is establishing a condition of population size for the delivery of different services, thereby encouraging inter-municipal co-operation between smaller municipalities.

Additional (voluntary) amalgamations could also be considered, though such institutional reforms take time to generate results and any additional reconfiguration might be too premature as there is insufficient data to determine how performance has changed over time given the recent reform cycle. Moreover, those communities that amalgamated only recently (i.e. in 2019 and particularly in 2020) have had very limited time to adjust to their new tasks and responsibilities. This puts them at a disadvantage, which may have been aggravated by the war. These are important elements to consider during discussions about any further amalgamations. At the same time, the debate around the merits of additional municipal amalgamations will also need to consider other variables besides efficiency, such as how mergers affect the quality of service delivery, local democracy and citizen well-being, for which the development of a robust performance monitoring system is needed. In the longer term, generating sustainable, more inclusive local and regional growth, as explored in the first part of this report, is called for.

Implications of the OECD analytical framework for future decentralisation reform

The combined qualitative and quantitative framework applied by the OECD shows that, across the board, municipalities considered that the decentralisation reform process, including amalgamation, had a positive impact on their administrative and human resources capacity, on the quality of several service delivery areas and on their revenues. Moreover, surveyed municipalities also indicated that the reforms had improved inter-municipal and vertical co-ordination (i.e. with other levels of government). These improvements have likely contributed to the ability of many municipalities to continue to execute their core administrative functions, and provide basic services during the war.

The results from the OECD analytical framework also show significant performance variation across types of municipalities, with the share of rural municipalities reporting improvements in areas such as revenue generation and vertical and horizontal co-ordination being higher than that of settlement and urban municipalities. Conversely, they also show that prior to February 2022, a relatively large share of rural municipalities considered that they did not have the necessary human resource capacity to carry out key tasks in the fields of strategic planning, public investment or budgeting. Boosting municipal capacity in these fields in the short term will be essential in ensuring that they have the necessary capacity to absorb recovery funding, design and implement projects, and manage procurement processes.

Furthermore, the results highlighted that across municipal typologies, there is ample room for improvement in terms of public engagement. This is another area demanding urgent action to ensure that the needs and priorities of citizens and local businesses are taken into consideration in the design and implementation of recovery projects. It is also important that non-governmental actors be able to monitor public spending and track progress of local recovery initiatives. Finally, the results demonstrate the impact that municipal size (particularly in terms of population) and their capacity to generate a minimum level of own-source revenue have on the efficiency with which municipalities are able to maintain public infrastructure. These results signal that measures such as increasing inter-municipal co-operation and, potentially additional (voluntary) amalgamation, could increase municipal efficiency.

Combined, these findings can help the government as it considers the next steps in the decentralisation reform process and to meet the challenges of the coming reconstruction phase. This should include investing in capacity building support initiatives that are tailored to territorially diversified reconstruction needs, as well as incentives to improve inter-municipal co-operation. Additional steps could also entail legislative, regulatory and fiscal reforms to clarify municipal service delivery responsibilities and to ensure that they have the necessary funds to carry out their mandate.

Finally, the findings point to the need for Ukraine to invest in a robust municipal performance measurement framework, which can help all levels of government to identify where progress has been made and where gaps remain. A periodic assessment of municipal perspectives on the impact of the decentralisation reforms, similar to the one conducted by the OECD, could be part of such a framework.

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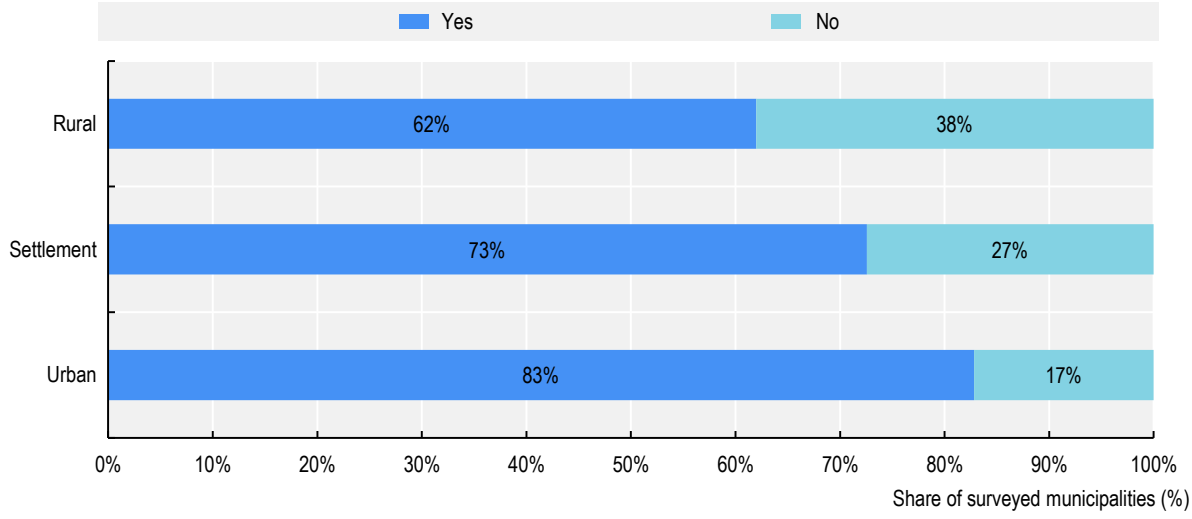
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Note

[1] Of Ukraine's 1 469 territorial communities, 31 are municipalities in Donetsk and Luhansk *Oblasts* that were temporarily-occupied prior to February 2022. Of the remaining 1 438, to which invitations to complete the survey were sent by the OECD in 2021, 625 are categorised as rural (43%), 433 as settlement (30%) and 380 as urban (26%).

