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## **FEATURES OF LOCAL BUDGET REVENUE FORMATION: CHALLENGES, MECHANISMS AND REFORM PROSPECTS**

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### **Abstract**

This article examines the key characteristics of local budget revenue formation in the context of Uzbekistan's ongoing fiscal decentralization. Drawing on theoretical frameworks and empirical evidence from transitional economies, the study analyzes the structural composition of local revenues, identifies systemic weaknesses in intergovernmental fiscal relations, and evaluates the effectiveness of existing revenue-sharing mechanisms. The article further proposes a set of policy recommendations aimed at enhancing the fiscal autonomy of local governments and ensuring the sustainability of subnational public finances.

**Keywords:** Local budget, revenue formation, fiscal decentralization, intergovernmental transfers, own-source revenues, tax assignment, subnational finance, Uzbekistan.

### **Introduction**

Local budgets constitute the financial foundation of subnational governance, enabling municipalities and districts to fund public services ranging from education and healthcare to infrastructure and social protection. The quality of local budget revenue formation directly determines the capacity of local authorities to fulfill their mandates, respond to community needs, and support economic development at the grassroots level.

In Uzbekistan, the process of fiscal decentralization has gained significant momentum over the past decade. Constitutional amendments, the adoption of the Budget Code, and a series of presidential decrees have progressively



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expanded the role of local governments in budget planning and execution. Nevertheless, local budgets in Uzbekistan continue to exhibit a high degree of dependence on transfers from the central government, raising fundamental questions about fiscal sustainability, revenue adequacy, and the incentive structures governing local financial management.

Against this backdrop, this article seeks to systematically analyze the features that distinguish local budget revenue formation from central government financing, identify structural bottlenecks in the current system, and propose evidence-based directions for reform. The relevance of this inquiry is further underscored by ongoing international discussions on fiscal decentralization as a tool for sustainable development and macroeconomic stability.

### **Literature Review and Theoretical Framework**

The theoretical underpinning of local budget revenue formation draws on three principal strands of fiscal federalism literature. The first, rooted in Tiebout's (1956) model of local expenditure, posits that decentralized revenue collection allows local governments to tailor fiscal policy to the heterogeneous preferences of their populations, thereby increasing allocative efficiency. The second strand, developed by Oates (1972) in his seminal *Fiscal Federalism*, argues that the assignment of tax powers to subnational governments must be conditioned on the mobility of tax bases and the administrative capacity of local authorities.

A third, more recent perspective emphasizes the importance of incentive-compatible fiscal design. Weingast (2009) and Qian & Roland (1998) demonstrate that local governments with meaningful own-source revenues are more likely to foster pro-growth policies, since they internalize the fiscal benefits of expanding their local tax base. This insight is particularly relevant for transitional economies where local governments historically functioned as administrative units rather than autonomous fiscal actors.

Empirical studies from Central Asian and post-Soviet economies paint a nuanced picture. Research on Kazakhstan (Kuralbayeva, 2021) and Kyrgyzstan (Isakova, 2019) documents that intergovernmental transfers, while stabilizing, tend to create fiscal dependency and reduce local incentives to mobilize own revenues. Studies specific to Uzbekistan (Yusupov, 2022; Nazarov, 2023)



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confirm that local budgets in the republic derive over 60% of their revenues from centrally allocated transfers, leaving a limited and uneven base of own-source revenues.

## **Structural Features of Local Budget Revenue Formation**

### **1. Composition of Local Revenues**

Local budget revenues in Uzbekistan are broadly classified into three categories: own-source (tax and non-tax) revenues, regulated revenues shared from national taxes, and intergovernmental transfers (subventions and grants). This tripartite structure reflects the hybrid nature of fiscal decentralization in the country — nominally decentralized in form but substantially centralized in substance.

Own-source revenues encompass a narrow set of local taxes (including property tax and land tax), fees and charges, and non-tax receipts such as revenues from the use of state property. These sources, while legally assigned to local governments, generate relatively modest and geographically uneven receipts due to limited tax bases, weak valuation methodologies, and administrative capacity gaps.

Regulated revenues — primarily shares of value-added tax, personal income tax, and corporate profit tax — constitute the second tier. Their allocation to local budgets follows a formula-based approach determined centrally, which limits local discretion and predictability. The proportion of regulated revenues received by any given local budget varies significantly depending on economic activity levels and negotiated sharing ratios.

