



## FACTORS AFFECTING THE ENSURING FINANCIAL SECURITY OF THE LOCAL BUDGET

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<b>Article history:</b>	<b>Abstract:</b>
<b>Received:</b> 11 <sup>th</sup> April 2026 <b>Accepted:</b> 10 <sup>th</sup> May 2026	The main role in ensuring the financial security of the local budget is played by the nominal values and financing of social programs. Financial stability is one of the important factors ensuring the strength and efficiency of local budgets. This article comprehensively analyzes the ways to ensure the financial security of local budgets and puts forward scientific and practical proposals for their strengthening. The main directions of the study are the expansion of the revenue base of local budgets, effective management of expenditures and increasing financial independence. Methods such as increasing tax revenues, diversifying local revenue sources, developing public-private partnerships and attracting investments are evaluated as effective tools for ensuring financial stability. The article also pays special attention to the issues of rational use of local budget funds, introducing an electronic budget system and strengthening state financial control. The need to reduce the dependence of local authorities on the central budget and expand the possibilities of financing infrastructure and social projects from their own funds is based on.

**Keywords:** Local budget, financial security, revenue sources, tax revenues, public-private partnerships, investments, budget expenditures, financial independence, electronic budget system, economic development.

### INTRODUCTION

Local budget financial security, as a separate and important area of modern public finance science, has been gaining increasing attention in recent decades. This concept includes not only the ability of local authorities to cover current expenses, but also the ability to finance the long-term socio-economic development of the territory, withstand external economic shocks, and provide citizens with uninterrupted quality services. According to the approach developed by international financial organizations, local fiscal security is assessed based on three interrelated criteria: revenue adequacy, expenditure sustainability, and resilience to external shocks.

At the heart of these three criteria, of course, are local budget revenues. The reason is simple and straightforward: no matter how much is spent, there must first be sufficient income to finance these expenses. If local budget revenues are not sufficient and stable, the other two security criteria — expenditure sustainability and resilience to shocks — will not be realized by themselves. Therefore, the study of the financial security of the local budget means, first of all, the study of the revenue base. The more independent, diverse and stable the revenues are, the stronger the financial security of the local budget [1].

In the theory of fiscal federalism, the composition and quality of local budget revenues are considered the main indicator of fiscal independence. There is an important difference here: although revenues generated through transfers and subsidies are financially favorable for local authorities, in the long run they weaken fiscal independence and increase dependence on the central government. On the contrary, revenues from their own tax base make the region financially independent and stable. It is for this reason that in many countries the share of own revenues without transfers — the fiscal independence index — is used as the main criterion for assessing the effectiveness of local authorities [2].

This issue is especially relevant for Uzbekistan. In the early years of independence, local budgets were formed mainly at the expense of funds allocated from the republican budget and transfers. This situation weakened the economic initiative of the regions and their incentive to develop their own potential, leading to a low level of financial independence. In order to solve this problem and provide local budgets with their own sources of income, a fundamental budget reform was implemented in our country in 2022.

### LITERATURE REVIEW

In addition, economist A. Mamanazarov conducted research aimed at increasing the role of



taxes in stabilizing local budgets. In his opinion, he notes that budget stability is expressed in the following two aspects. First, it means that the budget is balanced and there is no deficit; second, it means that even in the event of a deficit, it is maintained at the same level [3]. Z. Ro'ziyev also conducted research on the formation of local budget revenues, studying the problems on a regional scale and systematizing them as follows: first, the low level of tax collection in the formation of local budget revenues and the lack of full state registration of taxpayers. Second, the formation of local budget and enterprise finances in the structure of local finance, due to which receivables and payables are increasing from year to year. It is noted that local enterprises are not focused on creating added value, and fourthly, it is related to the determination of the norm of deductions from revenues from general state taxes and the allocation of subsidies to local budgets[4]. In addition, A. Khayriddinov formulated scientific conclusions aimed at increasing the role and importance of taxes in ensuring the stability of local budgets, and also cites an indicator expressed in the level of coverage of part of the expenses of local budgets by subsidies[5]. Sh. Kiyosov recommends giving the following powers to local authorities to solve the problems of ensuring the revenues of local budgets: "to set the rates of the tax on the use of natural resources in order to develop entrepreneurial activity in the region, to determine the priority areas of preferential taxation"[6]. It was emphasized that the first of these areas is to ensure economic and budgetary stability, and all sectors were instructed to optimize budget revenues and expenditures. An instruction was given to ensure additional income through the restoration of the activities of enterprises and the improvement of tax administration, not to exceed the established limit when concluding external debt transactions. In our opinion, the effective functioning of the financial strategy of local budgets largely depends on the financial potential of the region. This requires the transfer of the currently existing vertical financial powers to a horizontal one. Failure to implement this provision will obscure the prospects for financial independence. The main changes implemented within the framework of the reform can be listed as follows.