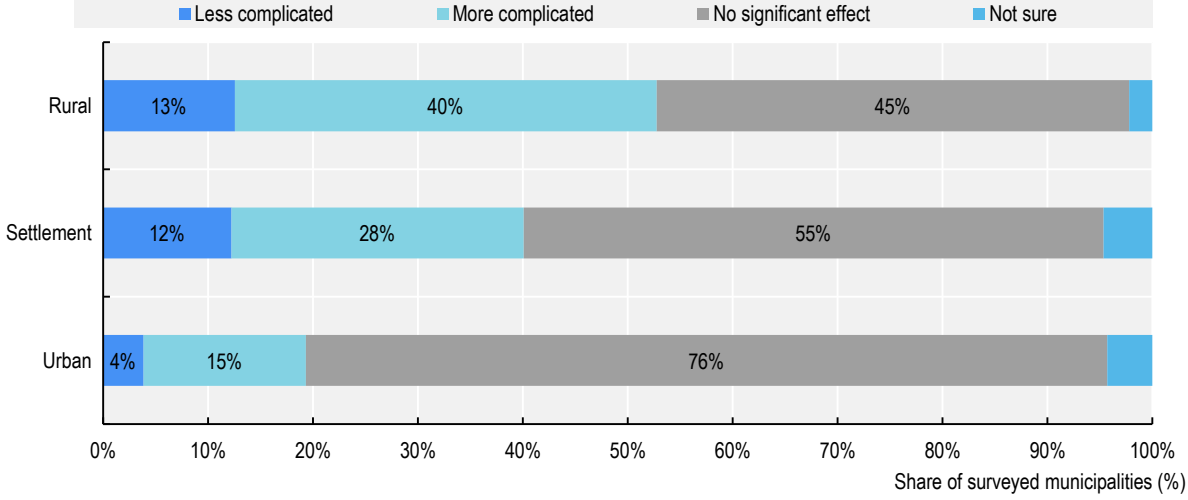
Annex 7.A. Results from the OECD survey

Annex Figure 7.A.1. Share of municipalities that reported having sufficient staff to carry out their responsibilities



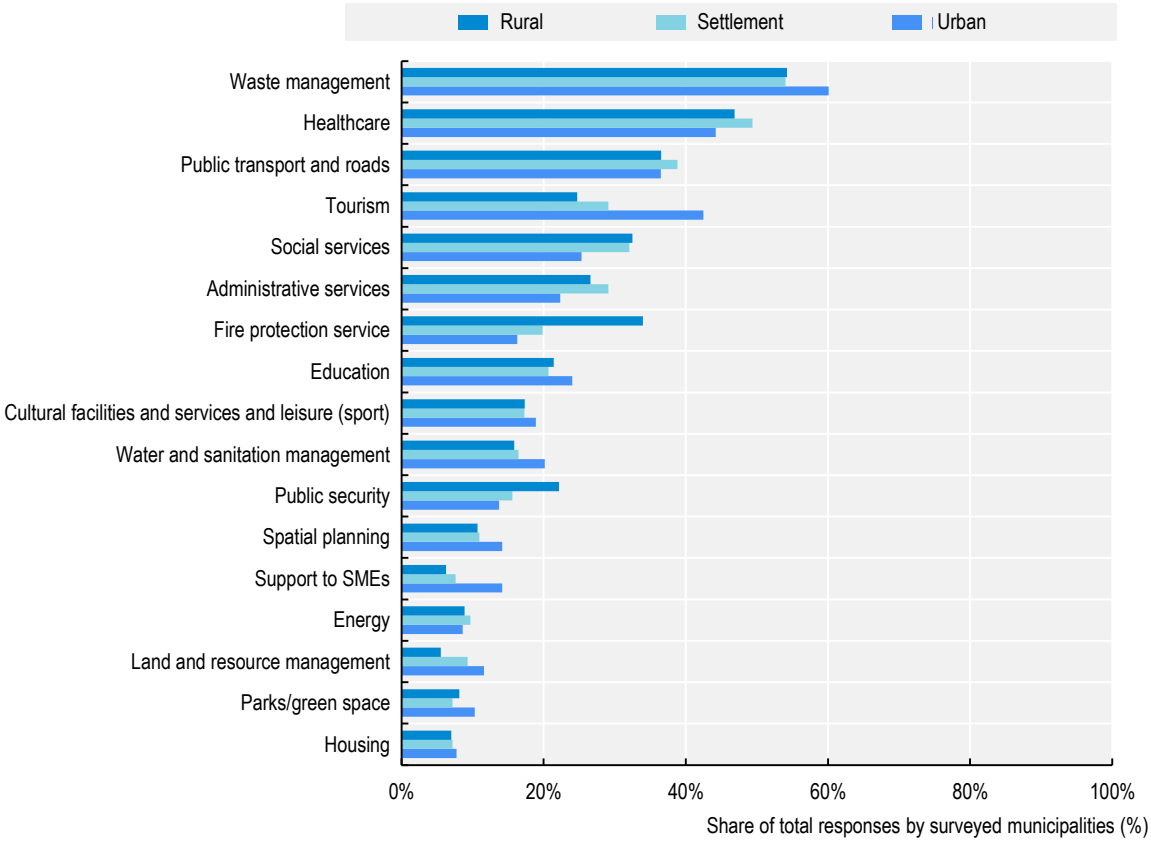
Note: Question: Does your municipality have sufficient staff to carry out its responsibilities? Response options: Yes; No. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

Annex Figure 7.A.2. Effects of the decentralisation reforms on the recruitment of qualified staff



Note: Question: Has the decentralization reform (including the amalgamation process) made the recruitment of qualified staff (1) less difficult, (2) more difficult, or (3) has it had no significant effect, or are you not sure? The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

Annex Figure 7.A.3. Areas for which municipalities reported that inter-municipal co-operation could be particularly beneficial for improving service delivery



Note: Question: In which of the following areas could inter-municipal co-operation help improve service delivery in your municipality? Full response options: Administrative services (e.g. registration, issuing passports, etc.); Cultural facilities and services, and leisure (sport); Education Energy; Fire protection service; Healthcare; Housing; Land and resource management; Parks/green space; Public security; Public transport and roads; Social services (e.g. support for families, children, elderly, etc.); Spatial planning; Support to SMEs; Tourism; Waste management; Water and sanitation management; Other. The survey was filled out by 741 municipalities (51% of all Ukrainian municipalities in 2021).
Source: Author's elaboration, based on the OECD online survey.

Annex 7.B. OECD Data Envelopment Analysis

Annex Table 7.B.1. List of the most efficient municipalities overall

Municipality	Type of municipality	*Oblast*	*Rayon*	DEA score
Berezove	Rural municipality	Rivne	Sarny	1
Bilky	Rural municipality	Zakarpattia	Khust	1
Borynia	Settlement municipality	Lviv	Sambir	1
Dnipro	Urban municipality	Dnipropetrovsk	Dnipro	1
Horodenka	Urban municipality	Ivano-Frankivsk	Kolomyia	1
Ivankiv	Settlement municipality	Kyiv	Vyshhorod	1
Kamin-Kashyrskyi	Urban municipality	Volyn	Kamin-Kashyrskyi	1
Keretsky	Rural municipality	Zakarpattia	Khust	1
Kharkhiv	Urban municipality	Kharkiv	Kharkiv	1
Kuty	Settlement municipality	Ivano-Frankivsk	Kosiv	1
Lubny	Urban municipality	Poltava	Lubny	1
Lviv	Urban municipality	Lviv	Lviv	1
Odessa	Urban municipality	Odessa	Odessa	1
Pohrebyshche	Urban municipality	Vinnytsia	Vinnytsia	1
Rohatyn	Urban municipality	Ivano-Frankivsk	Ivano-Frankivsk	1
Sokal	Urban municipality	Lviv	Chervonohrad	1
Solotvyn	Settlement municipality	Ivano-Frankivsk	Ivano-Frankivsk	1
Stryi	Urban municipality	Lviv	Stryi	1
Zolochiv	Urban municipality	Lviv	Zolochivskyi	1

Note: DEA scores range from 0 to 1, with 1 representing the highest level of efficiency relative to the other municipalities (including rural, settlement and urban municipalities) and are a product of the specific input and output indicators used for this analysis. This means that municipalities that obtained a relative efficiency score of 1 should not be understood to perform at a hypothetical efficiency "maximum".
Source: Author's elaboration with data provided by (MinRegion, 2021[49]).

