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THEORETICAL FOUNDATIONS OF THE FINANCIAL INDEPENDENCE OF LOCAL BUDGETS AND CRITERIA FOR ITS ASSESSMENT

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Abstract: This article examines the theoretical foundations of local budget financial autonomy and the criteria for its assessment. The study is based on fiscal federalism theory, intergovernmental fiscal relations, and financial decentralization approaches to define the economic essence of local budget autonomy. Drawing on the works of Oates, Musgrave, Shah, and OECD indicators, the key evaluation criteria are systematized.

The author proposes a comprehensive assessment model integrating revenue independence, tax authority, expenditure discretion, and transfer dependency. The findings provide a theoretical framework for improving fiscal policy and strengthening regional financial sustainability.

Key words: local budgets, financial autonomy, fiscal federalism, fiscal decentralization, intergovernmental relations, tax authority, transfers, fiscal sustainability, composite index, evaluation criteria, regional finance.

INTRODUCTION

In the context of contemporary economic reforms, improving the public financial management system and enhancing the effectiveness of fiscal policy remain among the most pressing priorities. In particular, the deepening of fiscal decentralization processes necessitates a comprehensive theoretical and practical examination of the financial independence of local budgets. The financial independence of local budgets serves as a crucial factor in promoting regional development, ensuring the efficient use of resources, and improving the quality of public services delivered to the population. Therefore, this article systematically analyzes the theoretical foundations of the financial independence of local budgets and the criteria for its assessment.

According to the theory of fiscal federalism, public finance is structured through the distribution of powers and resources between central and local levels of government. Within this framework, the financial independence of local budgets is determined by their autonomy in revenue generation and decision-making authority over expenditures. In the principles of fiscal federalism advanced by Oates, the efficiency of resource allocation at the local level is explained by the ability to account for the specific characteristics and needs of individual territories. Musgrave, in turn, emphasizes that the three fundamental functions of public finance—allocation, redistribution, and stabilization—should be rationally distributed between central and local levels of government. These theoretical perspectives constitute the methodological foundation for assessing the financial independence of local budgets.

The concept of financial independence of local budgets is interpreted differently across academic sources. Some researchers associate it solely with the share of own-source revenues, while others also consider factors such as tax authority, control over expenditures, budget planning autonomy, and the degree of dependency on intergovernmental transfers. In the methodologies of the OECD and the World Bank, financial independence is evaluated through indicators such as the share of own revenues in total budget revenues, the authority to set or modify taxes, and the conditionality of transfers. Consequently, it is appropriate to assess financial independence not through a single indicator but through a comprehensive system of criteria.

In recent years, the Republic of Uzbekistan has implemented large-scale reforms aimed at liberalizing fiscal policy and strengthening the role of local budgets. Regulatory and legal measures have been adopted to improve the state budget system, expand the revenue base of regions, and optimize the transfer mechanism. In particular, systematic measures have been undertaken to enhance intergovernmental fiscal relations, assign additional revenue sources to local budgets, and broaden their expenditure authorities. Although these processes contribute to increasing the financial independence of local budgets, in practice, certain regions continue to exhibit a relatively high degree of dependence on transfers.

A key challenge in assessing the financial independence of local budgets lies in the fact that existing approaches often rely on individual indicators, while comprehensive analytical frameworks remain insufficiently developed. As a result, accurately evaluating regional financial sustainability becomes more complex. Therefore, assessing financial independence through an integral index—by consolidating indicators such as the share of own revenues, the level of tax authority, expenditure autonomy, and transfer dependency into a unified system—has significant scientific and practical importance.

The main objective of this article is to systematize the theoretical foundations of the financial independence of local budgets and to develop comprehensive criteria for its assessment. Within the scope of the study, the theory of fiscal federalism, international experience, and national practice are examined, and an integral model for assessing the financial independence of local budgets is proposed. This model serves as a methodological basis for identifying regional financial sustainability and improving fiscal policy.

The article is structured as follows: the next section reviews the relevant academic literature; this is followed by a description of the research methodology; subsequently, the criteria for assessing financial independence and the proposed comprehensive model are presented; finally, conclusions and practical recommendations are provided.

LITERATURE REVIEW

The issue of the financial independence of local budgets constitutes one of the central themes in the theories of fiscal federalism and financial decentralization. It is closely linked to the efficiency of public financial management, regional economic development, and the stability of intergovernmental fiscal relations. In academic literature, the financial independence of local budgets has been interpreted through various theoretical and methodological approaches.