First, redistribution of taxes. In the previous system, the tax on turnover was mainly transferred to the republican budget, and only a small part remained in the local budget. The new procedure established that 50 percent of this tax would be deposited in the local budget. The share transferred to the local budget for property tax (legal entities) was also significantly

increased. For land tax (legal entities), the procedure for full deposit in the local budget was strengthened.

Secondly, the introduction of new local taxes. As part of the reform, a number of types of taxes were for the first time fully designated as local budget revenues. Local fees — various administrative fees and fees for the provision of services — were fully transferred to the local budget. This allowed local authorities to have a source of income at their disposal.

Third, tax administration reform. As a result of the expansion of the electronic tax declaration system and the digitalization of tax control, the efficiency of tax collection increased. Previously, the full collection of real estate tax and land tax was difficult - the introduction of a new electronic cadastre and tax database has significantly reduced this problem.

Fourth, the reorganization of budgetary relations. A new formula for the distribution of funds between local budgets and the republican budget has been introduced. The formula takes into account the economic potential of the region, the number of inhabitants and social needs. This has served to make the transfer system more transparent and fair.

Fifth, the expansion of the right of local budgets to plan their revenues. As part of the reform, local authorities have the opportunity to change their tax rates within established limits. This has made it possible, in particular, to adapt land tax rates to local conditions and economic needs.

Initial assessments of the results of this reform have shown positive indicators: over the period 2022–2024, the share of local budgets' own revenues increased, the regions' dependence on transfers decreased, and the growth rate of tax revenues exceeded GDP growth. However, the reform did not solve all the problems at once - systemic problems such as fiscal imbalances between regions, problems in regions with weak tax administration, and a large share of the informal economy still await their solution. External factors include the macroeconomic environment of the region, demographic composition, monetary environment, and institutional conditions. Although these factors are beyond the control of local authorities, they play a decisive role in determining local budget revenues. One of the important directions for the development of the budget-tax system in the world is the expansion of the source of revenues of local budgets. In developed countries, taxes on land, property and real estate constitute the main share of local budget revenues. It is worth noting that in developed and developing countries, local budget revenues occupy a significant share in the structure of



state budget revenues. In particular, this figure is 30% in Japan, 33% in the UK, 30% in Austria, 38% in France, 39% in Portugal, 58% in Norway, and 60% in Luxembourg. It is important to expand local budget revenues and clarify taxpayers and implement them based on approaches. Today, increasing the financial stability of local budgets may not have the same characteristics at the national level, but there are differences from a regional point of view. Ensuring the implementation of local budgets and strengthening their financial stability are important areas of financial strategy[7]. Strengthening the financial stability of local budgets can be viewed from two perspectives. Firstly, it is expressed in the well-formed revenue base, and secondly, in the achievement of cost stability.

## **MATERIALS AND METHODS**

Gross domestic product and economic growth. The overall level of economic activity in a region, i.e. gross domestic product, directly determines the expansion or contraction of the tax base. GDP growth increases tax revenues in several ways at once: as production increases, enterprises pay more property and land taxes; as the wage bill increases, income taxes increase; as consumer demand increases, turnover taxes increase. At the same time, the impact of GDP on local revenues is not uniform - in regions with inefficient tax administration, the transfer of economic growth to tax revenues is incomplete and the elasticity is lower[8].

Population, density, and demographic composition. Population is a quantitative measure of the taxpayer base. More population means more property and land tax payers, a larger consumer market, and higher trade turnover. However, numbers alone are not enough — demographic composition is important. In regions with a high share of the working-age population, officially employed, the ability to pay taxes is also high. The level of urbanization is also highlighted as a separate factor: urban residents pay more taxes through commercial property and the service sector.

Average wages and income levels. The income level of the population, first of all, determines consumer demand and purchasing power — which directly affects tax revenues from the trade and service sectors. Secondly, high wages increase labor costs for enterprises and can reduce corporate income tax, but increase the total income tax. Monitoring wage dynamics allows us to predict changes in the revenue base in advance.