Annex Table 7.B.2. Most efficient municipalities by *oblast* and proportion of own-source revenues

Oblast	# Most efficient municipalities	Own-source revenue* interval of most efficient municipalities (approx. %)	Type of municipality		
			Urban	Settlement	Rural
Cherkasy	7	20–40	5	-	2
Chernihiv	7	20–50	4	3	-
Chernivtsi	8	10–40	2	1	3
Dnipropetrovsk	11	20–40	5	4	2
Donetsk	7	10–40	3	4	-
Ivano-Frankivsk	7	15–35	5	2	-
Kharkiv	11	20–50	7	4	-
Kherson	6	20–45	4	1	1
Khmelnytskyi	13	15–35	6	4	3
Kirovohrad	13	15–50	7	5	1
Kyiv (*oblast*)	9	15–50	5	4	-
Luhansk	13	5–30	3	7	-
Lviv	9	15–40	7	2	-

Mykolaiv	5	15–45	2	3	-
Odesa	14	20–60	6	4	4
Poltava	7	15–45	6	-	1
Rivne	10	20–35	5	4	1
Sumy	8	10–40	7	1	-
Ternopil	10	10–30	9	-	1
Vinnytsia	11	20–40	7	3	1
Volyn	3	18–35	2	-	1
Zakarpattia	21	15–40	5	5	11
Zaporizhzhia	12	20–50	5	5	2
Zhytomyr	10	10–35	5	4	1

Note: *Own-source revenue as a share of the revenue that is part of the General Budget of municipalities.
Source: Author's elaboration with data provided by (MinRegion, 2021[49]).

Annex Table 7.B.3. List of the most efficient rural municipalities

Municipality	*Oblast*	*Rayon*	DEA score
Berezove	Rivne	Sarny	1
Brusnytsia	Chernivtsi	Vyzhnytsia	1
Irkliiv	Cherkasy	Zolotonosha	1
Kamianka	Chernivtsi	Chernivtsi	1
Kamianske	Zakarpattia	Berehove	1
Keretsky	Zakarpattia	Khust	1
Kozyova	Lviv	Stryi	1
Kuialnyk	Odesa	Podilsk	1
Nedoboivtsi	Chernivtsi	Dnistrovskyi	1
Neresnytsia	Zakarpattia	Tiachiv	1
Palanka	Cherkasy	Uman	1
Pavlivka	Volyn	Volodymyr-Volynski	1
Piyterfolvo	Zakarpattia	Berehove	1
Popivka	Sumy	Konotop	1
Soshychne	Volyn	Kamin-Kashyrskyi	1
Srilky	Lviv	Sambir	1
Stavne	Zakarpattia	Uzhhorod	1
Berezove	Rivne	Sarny	1
Brusnytsia	Chernivtsi	Vyzhnytsia	1
Irkliiv	Cherkasy	Zolotonosha	1
Kamianka	Chernivtsi	Chernivtsi	1
Kamianske	Zakarpattia	Berehove	1
Keretsky	Zakarpattia	Khust	1
Kozyova	Lviv	Stryi	1

Note: DEA scores range from 0 to 1, with 1 representing the highest level of efficiency relative to the other rural municipalities and are a product of the specific input and output indicators used for this analysis. This means that municipalities that obtained a relative efficiency score of 1 should not be understood to perform at a hypothetical efficiency "maximum".
Source: Author's elaboration with data provided by (MinRegion, 2021[49]).

Annex Table 7.B.4. List of the most efficient settlement municipalities

Municipality	*Oblast*	*Rayon*	DEA score
Borynia	Lviv	Sambir	1
Chemerivtsi	Khmelnytskyi	Kamianets-Podilskyi	1
Drabiv	Cherkasy	Zolotonosha	1
Ivankiv	Kyiv	Vyshhorod	1
Kelmentsi	Chernivtsi	Dnistrovskyi	1
Kuty	Ivano-Frankivsk	Kosiv	1
Liublynets	Volyn	Kamin-Kashyrskyi	1
Makariv	Kyiv	Bucha	1
Mizhhirya	Zakarpattia	Khust	1
Murovani Kurylivtsi	Vinnytsia	Mohyliv-Podilskyi	1
Nova Ushytsia	Khmelnytskyi	Kamianets-Podilskyi	1
Orzhytsia	Poltava	Lubny	1
Petrove	Kirovohrad	Oleksandriia	1
Rokytne	Rivne	Sarny	1
Romaniv	Zhytomyr	Zhytomyr	1
Solotvyn	Ivano-Frankivsk	Ivano-Frankivsk	1
Solotvyno	Zakarpattia	Tiachiv	1
Teofipol	Khmelnytskyi	Khmelnytskyi	1
Vylok	Zakarpattia	Berehove	1
Zhuravne	Lviv	Stryi	1
Zolochiv	Kharkiv	Bohodukhiv	1

Note: DEA scores range from 0 to 1, with 1 representing the highest level of efficiency relative to the other settlement municipalities and are a product of the specific input and output indicators used for this analysis. This means that municipalities that obtained a relative efficiency score of 1 should not be understood to perform at a hypothetical efficiency "maximum".
Source: Author's elaboration with data provided by (MinRegion, 2021[49]).

Annex Table 7.B.5. List of the most efficient urban municipalities

Municipality	*Oblast*	*Rayon*	DEA score
Buchach	Ternopil	Chortkiv	1
Dnipro	Dnipropetrovsk	Dnipro	1
Horodenka	Ivano-Frankivsk	Kolomyia	1
Kamin-Kashyrskyi	Volyn	Kamin-Kashyrskyi	1
Kharkhiv	Kharkiv	Kharkiv	1
Khyriv	Lviv	Sambir	1
Lubny	Poltava	Lubny	1
Lviv	Lviv	Lviv	1
Odesa	Odesa	Odesa	1
Pohrebyshche	Vinnytsia	Vinnytsia	1
Rohatyn	Ivano-Frankivsk	Ivano-Frankivsk	1
Sniatyn	Ivano-Frankivsk	Kolomyia	1
Sokal	Lviv	Chervonohrad	1
Stryi	Lviv	Stryi	1
Zolochiv	Lviv	Zolochivskyi	1

Note: DEA scores range from 0 to 1, with 1 representing the highest level of efficiency relative to the other urban municipalities and are a product of the specific input and output indicators used for this analysis. This means that municipalities that obtained a relative efficiency score of 1 should not be understood to perform at a hypothetical efficiency "maximum".
Source: Author's elaboration with data provided by (MinRegion, 2021[49]).