### **2. Role of Intergovernmental Transfers**

Transfers from the State Budget represent the dominant source of financing for the majority of district and city budgets in Uzbekistan. They serve both equalization and gap-filling functions — redistributing resources from wealthier to poorer regions and compensating for the structural inadequacy of local own-source revenues. While essential for maintaining baseline service delivery, transfers also carry well-documented adverse incentive effects:



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- They reduce local governments' motivation to pursue revenue mobilization, since increased own revenues may result in reduced transfer allocations (the so-called 'flypaper effect');
  - They expose local budgets to fiscal uncertainty, as transfer amounts may be revised mid-year in response to central budget pressures;
  - They limit local government accountability, as citizens perceive public services as centrally funded rather than locally generated.

### **3. Geographic and Sectoral Disparities**

A defining feature of local budget revenue formation in Uzbekistan is pronounced regional disparity. Economically active urban centers — particularly Tashkent city and the Tashkent region — generate significantly higher own-source revenues per capita compared to predominantly agricultural regions such as Surkhandarya, Kashkadarya and Khorezm. This asymmetry reflects the spatial concentration of industrial enterprises, financial services, and trade activity, all of which generate substantial tax revenues.

This geographic dimension of revenue inequality has important policy implications. A uniform revenue-sharing formula that does not account for structural differences in local tax potential may perpetuate fiscal inequality rather than address it. Evidence from comparative fiscal policy studies suggests that equalization transfers must be complemented by targeted capacity-building and revenue administration reforms to produce durable improvements in local fiscal health.

### **Key Challenges in Local Revenue Mobilization**

Several systemic challenges inhibit effective local budget revenue formation in Uzbekistan.

First, the narrow tax assignment framework leaves local governments with insufficient fiscal instruments to respond to changing revenue needs. Unlike OECD countries where local governments often enjoy discretion over tax rates within nationally set bands, Uzbek municipalities have limited authority to adjust tax rates or introduce local surcharges.



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Second, property tax administration remains underdeveloped. Despite property taxes being a globally recognized 'ideal' local tax due to their immobile base, their contribution to local revenues in Uzbekistan is constrained by outdated cadastral valuations, incomplete property registries, and low collection rates. Modernizing the property tax system represents one of the highest-impact reforms available to local fiscal authorities.

Third, the informal economy continues to suppress the taxable base available to local governments. Small traders, service providers, and micro-enterprises operating outside the formal sector do not contribute to local tax revenues, placing a disproportionate fiscal burden on registered businesses and salaried employees.

Fourth, administrative capacity at the local level remains uneven. Tax collection, audit functions, and fiscal planning expertise are often concentrated in urban centers, with rural and remote localities struggling to identify and mobilize available revenue streams.

### **Reform Directions and Policy Recommendations**

Based on the foregoing analysis and international best practices, the following reform directions are recommended to strengthen local budget revenue formation in Uzbekistan:

- Expand the scope of own-source revenues by assigning a broader set of taxes to local governments and granting limited rate-setting authority within nationally defined bands, consistent with international principles of fiscal federalism;
- Modernize property valuation systems through mass appraisal methodologies and digital cadastre platforms, thereby unlocking the full revenue potential of property taxation;
- Reform the intergovernmental transfer system to incorporate transparent, formula-based equalization mechanisms that decouple transfer allocations from local revenue mobilization efforts, removing disincentives to own-source revenue collection;



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- Strengthen local tax administration capacity through investment in digital taxpayer registries, risk-based audit systems, and professional training programs for local fiscal officials;
  - Integrate local budget revenue planning with local economic development strategies, ensuring that land use planning, business registration policies, and investment promotion efforts are aligned with revenue maximization objectives.

### **Conclusion**

The formation of local budget revenues in Uzbekistan is characterized by structural dependence on central transfers, narrow own-source revenue bases, significant regional disparities, and administrative capacity constraints. These features reflect both the legacy of centralized fiscal governance and the incomplete nature of ongoing decentralization reforms.

Addressing these challenges requires a coherent and sequenced reform agenda that expands local tax assignment, modernizes revenue administration, redesigns equalization transfers, and builds institutional capacity at the subnational level. Such reforms, if implemented with political commitment and technical rigor, have the potential to substantially enhance local fiscal autonomy, strengthen service delivery, and contribute to macroeconomic stability in Uzbekistan.

The experience of successful fiscal decentralizers — including Georgia, Estonia, and the Baltic states — demonstrates that reforming local revenue formation is not merely a technical fiscal exercise, but a foundational investment in democratic governance and sustainable development.

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