One of the founders of fiscal federalism theory, Oates (1972), emphasizes that broader fiscal authority at the local level enhances the efficient use of resources. According to his argument, local governments possess more precise knowledge of territorial needs compared to the central government, thereby increasing the efficiency of resource allocation. Oates associates the financial independence of local budgets with their authority to generate revenues and manage expenditures. This approach theoretically substantiates the positive impact of fiscal autonomy of local budgets on regional development.

Musgrave and Musgrave (1989), within the framework of the three fundamental functions of public finance—allocation, redistribution, and stabilization—explain the distribution of powers between central and local levels of government. They argue that redistribution and macroeconomic stabilization functions should primarily be performed at the central level, whereas resource allocation and the financing of public services can be more effectively carried out at the local level. Accordingly, the financial independence of local budgets is viewed as an instrument for enhancing allocative efficiency.

Shah (2007) considers fiscal decentralization as a factor contributing to economic growth and improved governance quality. He proposes assessing the financial independence of local budgets through three key indicators: the share of own-source revenues, the degree of tax authority, and the level of dependence on intergovernmental transfers. Shah's approach highlights the necessity of evaluating financial independence through a comprehensive system of indicators rather than relying on a single measure.

Reports by the OECD (2020) and the World Bank also recommend a set of indicators for assessing the financial independence of local budgets. These include the share of own revenues in total revenues, the authority to set or modify tax rates, the proportion of conditional and unconditional transfers, and the degree of discretion in budget expenditure planning. The OECD methodology links financial independence not only to revenue shares but also to institutional authority and fiscal discipline.

Researchers examining transition economies note that the actual level of financial independence often differs from formally assigned powers. For example, in some countries local taxes formally exist, yet the authority to determine or modify tax rates remains centralized. Such arrangements limit fiscal autonomy and increase local budget dependence on transfers.

Uzbek scholars have also extensively studied the financial independence of local budgets. Academic works have proposed measures to strengthen the revenue base of local budgets, increase the share of tax

revenues, and improve the transfer system. While some studies assess financial independence through the share of own revenues, others focus primarily on transfer dependency as the key indicator. However, the issue of evaluating financial independence through an integral composite index has not been sufficiently developed in the existing literature.

The literature review indicates that there is no single universal approach to assessing the financial independence of local budgets. Although multi-factor indicators are applied in international practice, there remains a need to develop a comprehensive model adapted to national conditions. Therefore, this article proposes an integral model for assessing the financial independence of local budgets, systematically integrating indicators such as the share of own revenues, the degree of tax authority, expenditure autonomy, and transfer dependency. This approach aims to address the existing research gap and provide a more comprehensive analytical framework.

RESEARCH METHODOLOGY

This study is theoretical and conceptual in nature and is aimed at providing a systematic analysis of the financial independence of local budgets and developing comprehensive criteria for its assessment. The research methodology is grounded in the theory of fiscal federalism, the concept of financial decentralization, and models of intergovernmental fiscal relations. Systemic analysis, comparative analysis, generalization, and composite index construction methods were employed as the main methodological approaches.

At the first stage of the research, scientific literature and international methodologies were analyzed. Based on the approaches of Oates, Musgrave, Shah, and the OECD, the key structural components of local budget financial independence were identified. During this stage, a system of indicators reflecting financial independence was developed. The analysis resulted in the specification of four main criteria:

- the share of own-source revenues;
- the degree of tax authority;
- expenditure decision-making autonomy;
- the level of dependence on intergovernmental transfers.

At the second stage, an integral model for assessing financial independence was developed based on these criteria. The composite index is expressed in the following general form:

$$FMI = w_1R + w_2T + w_3E - w_4D \text{ Where:}$$

- FMI — Financial Independence Index;
- R — share of own-source revenues;
- T — degree of tax authority;
- E — expenditure autonomy indicator;
- D — level of transfer dependency;
- w_i — weight coefficients assigned to each criterion.

The weight coefficients are determined based on expert evaluation and theoretical priority. This model enables the assessment of financial independence not only through the revenue structure but also by incorporating institutional and fiscal authority dimensions.