8 Success factors and municipal performance measurement

Based on data and information analysed by the OECD, this chapter identifies a number of success factors that contribute to municipal performance in Ukraine. These relate, among other elements, to the fiscal and administrative capacity of municipalities and the time they had to adjust to the new powers and responsibilities that came with amalgamation. This chapter also provides recommendations to help the government establish a municipal performance measurement framework. This can support post-war recovery and enable evidence-based decision making on the legislative, regulatory, fiscal and capacity building measures necessary to improve local public service delivery, citizen well-being and municipal resilience throughout the country.

Introduction

Russia's war in Ukraine has highlighted the role that municipal leaders play in providing essential public services and supporting the well-being of communities in times of crisis. In addition to their pre-war, decentralised responsibilities, municipalities are now also responsible for new and often resource-intensive tasks, such as providing housing to internally displaced people, supporting territorial defence and organising the allocation of humanitarian assistance (VOA, 2022[1]). In the forthcoming recovery period, they are also likely to play a critical role in supporting local reconstruction and recovery initiatives. To ensure that all municipalities are able to deliver on their responsibilities, and to provide the necessary support to municipalities facing the most urgent challenges, policy makers need to have a broad-based and detailed understanding of the relative performance of different municipalities. Insight into why some municipalities may perform better than others after the decentralisation reforms is also valuable when considering further territorial and multi-level governance reforms as part of national recovery efforts.

The findings discussed in chapters 6 and 7 show that, prior to February 2022, there were already large disparities in the performance of different types of municipalities (urban, rural and settlement) in such areas as administrative capacity, public engagement, local finance and investment, and the efficiency of local spending on public services. Russia's war against Ukraine has exacerbated many of these disparities. While in some parts of the country, municipal governance structures still function relatively well and local self-governments continue providing basic services to citizens, in other parts local authorities face severe challenges in maintaining their governing structures, while most infrastructure has been destroyed and large swathes of the population have been forced to flee. These disparities have the potential to undermine municipal success. According to OECD interviews with local leaders, many of them believe that success depends on two elements: a) improving the quality of local public services and access to them, and b) supporting local economic development (OECD, 2021[2]).

This chapter identifies a range of factors that are enabling successful municipal performance in Ukraine, while providing reflections that can help policy makers to better support weaker municipalities in the forthcoming recovery and reconstruction period. The success factors identified are based on two analytical components: i) a perception-based online survey (see Chapter 7 Box 7.3) and ii) data on the efficiency of local public expenditures (see Chapter 7 Box 7.8). The trends in relative municipal performance that are highlighted by these two analytical components enable preliminary conclusions to be drawn as to why some municipalities perform better than others.

At the same time, the current lack of municipal-level data on a wide range of indicators (e.g. the quality of and access to key public services, such as education, healthcare, water and waste management) presents a particular challenge to local performance measurement in Ukraine. This is compounded by the absence of baseline values for a wide range of indicators (e.g. number of students enrolled in secondary education institutions, and number of education and healthcare institutions) needed to compare the performance of local self-governments before and after amalgamation.

These limitations will need to be addressed in post-war recovery initiatives, given that access to comprehensive performance data will be essential in identifying and addressing specific local recovery needs. In fact, investing in a robust performance measurement framework is crucial for the reconstruction and recovery period as it gives national and subnational level policy makers timely information to enhance decision making. For example, it can help municipalities make informed decisions on how to boost local economies, redress territorial inequalities and improve the well-being of local communities. It can also help the national-level government strengthen the design of place-based regional and local development strategies and projects that identify specific and urgent development gaps, map the assets of different localities, and, subsequently, propose territorially-differentiated policy solutions. At the same time, it can provide non-governmental actors, including citizens, with the necessary information to hold policy makers accountable.

This chapter has two objectives. First, based on the limited data available, it seeks to identify a number of success factors that appear to drive municipal performance in Ukraine. Second, it provides recommendations that can help the government develop an effective municipal performance measurement framework, which can contribute to effective post-war recovery.

Box 8.1. OECD recommendations to strengthen municipal performance measurement in Ukraine

The following recommendations should be considered in a timeframe that is appropriate to the current context of war and post-war reconstruction and recovery.

To support evidence-based decision making at the national and subnational levels for improved municipal development outcomes, Ukraine is advised to:

- Develop a set of municipal performance and development indicators (e.g. socio-demographic, fiscal, operational, political system) applicable to all 1 469 municipalities, that capture:
  - Outputs establishing to what extent formal or informal mechanisms, practices, rules, structures exist to help facilitate municipal performance.
  - Outcomes determining to what extent different municipalities are able to deliver on their objectives and responsibilities efficiently and effectively.
- Link the available statistics on municipal revenues, expenditures and debt to up-to-date data on the population of each municipality to facilitate in-depth cross-municipal comparisons.
- Ensure that data on municipal performance and development are widely accessible and regularly updated.
- Invest in the generation, analysis and dissemination of information on citizen satisfaction with public service delivery.

Success factors for municipal performance in Ukraine

The OECD has identified success factors for municipal performance in Ukraine based on data that pre-date the Russian Federation's large-scale war against Ukraine. As noted above, even for the period covered (2016-2021), the data are limited in their ability to present a holistic picture of municipal performance before and after amalgamation. While the OECD project's survey provides insights into how municipalities perceive various aspects of their own performance, the data are vulnerable to the subjectivity of respondents. In addition, while the OECD Data Envelopment Analysis (DEA) provides valuable information regarding how efficient different municipalities are at managing local public finances, it does not consider the broader effectiveness of local public service delivery, such as how the decentralisation reforms (including amalgamation) have improved the quality and/or access to services, and whether they have also led to better service outcomes, for example in education, healthcare, living environment, etc. Nevertheless, the combined datasets offer indications of factors contributing to successful municipal performance in Ukraine, with implications for the post-war recovery. These factors include institutional, fiscal and investment capacity, as well as effective inter-municipal co-operation.