Inflation and price stability. The impact of inflation on local budget revenues is manifested in two opposite directions. In the short run, price increases can

increase nominal tax revenues — for example, when the nominal value of property increases, property taxes also increase. However, in the long run, high inflation is harmful: it reduces the real profits of enterprises, worsens the investment climate, and reduces the real purchasing power of the population. As a result, economic activity slows down and the tax base shrinks. Therefore, stable and low inflation is a prerequisite for a healthy fiscal environment.

Monetary policy and interest rates. The key interest rate of the central bank is the main instrument of monetary policy and indirectly affects local budget revenues. An increase in the rate makes credit resources more expensive and reduces the demand for credit by enterprises. This reduces investment activity, production, and, as a result, tax revenues. Conversely, a decrease in the rate stimulates economic activity. There is usually a strong correlation between the interest rate and inflation — this creates the risk of multicollinearity when both factors are included in the model simultaneously.

Unemployment rate. Unemployment has a direct and indirect negative impact on local budget revenues. Direct impact: the number of taxpayers decreases with the loss of jobs. Indirect impact: the decrease in the purchasing power of the unemployed population reduces consumer demand and reduces sales taxes. In addition, high unemployment is often associated with the fact that industrial enterprises are reducing production or closing down, which directly reduces property taxes. Number of enterprises and the business environment. The number of officially registered enterprises is the most direct indicator of the taxpayer base. The opening of a new enterprise immediately becomes a new source of property, land and turnover taxes. Improving the business environment, simplifying the registration process and reducing bureaucratic obstacles will increase the number of enterprises in the formal sector. At the same time, the transition of the informal economy to the formal sector — legalization — also expands the tax base, but it is difficult to measure directly[9].

External economic factors: exports, exchange rate, trade turnover. For export-oriented regions, external market conditions, raw material prices, and the exchange rate play an important role. For example, in regions specializing in mining, an increase in raw material prices directly expands the profits of enterprises and the property tax base. However, this effect varies by region: for regions specializing in agriculture, domestic market demand is more important than external factors.



## RESULTS

Internal factors represent factors that local authorities can directly or indirectly control. These factors depend, first of all, on the structure and quality of the local tax system[10].

**Tax composition and diversity.** The distribution of local budget revenues between several types of taxes — diversification — increases the stability of revenues. If the budget relies mainly on one type of tax, the crisis of that sector will have an adverse effect on the entire budget. For example, a region that relies only on land taxes will suffer more from a crisis in the construction sector. Therefore, finance considers the natural diversification of revenue sources to be a prerequisite for financial security.

**Property-based taxes.** Land and property taxes are recognized in international practice as the most stable and predictable source of local budgets. The main advantage of these taxes is their low sensitivity to economic cycles: land and buildings do not disappear even during economic crises, they cannot be transferred to another jurisdiction. As a result, property-based taxes remain relatively stable even during periods of economic downturn. This serves as a climate-resilient source of revenue for local budgets[11].

**Small business taxes.** Turnover taxes and local levies reflect the activities of small and medium-sized businesses. These taxes are more sensitive to economic cycles - they increase rapidly in good times and decrease rapidly in times of crisis. However, they provide a great opportunity to broaden the tax base and formalize the informal sector. Attracting small businesses to the formal sector through tax incentives and simplified taxation procedures is an effective way to increase local revenues.

**Tax administration efficiency.** Even if tax legislation is good, if it is not possible to effectively implement it in practice, revenues will not be at the expected level. The efficiency of tax administration depends on: the completeness of cadastres and property registers; the technical capabilities of tax inspectorates; the level of digitalization - electronic declaration and payment systems; the level of corruption; the culture and attitude of taxpayers to the law [12].

**Transfers and inter-budgetary relations.** Transfers from the republican budget, on the one hand, allow regions with insufficient tax bases to be served. On the other hand, the phenomenon of the 'soft budget constraint', widely studied in economic theory, can weaken the incentive to develop their own revenue base

in regions that rely heavily on transfers. This paradox has been confirmed in many empirical studies, highlighting the importance of implementing transfer policies on a conditional basis - depending on local income growth.

## CONCLUSIONS

The results of the study show that ensuring the financial independence of local budgets is an important factor in strengthening regional economic development and fiscal stability. The stability of the revenue base of local budgets is largely dependent on the economic activity of the regions, the level of infrastructure development, the investment climate, demographic factors, and the effectiveness of the management system. Analysis of the financial performance of local budgets shows that an increase in economic growth rates in the regions, the development of small business and entrepreneurship, and the creation of new jobs lead to an expansion of the tax base. As a result, the stability of local budget revenues is ensured.

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