At the third stage, an evaluation algorithm was developed. First, each indicator is normalized within a range from 0 to 1. Then, the composite index is calculated using the assigned weight coefficients. This approach allows for comparative analysis of financial independence across regions or over time.

Overall, the proposed research methodology provides a comprehensive and systematic framework for assessing the financial independence of local budgets. Unlike traditional single-indicator approaches, it introduces a multi-factor model that offers a more complete analytical perspective. This methodological framework serves as a theoretical foundation for evaluating fiscal policy effectiveness and improving intergovernmental fiscal relations.

ANALYSIS AND RESULTS

The results of this study demonstrate that existing approaches used to assess the financial independence of local budgets are not sufficiently comprehensive. Although financial independence is frequently measured in academic literature by the share of own-source revenues, this indicator alone does not fully reflect the actual level of local fiscal autonomy in practice. Therefore, within the framework of this research, a comprehensive model for assessing the financial independence of local budgets was developed.

Structural Elements of Financial Independence

The analysis substantiated that financial independence consists of the following four key structural components:

1. Share of Own-Source Revenues (R). This indicator reflects the proportion of locally generated revenues within total budget revenues. Regions with a higher share of own-source revenues are generally less dependent on central transfers and possess greater capacity to shape their budget policy independently. However, the study revealed that a high share of own revenues does not automatically imply full fiscal autonomy, since certain taxes and their rates may still be determined at the central level.

2. Degree of Tax Authority (T). The degree of tax authority represents the ability of local governments to set, modify, or introduce taxes. International experience shows that real fiscal independence is closely linked to tax-setting powers. Even if local taxes formally exist, when tax rates are determined centrally, the practical level of financial independence remains limited.

3. Expenditure Autonomy (E). The extent to which local governments can independently determine expenditure priorities is also a critical factor. If a significant portion of expenditures is financed through earmarked transfers, the actual decision-making autonomy of local authorities decreases. Therefore, the share of discretionary expenditures was evaluated as an essential criterion of financial autonomy.

4. Level of Transfer Dependency (D). Transfer dependency reflects the degree of financial reliance of local budgets on central government transfers. The study findings indicate that while transfers perform an equalizing function, their excessive share may weaken fiscal incentives and reduce accountability. For this reason, this indicator is incorporated into the model as a negative factor (see Figure 1).

Algorithm for Calculating the Financial Independence Index (Flowchart)



Figure 1. Algorithm for Calculating the Financial Independence Index (Flowchart)¹

This algorithm reflects a step-by-step mechanism for assessing the financial independence of local budgets. Initially, indicators such as own-source revenues, tax authority, expenditure autonomy, and transfer dependency are collected and normalized.

At the next stage, weight coefficients are assigned to each indicator, and the integral Financial Independence Index (FMI) is calculated.

In the final stage, the obtained results are comparatively analyzed across regions and over time, and practical conclusions are formulated to improve fiscal policy.

Proposed Integral Model. Based on the above elements, the Financial Independence Index (FMI) is proposed in the following form:

$$FMI = w_1R + w_2T + w_3E - w_4D \text{ Where:}$$

- FMI – Financial Independence Index;
- R – Share of own-source revenues;

¹ author's development

- T – Degree of tax authority;
- E – Expenditure autonomy indicator;
- D – Level of transfer dependency;
- w_1, w_2, w_3, w_4 – Weight coefficients assigned to each indicator.

This model enables a comprehensive assessment of financial independence by integrating revenue capacity, institutional tax authority, expenditure discretion, and transfer dependency into a unified analytical framework.

Structure of the Financial Independence Index (FMI)

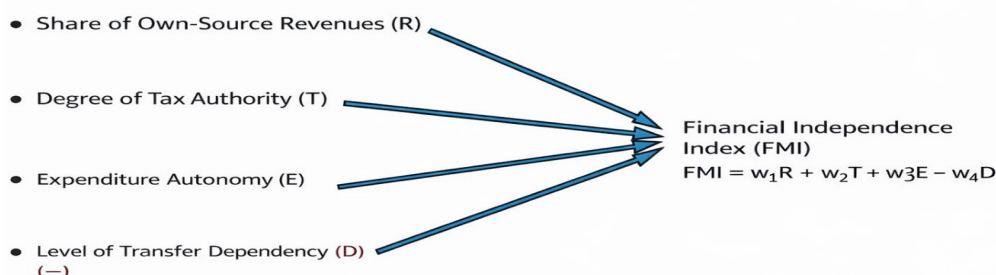


Figure 2. Conceptual Model for Assessing the Financial Independence of Local Budgets²

According to the proposed conceptual model, the financial independence of local budgets is formed on the basis of four key components: the share of own-source revenues (R), the degree of tax authority (T), expenditure autonomy (E), and transfer dependency (D). These factors are integrated through a composite index, enabling a comprehensive assessment of the level of financial independence.