Municipal success is linked to population size and sufficient time to build institutional capacity

The OECD DEA assessment highlights that population size is a key indicator of municipal efficiency. Overall, Ukraine's more populous municipalities tended to be more efficient managers of local public

spending, while every municipality in the bottom 5% of the efficiency index had a population of less than 10 500 inhabitants. These findings could reflect the value of economies of scale at the municipal level. This may seem intuitive. However, there is no iron-clad rule about what the best size is for a municipality, in terms of optimising its cost-efficiency. Studies on the impact of municipal size on service costs in different countries present a mixed picture, and one that depends heavily on the subnational institutional context, while optimal scale is thought to vary by service delivery areas. For example, one study from New Zealand suggested that cost savings resulting from amalgamation are more visible in services for which constant costs play a role, such as water and sewage (Dollery, Grant and Kortt, 2013[3]; Faulk, Schaal and Taylor, 2013[4]; Sinnewe, Kortt and Dollery, 2016[5]; Tran and Dollery, 2019[6]; Gendźwiłł, Kurniewicz and Swianiewicz, 2020[7]). The positive relation between population size and municipal performance was also supported by results from the OECD project's online survey. While 39% of surveyed urban municipalities believed that they were already carrying out all their tasks and responsibilities effectively, this figure was lower among rural and settlement municipalities (28% and 33% respectively).

In addition, time appears to be an important factor underlying improvement in municipal performance. As discussed in chapters 6 and 7, many large, urban municipalities that were formerly categorised as cities of *rayon* and *oblast* significance, already had extensive responsibilities at the outset of the decentralisation reform process. As such, these municipalities, which, on average had relatively high efficiency scores, had a longer period of time to build their institutional capacities than many of their peers. By contrast, some smaller municipalities only received their responsibilities as recently as 2020 as a result of mandatory amalgamation.

In the context of the post-war recovery, the government should recognise that enhancing municipal capacity and improving performance takes time, and particularly so given that the institutional capacity of many municipalities will have been significantly affected by the war. Municipalities will require sustained capacity building support in areas such as financial and public investment management, strategic planning and inter-municipal co-operation. They will also need adequate time to fully understand and manage additional administrative and service delivery responsibilities, and effectively fulfil their mandate.

Sufficient fiscal capacity is a prerequisite for successful municipal performance

The OECD assessment suggests that having sufficient fiscal capacity is a pre-condition for successful municipal performance. As discussed in the previous chapter, the DEA identified municipalities that boasted a higher share of own-source revenues as being more efficient managers of local public funding.

Research has shown that a stronger reliance by municipalities on own-source revenues can contribute to improving the accountability and efficiency of local public service provision (OECD, 2019[8]). Traditionally, municipalities have been highly dependent on intergovernmental grants (often earmarked) and transfers, which reduces their ability to spend on territorially-specific needs and may reduce the incentive to generate own-source revenue. Creating the conditions for municipalities to increase own-source revenue should be a priority.

Boosting own-source revenues will depend on additional fiscal reforms from the government and, in particular, Personal Income Tax reform (see Chapter 5) as well as expanding municipal power to set the tax base and rates for own-source taxes. This could be done within a nationally determined range or band in order to avoid too much variation among municipalities, i.e. a "race to the bottom" in certain tax rates (e.g. property tax). It could be coupled with reforms that give municipalities more power to collect taxes themselves, provided that adequate oversight mechanisms are in place. Such reforms would improve their fiscal capacity, give them more flexibility to address local priorities, and could also bolster public accountability. Responses to the OECD project's survey indicated that municipalities considered increasing their powers to set the local tax base or rate as a particularly urgent area of fiscal reform. In parallel, the government could also support municipal own source-revenue generation by expanding their

power to set fees for certain administrative services – such as business registrations – within a national established range.

Finally, ensuring that municipalities are equipped with sufficient fiscal capacity is critical to avoiding un- or under-funded mandates, where subnational governments have the responsibility to provide services or manage policies without the requisite resources. This will be particularly important for Ukraine's reconstruction and recovery given the significant costs that will be involved in rehabilitating or rebuilding municipal infrastructure and hiring new municipal staff that can manage recovery activities. Reducing the risk of underfunded mandates can be addressed by increasing central government transfers (e.g. block transfer), allocating a higher share of Personal Income Tax to municipalities or increasing the powers of municipalities to set the base and rate of own-source taxes, user charges and fees, as discussed earlier (see chapters 5 and 6) (OECD, 2019[8]).

Increased public investment capacity contributes to municipal success

Beyond the ability to generate own-source revenues, another factor for municipal success is investment capacity, both in terms of accessing investment financing and in terms of effective investment management. The latter will be particularly necessary given the large injection of funds that municipalities may be expected to manage—effectively and responsibly—as part of the reconstruction and recovery process. At the same time, it is important to ensure that all municipalities have a fair chance of accessing regional development funds, which can provide valuable financing for investment in local infrastructure projects and support subnational economic cohesion.

Only 50% of municipalities surveyed by the OECD in 2021 that had previously applied for funding from the flagship State Fund for Regional Development (SFRD) said they had received any funds through it, while 28% said they had not and an additional 22% were unsure whether they had (OECD, 2021[9]). These findings suggest that certain municipalities may be systematically missing out on a key source of investment financing, which could exacerbate territorial inequalities. This may be due to the fact that municipalities are required to provide co-financing to be able to compete for SFRD funding, which is problematic for poorer municipalities. Competitive financing arrangements also require high quality project proposals. This can pose a challenge for many smaller or disadvantaged municipalities, as they frequently lack the necessary expertise to develop project proposals of sufficient quality, and have neither the internal resources to fill this gap in capability nor the financial means to hire external consultants.

In the forthcoming post-war period, policy makers will need to ensure that all municipalities have equal opportunities to access public investment financing, in order to meet the significant reconstruction needs and contribute to increased territorial cohesion and resilience in the longer term. This could include measures to strengthen the capacity of poorer municipalities to apply for competitive funds, for instance by providing them with greater clarity on eligibility and boosting their technical skills to develop competitive proposals.

Strategic planning capacity is essential for guiding municipal development

The OECD assessment identified large variations in the institutional capacity of municipalities to design, implement and monitor local strategies, as well as manage public investment. For example, over 25% of surveyed municipalities suggested that they lacked the capacity to develop a strategy, while 40% indicated that they were unable to develop a realistic monitoring framework with clear objectives and indicators. There were also significant typological variations to this effect. For instance, 52% of rural municipalities indicated that they were able to develop a realistic monitoring framework, compared with 68% of urban municipalities (OECD, 2021[9]).

These perceived capacity gaps may be explained by the fact that, until 2021, legislation did not mandate municipalities to develop a local development strategy (Verkhovna Rada, 2015[10]). In fact, by the end of

2021, only about half of all municipalities had an approved strategy, which limited their ability to steer local development efforts (OECD, 2021[2]). OECD interviews with representatives of municipalities that had created a local development strategy indicated that this planning document enabled them to engage more effectively with citizens and the local private sector on the actions necessary to reach specific development targets. It also helped them formulate proposals for competitive regional and local development funds (OECD, 2021[2]).

There is a risk that gaps in municipal planning capacities could undermine territorial development efforts in the future. The scale of social, infrastructure and economic development that is and will continue to be required in municipalities across the country as part of the reconstruction and recovery process will necessitate extensive capacities for all the phases of the strategic planning cycle: from conducting accurate diagnostics of reconstruction needs, and defining development objectives, to designing realistic action plans and rigorous monitoring and evaluation systems. These capacities are essential for municipalities to be better able to develop and implement local reconstruction projects, absorb recovery funding, and monitor project results in order to support the rebuilding of their economies and to boost service delivery. Improved municipal strategic planning also requires a sustained investment in the ability of municipalities to access, generate, analyse and share data on a wide range of economic, social and demographic indicators, as well as on recovery funding and spending by sector and region.

Inter-municipal co-operation can contribute to municipal success

Inter-municipal co-operation can make a strong contribution to municipal success, as it can help create economies of scale and ensure more cost-efficient service delivery. Of the municipalities surveyed by the OECD, only a minority (29%) that did not formally co-operate with another municipality reported having the capacity to fulfil all their tasks and responsibilities effectively. By contrast, a majority of municipalities (56%) that did formally co-operate with another municipality indicated that they had the capacity to do so (OECD, 2021[9])[1].

Inter-municipal co-operation appears most beneficial in smaller municipalities that face administrative, human resource and infrastructure gaps hampering service delivery and may lack economies of scale. Among the three municipal typologies, the share of rural and settlement municipalities that reported that the decentralisation reforms had had a positive impact on their co-operation with other municipalities (48% and 52%, respectively) was significantly higher than that of urban municipalities (33%) (OECD, 2021[9]). Moreover, across typologies, municipalities indicate that inter-municipal co-operation is particularly beneficial in service delivery areas where large amounts of investment may be required to develop and maintain physical infrastructure, such as healthcare and waste management.

As Ukraine looks to recover from Russia's war, effective co-operation among municipalities will become even more important. First, during the reconstruction phase, inter-municipal co-operation can ensure that local public services continue to be delivered to municipalities where public infrastructure (e.g. schools, hospitals, etc.) has been severely damaged or even destroyed, and/or where human resources are very limited. Moreover, the population displacements caused by the war may leave some municipalities in greater need of inter-municipal co-operation than before 24 February 2022, owing to the corresponding changes in financial and human resource capacities and demands for public service delivery. Second, in the context of the additional constraints placed on local budgets by the war, cross-jurisdictional co-operation can help manage costs while ensuring similar levels of quality and access to local services.

The government could consider several policy interventions to boost the use of inter-municipal co-operation (see Chapter 6 and Chapter 7). These include investing in outreach to municipalities about the value of inter-municipal co-operation, as well as providing additional support materials (e.g. on relevant legislation, good practices, draft co-operation agreements, etc.) and training on how to set up and manage inter-municipal co-operation. The associations of local governments could also facilitate exchanges between municipalities interested in inter-municipal co-operation in specific service areas, such as

healthcare, and municipalities that have practical experience setting up and managing such cross-jurisdictional co-operation mechanisms. The government could also consider increasing financial and functional incentives for cross-municipal co-ordination (see Chapter 7). Financial incentives include granting a higher tax-share for delivering joint services. Functional incentives include establishing a condition of size for the delivery of different services, thereby encouraging inter-municipal co-operation between smaller municipalities (COE/UNDP/LGI, 2010[11]). Finally, as per the example of Greece, the government could also consider mandating smaller municipalities to collaborate in areas such as town planning (OECD/UCLG, 2018[12]).

Other potential success factors underpinning municipal performance should be further explored

The elements identified above do not represent an exhaustive list of factors determining why some Ukrainian municipalities performed better than others in the context of amalgamation. Other factors are likely at play as well. These include the extensive financial and technical support that some municipalities have received from one or more international development partners. In addition, the experience and skillset of municipal leaders during and after the amalgamation process, including their ability to understand the benefits of different territorial governance mechanisms, such as inter-municipal co-operation, and to attract and retain skilled staff play a role, as well. Further research, for example through in-depth interviews with municipal leaders and non-governmental representatives in 'leading' municipalities in the post-war period, would be needed to explore the extent to which such factors affect municipal performance. Other elements that likely also influence municipal performance include the level of public trust in local authorities, as well as local economic performance.

The geographic location of municipalities is another factor that is likely to have at least some influence on municipal performance. This is related to the fact that, as highlighted in earlier OECD studies (OECD, 2014[13]; OECD, 2018[14]) and Chapter 3, productivity levels, employment and education patterns, as well as economic specialisation, among other factors, vary significantly across regions. The OECD DEA assessment hinted at the relevance of a municipality's geographic location with the finding that, on average, municipalities from *oblasts* in the west of Ukraine tended to be more efficient managers of local funding than their peers in other parts of the country. At the same time, however, in responses to the OECD project's online survey, municipalities from the west of Ukraine were the least likely to indicate that they were already performing all their tasks and responsibilities effectively (OECD, 2021[9]). Further study based on objective data gathered in the post-war period will therefore be necessary to determine to what extent municipalities from a certain part of the country are more effective at delivering local services and promoting economic development, and to identify what specific factors could explain the variation. Such measures should be part of a sustained investment in setting up a robust municipal performance monitoring framework.

A more robust performance measurement framework can support post-war recovery

Establishing a comprehensive performance measurement framework is advisable for the post-war recovery period, as it will enable evidence-based decision making to best meet local reconstruction and recovery needs. In addition to efficiency indicators and performance self-assessments, it will be critical to have a more complete picture of the effectiveness and equity of local service delivery (Public Policy Forum, 2014[15]). A first step in this regard would be to conduct a baseline assessment of municipal performance and development, from which the progress of municipalities in meeting their local service delivery responsibilities can be monitored over time.

Data on policy outcomes, including information on access to and the quality of local public services, were already much-needed before February 2022 given that a large majority of municipalities surveyed by the OECD felt that they were not executing all their tasks and responsibilities effectively (OECD, 2021[9]). Moreover, data on outcomes are essential for policy makers to target policy and programming interventions and reinforce municipal capacity. The need for such data is much more important in the context of the war, given that the geographic concentration of Russian destruction in Ukraine has led to significant variations in the ability of municipalities to continue with day-to-day functions. This results in a need for tailored support in order to meet a range of divergent local needs. It will also be important to identify and disseminate good practices in municipal administration and service delivery—in fields such as strategic planning, project appraisal, investment management, public engagement, local data management, etc.—in the post-war period to improve performance across the board.