The scientific significance of this model lies in its interpretation of financial independence not as a single-dimensional indicator, but as a multidimensional system. Within the framework of the model, each indicator is normalized within the 0–1 range, while the weight coefficients may be determined based on expert evaluation or empirical analysis results. This approach makes it possible to integrate financial and institutional factors into a unified framework, conduct comparative analysis across regions, and assess dynamics over time. Furthermore, the model has practical relevance for evaluating fiscal policy effectiveness.

The research findings demonstrate that assessing the financial independence of local budgets solely through the share of own-source revenues is not scientifically sufficient. Real financial autonomy should be evaluated comprehensively, taking into account revenue-generating authority, the degree of expenditure autonomy, and the level of transfer dependency. The results substantiate that fiscal independence is a multidimensional economic concept and indicate that the conditionality of transfers is more significant than their absolute volume. Moreover, tax authority emerges as a key determinant of real fiscal autonomy, and financial independence is identified as an essential factor in ensuring regional economic stability.

The scientific novelty of this study is reflected in the development of a comprehensive definition of local budget financial independence, the construction of an integral index model, and the integration of financial and institutional indicators into a unified analytical system. In addition, a clear assessment algorithm is proposed, and a methodological framework adapted to practical analytical procedures is developed.

CONCLUSIONS AND RECOMMENDATIONS

This study was devoted to a systematic theoretical and conceptual examination of the financial independence of local budgets. The conducted analysis demonstrated that the financial independence of local budgets is a multidimensional economic category and cannot be adequately assessed solely through the share of own-source revenues. Based on fiscal federalism theory, international experience, and national budgetary practice, it was substantiated that financial independence is closely linked to revenue-generating authority, autonomy in expenditure decision-making, and the level of dependence on intergovernmental transfers.

As a result of the research, a comprehensive model for assessing the financial independence of local budgets was proposed. The model integrates the share of own-source revenues (R), the degree of tax authority (T), expenditure autonomy (E), and transfer dependency (D) into a unified composite index. This approach

² author's development

interprets financial independence not as a single-dimensional indicator but as a systemic and institutionally grounded concept. The proposed index enables comparative analysis of financial independence across regions, assessment of temporal dynamics, and evaluation of fiscal policy effectiveness.

The theoretical analysis also revealed that the existence of transfers is not inherently a negative factor. However, an excessively high share of transfers may weaken fiscal incentives and limit local economic initiative. Therefore, while maintaining their equalizing function, the transfer system should be improved based on incentive-oriented principles. In particular, increasing the share of unconditional transfers and simplifying the conditions attached to earmarked transfers would contribute to strengthening local fiscal autonomy.

Based on the research findings, the following practical recommendations are proposed:

First, expanding the revenue base of local budgets and increasing the share of own-source revenues should be a priority direction. In this process, improving tax administration, reducing the size of the informal economy, and enhancing the potential of local taxes are of crucial importance.

Second, strengthening real fiscal autonomy at the local level requires the expansion of tax authority. Granting local governments the power to set or differentiate certain tax rates would enhance fiscal responsibility.

Third, in order to increase expenditure autonomy, it is advisable to gradually reduce the share of earmarked transfers and introduce performance-based financing mechanisms.

Fourth, the practical implementation of the proposed Financial Independence Index would enable regular monitoring of the financial condition of regions. This would support evidence-based fiscal policymaking.

Enhancing the financial independence of local budgets is a key condition for ensuring fiscal stability and promoting regional development. The proposed conceptual model and composite index provide a methodological foundation for improving the local financial management system and contribute to a more rigorous scientific substantiation of fiscal policy.

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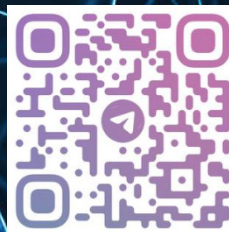
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