In addition to shedding light on the effectiveness of municipal performance, robust performance measurement frameworks can also support other goals. For example, performance measurement frameworks can aid national and subnational strategic planning by identifying clear benchmarks for meeting short-, medium- and long-term goals. They can also inform decision makers about the need to adjust multi-level governance arrangements or other mechanisms to improve policy and/or service delivery, efficiency, oversight, accountability and transparency. The latter will be particularly important in the aftermath of the war, as the design, implementation and monitoring of regional and local recovery initiatives will likely depend on effective co-ordination and co-operation among levels of government and with donors. Furthermore, publicly-accessible performance measurement frameworks can help to reinvigorate local accountability by providing residents with information on whether strategic priorities and objectives are being delivered by their elected municipal representatives.

Recommendations to improve the quality of performance measurement at the municipal level in Ukraine

In order to ensure that all municipalities are well-supported in the post-war recovery period, the government should develop a comprehensive monitoring and evaluation framework that enables cross-comparability of local government performance and can help to identify where capacity gaps exist. In this regard, it will be important for policy makers to develop indicators that can capture: a) outputs (e.g. to what extent formal or informal mechanisms, practices, rules, structures exist to help facilitate municipal performance) and b) outcomes (e.g. to what extent different municipalities are able to deliver on their objectives and responsibilities efficiently and effectively) (Ebinger, Grohs and Reiter, 2011[16]).

Output indicators that establish to what extent multi-level governance mechanisms have been created/exist to facilitate co-ordination and co-operation among levels of government would be valuable. They can help ascertain whether and to what extent various municipalities are working with other government actors to meet their service delivery responsibilities. This might include indicators establishing the existence and functioning of co-ordination bodies or contractual agreements and partnerships for delivering public investments across levels of government. With regard to horizontal co-ordination between municipalities, this might include indicators to clarify the existence and functioning of cross-jurisdictional investment partnerships, such as joint local investment authorities or co-ordinated investment strategies between municipalities (OECD, 2019[17]).

Output indicators can also include assessments of practices or structures established by municipalities to improve performance. With regard to strategic planning, which can help municipalities to identify needs, define development priorities and guide investment, relevant indicators could include whether local development strategies include an assessment of territorial needs, strengths and planned projects, and comprise a results framework with clear indicators and realistic targets (OECD, 2019[17]). Other relevant output indicators include the existence of Administrative Service Centres (ASCs) and *starostas* in municipalities, for which accurate data appears limited or even unavailable. Such indicators can help

ascertain whether structures are in place to support service delivery and local accountability. In addition, output indicators could include metrics that establish whether local information management systems (e.g. software for the collection, organisation and presentation of municipal statistics) are in place.

At the same time, outcome indicators are necessary to gain insights into municipal effectiveness. They capture the dimension that is expected to change as a result of an intervention (policy, programme, or project) (see Chapter 4). They show the real-world changes that practical outputs will produce (e.g. the share of people who receive mental healthcare are a result of the construction of a mental healthcare clinic). As such, outcome indicators can measure the extent to which municipalities are able to achieve policy objectives across different sectors for which they are responsible, such as education, healthcare, housing and utilities management. Examples of outcome indicators in the field of education include the number of students enrolled in different education institutions (e.g. kindergartens, primary and secondary schools, universities) or the share of a municipality's working age population that has a tertiary education. In the field of healthcare, indicators such as the number of doctors per 10 000 inhabitants or the number of people who receive mental healthcare support (for example to treat post-traumatic stress disorder) or hospital services for substance abuse could be considered. To measure municipal performance in utilities management, the government could use indicators such as wastewater treated (m^3), the proportion of households covered by sewage collection or the share of households with access to electricity.

Outcome indicators are relatively hard to measure as concrete policy interventions, such as the construction of a school or hospital, take time to generate tangible results in the target population (e.g. improvements in education or healthcare outcomes). As such, output and outcome indicators are complementary. Both will be key to assessing municipal capacity to deliver services for local residents in the recovery period. They can also help national and subnational leaders to identify areas where additional financial and capacity building support may be required. International benchmarks and indicators, such as the OECD Infrastructure Governance Indicators (IGIs), could also serve as a useful basis for developing tools to assess and monitor municipal performance over time, particularly as Ukraine's regions and municipalities rebuild damaged or destroyed public infrastructure (OECD, 2021[18]).

Municipal efficiency indicators can help to measure the cost-efficiency of local public expenditure

Municipal efficiency indicators typically seek to measure the amount of public goods that each municipality is able to produce relative to their available resources (e.g. the ratio of inputs to outputs in service delivery). This reflects the Data Envelopment Analysis (DEA) approach applied by the OECD, which evaluated how relatively efficient different municipalities were at maintaining social infrastructure (e.g. hospitals, schools) given their local revenues.

With large-scale reconstruction needs and scarce resources confronting many of Ukraine's municipalities, measuring municipal efficiency will be particularly important in order to ensure that local reconstruction projects are not leading to cost overruns and an inefficient allocation of resources (Public Policy Forum, 2014[15]). Metrics that can help to evaluate municipal efficiency include revenues, expenditures and debt data, as well as information measuring how many social infrastructure facilities (e.g. primary healthcare, education facilities) have been built or rebuilt in each territory. A large amount of information are already available through the Ministry of Finance's Open Budget Portal, which enables governmental and non-governmental actors alike to obtain information on issues such as municipal dependence on intergovernmental grants or local taxes and spending profiles. Currently, however, such data do not control for differences or changes in population, which limits comparisons between municipalities. If the data from the Ministry of Finance are adequately linked to up-to-date statistics on the population of each municipality—using the unique codifiers developed by MinRegion—revenues and expenditures and debt per capita can be calculated, which would facilitate cross-municipal comparisons of fiscal health and targeted interventions to support weaker municipalities.

Municipal effectiveness indicators can help to measure service quality and access

With regard to municipal effectiveness, indicators typically measure the quality, equity and accessibility of local public services and infrastructure for a specific territory. In light of the widespread destruction resulting from the war, these metrics are also critical for supporting the post-war recovery. They can help evaluate to what extent local infrastructure damage or strained resources may have disrupted local service delivery, while also pinpointing areas where additional support is needed. Effectiveness indicators are often relative metrics that aim to objectively assess the efficacy of local service operations (Public Policy Forum, 2014[15]). For example, the number of cubic metres of drinking water supplied by a municipality and the proportion of households covered by drinking water supply are both metrics that can help determine the equity, quantity and quality of local water service provision in each territory. These kinds of operational metrics can be complemented by citizen satisfaction data, obtained through surveys, to determine how users experience public service delivery. Satisfaction data are generally faster and more inexpensive to collect, process and disseminate than objective measures of performance. This can make them an attractive option for Ukraine in the short term while it expands its capacity to generate, analyse and disseminate data on operation indicators.

In addition to measuring the efficiency and effectiveness of local service delivery, output indicators can also help to capture economic performance at the municipal level. Developing data to track local-level unemployment and GDP per capita will be particularly important in identifying which territorial economies have been hardest-hit by the war. It will also be crucial in tailoring support in order to be of greatest value to municipalities as they chart a place-based recovery grounded in local needs and capacities. The pertinence of economic development indicators is further enhanced when they exist alongside territorially-disaggregated population data, which can help to clarify the relationship between changes in the size of the population and shifts in economic performance at the local level. This is particularly salient given the significant demographic changes occurring as a result of the war.

Developing a framework that could gather reliable data on the aforementioned indicators would help to provide a comprehensive picture of municipal performance and local development challenges and strengths, improving the ability of all levels of government to assess the results of their initiatives and support informed decision making on future initiatives. This would, however, require continued investment in the capacity of the national and subnational governments to produce, analyse and share reliable data, In addition, the list of indicators for which territorially-disaggregated data are available needs to be expanded well beyond the indicators that are currently presented on the Hromada Performance Monitoring Platform. This would have to be coupled with measures to promote an institutional culture, at all levels of government, that is oriented towards the use of monitoring and evaluation results to inform decision making. Examples of the type of indicators that the government could consider collecting annually and share through a publicly accessible digital platform are highlighted in the table below, along with suggestions for which agency could manage the information (Table 8.1). Information obtained by using indicators such as these can help national-level policy makers to make evidence-based decisions on what legislative and regulatory reforms, amendments to the Budget Code and capacity building support may be needed to improve local service delivery and citizen well-being throughout the country, while boosting territorial cohesion. Data on indicators such as these can also provide municipalities with information on their own performance and inform the design of municipal development strategies.

Table 8.1. Examples of indicators for measuring municipal performance and development

Category	Sub-category	(Description of) indicator	Possible public institution to manage the information
General	Horizontal co-ordination	- Number of cross-jurisdictional municipal partnerships	MinRegion
	Strategic planning	- Number of approved local development strategies that include an assessment of territorial needs, strengths, planned projects, and have a results framework with clear indicators and targets	MinRegion
		- Number of publicly accessible local development strategy monitoring and evaluation reports	
	Starostas	- Number of *starostas* per municipality; number of municipalities with a least one *starosta*	MinRegion, supported by the All-Ukrainian Starostas Association
	Trust	- Share of the population who report having confidence in the mayor	MinRegion, supported by the different local government associations
		- Share of the population who report having confidence in the municipal council	
Socio-demographic and economic indicators	Population	- Total population	State Statistics Service
		- Population per square kilometre	
		- Share of working age population	
		- Share of population older than working age	
		- Share of population younger than working age	
	Economic development and labour	- GDP per capita	Ministry of Economic Development and Trade
		- (Un)employment rate	
Budgetary indicators	Revenues	- Total municipal revenues	Already gathered by the Ministry of Finance
		- Municipal revenues from transfers	
		- Municipal revenues from shared taxes	
		- Own-source municipal revenues	
	Expenditures	- Municipal expenditures (functional and economic classification)	
	Transfers	- Current transfers	
		- Capital transfers	
	Debt	- Net municipal debt	
Operational indicators	Human resources	- Number of full-time equivalent staff	MinRegion
	Administrative Service Centres (ASCs)	- Number of ASCs	National government / MinRegion, supported by the Association of Administrative Service Centres
		- Number of essential services provided by ASCs	
		- Number of passports issued per capita	
		- Average processing time for key administrative service requests (e.g. business registration)	
		- Share of the population who report being satisfied with access to and the quality of services provided by the ASC	
	Student enrolment	- Share of children of eligible age enrolled in preschool institutions	MinRegion, as well as line ministries responsible for education, social services, healthcare, etc.
		- Share of children of eligible age enrolled in primary education institutions	
		- Share of children of eligible age enrolled in secondary education institutions	
	Primary healthcare	- Share of the population with access to primary healthcare centres.	
		- Infant mortality rate	
		- Number of people with access to mental healthcare (or who are treated for mental disorders such as post-traumatic stress disorder)	
		- Share of the population who report being satisfied with the access to and quality of local healthcare services	
	Social services	- Share of workers paying social security contributions	
		- Share of the population who receive welfare subsistence	

		- Share of the population who report being satisfied with the access to and quality of local social services	
	Housing	- Share of social rental dwellings as a percentage of the total housing stock	
		- Share of the population who report being satisfied with access to and the quality of housing	
	Utilities	- Drinking water supplied (m^3); proportion of households covered by drinking water supply	
		- Wastewater treated (m^3) and proportion of households covered by sewage collection	
		- Share of the population who report being satisfied with access to and the quality of different utilities (e.g. energy, water, waste collection)	
	Other	- Share of municipal streets with street lighting	
		- Number of building permits issued per 100 000 inhabitants	
		- Urban parks and green spaces (km^2)	
		- Number of grievous bodily harm with intent crimes per 100 000 inhabitants	
		- Number of premeditated murders per 100 000 inhabitants	
Political system indicators	Electoral participation	- Voter turnout as a percentage of registered voters	MinRegion and/or Ministry of Internal Affairs

Source: Author's elaboration.

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Note

[1] Of the 741 municipalities that completed the OECD survey, 57% indicated that they were formally co-operating with other municipalities to deliver one or more services, with healthcare and social services cited as the most common areas for co-operation (OECD, 2021[9]).

OECD Multi-level Governance Studies

Rebuilding Ukraine by Reinforcing Regional and Municipal Governance

Prior to Russia's large-scale invasion on 24 February 2022, Ukraine had made significant progress in implementing ambitious regional development and decentralisation reforms. These reforms resulted in the creation of 1 469 amalgamated municipalities, the establishment of an elaborate multi-level regional development planning framework, as well as a significant increase in local public service delivery, and public funding for regional and local development. However, the reforms faced a number of challenges, many of which have been significantly exacerbated by Russia's war against Ukraine. These challenges include increasing regional economic, demographic and well-being disparities, a fragmented regional development funding framework, as well as marked discrepancies in municipal administrative, human resource and fiscal capacity. This report presents an in-depth analysis of Ukraine's progress in implementing its multi-level governance reforms and explores the role of subnational governments in disaster management. From there, it recommends how Ukraine, together with international partners, can use multi-level governance, regional development and decentralisation to support subnational reconstruction and recovery to address urgent humanitarian needs, rebuild local economies and communities, and strengthen their resilience.

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