

Fiscal Decentralization and Local Tax Policy: An Empirical Analysis of Community Self-Sufficiency in Ukraine

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Article's History

Received 5th of January, 2025; Revised 9th of February, 2026; Accepted 2nd of March, 2026; Available online: 30th of March, 2026. Published as article in the Volume XXI, Spring, 2(92), March, 2026.

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Suggested Citation

Mazur, H., Shkurat, S., Tsap, V., Samsin, I., & Bukhanevych, O. (2025). Fiscal Decentralization and Local Tax Policy: An Empirical Analysis of Community Self-Sufficiency in Ukraine. *Journal of Applied Economic Sciences*, Volume XXI, Spring, 2(92), 529–544. [https://doi.org/10.57017/jaes.v21.2\(92\).08](https://doi.org/10.57017/jaes.v21.2(92).08)

Abstract

This study evaluates the impact of local taxation on the financial self-sufficiency of territorial communities in Ukraine within the context of ongoing fiscal decentralisation. As transitional economies seek to empower local governance, the ability to generate autonomous revenue becomes a prerequisite for sustainable regional development. Utilizing a structural-empirical analysis of budget data, the

research identifies the specific tax instruments, primarily property and land taxes, that most effectively drive community autonomy. The findings demonstrate a significant correlation between tax base diversification and the reduction of vertical fiscal imbalances. The study highlights the challenges posed by martial law and economic volatility, proposing a model for strengthening local fiscal resilience through digital administrative reforms and optimised tax incentive structures. The research concludes with policy recommendations for harmonising Ukrainian local tax frameworks with European standards to ensure long-term financial stability at the municipal level.

Keywords: local taxation; fiscal decentralization; financial self-sufficiency; territorial communities; public finance; economic resilience.

JEL Classifications: H71; H77; R51; O23; P35.

Introduction

In the context of decentralization, a significant part of the powers and budgets are transferred from state bodies to local governments (Petrovito *et al.*, 2023). This brings management and decision-making closer to the local population, contributing to improving the quality of public services and providing the opportunity to respond promptly to the needs of a specific territory (Caldeira *et al.*, 2023; Orton, 2023). At the same time, increasing demands on local governments create new challenges related to the lack of financial resources, limited management capabilities, insufficient skills, problems with the administration of local taxes (Bellofatto & Besfamille, 2021). In such conditions, an important task is to balance centralized support and autonomy of local communities to ensure an optimal level of their financial self-sufficiency.

Local taxes and fees are an independent source of revenue for local budgets, which play an important role in their financing (Rubolino & Giommoni, 2023). The effectiveness of local taxation largely determines the financial autonomy and financial self-sufficiency of territorial communities. At the same time, the share of local taxes and fees in the total revenues of local budgets in Ukraine remains quite low compared to the practice of Western countries (Szydłowski, 2022). This prevents the proper performance of the function of local taxes and fees in ensuring the financial autonomy of territorial communities. Accordingly, the institution of local taxes and fees in Ukraine remains insufficiently effective even in the context of decentralization. This urges the issue of studying their impact on the financial self-sufficiency of territorial communities and finding ways to optimize them.

At the same time, complete financial self-sufficiency may be impractical and impossible in real conditions. Therefore, the research uses the level of financial capacity, which includes financing from both own and external sources. Financial self-sufficiency is a component of financial capacity, reflecting the ability of local budgets to meet their own needs at the expense of their own funds. The analysis of financial capacity allows us to assess the role of own revenues in the formation of local budgets compared to external sources of financing, such as transfers or subsidies. The key hypothesis of the study was the assumption that local taxes and fees play a leading role in ensuring the financial capacity of territorial communities, increasing the level of their financial self-sufficiency. The novelty is the assessed role of local taxes in shaping of the financial self-sufficiency of territorial communities depending on the level of their financial capacity, taking into account the simultaneous influence of revenues and expenditures. The aim of the research was to identify the key factors that determine the financial capacity of territorial communities in Ukraine and assess the impact of local taxes and fees on its level.

The objectives of the study are as follows:

- to identify the key determinants of the financial capacity of territorial communities;
- to assess the impact of financial and related factors on the overall financial capacity of communities in Ukraine;
- to compare the role of local taxes and fees in shaping the financial capacity of territorial communities across different clusters.

1. Literature Review

A number of researchers studied local taxes and fees as important components for increasing the financial autonomy and self-sufficiency of territorial communities (Miceikienė *et al.*, 2021; Pupysheva *et al.*, 2025). Plahotniuk (2024) notes that the financial capacity of communities is the basis for the socio-economic well-being of regions. It was noted that the decentralization reform in Ukraine was aimed at increasing the financial capacity of communities along with increasing their financial independence. However, the work did not assess the direct impact of the decentralization reform on the financial independence and capacity of territorial communities.

Vatamaniuk-Zelinska & Danyliak (2024) and Vozniak & Koval (2023) emphasized the important role of local taxes in forming the local budget revenues and ensuring the autonomy of territorial communities. At the same time, the researchers didn't reveal how these revenues affect the financial self-sufficiency of territorial communities, and the impact of expenditures has not been taken into account.

Vozniak *et al.* (2022) have described problems in the local taxation system that cause significant inequality between communities. In particular, this is the issue of collecting personal income tax (PIT) and other taxes. The researchers found that communities in whose territory's enterprises operate received more budget-forming taxes (PIT, land tax, real estate tax). Communities through which important highways pass receive more excise taxes. This leads to increased inequality between financially capable and weak communities. Their study notes the negative impact of the war in Ukraine on tax revenues of local budgets and analyses the structure and dynamics of the relevant indicators. However, the researchers do not assess the direct impact of local taxes on the financial self-sufficiency and autonomy of territorial communities.

Ptashnyk & Temchenko (2023) predict a further decline in the financial capacity of communities because of increasing unemployment, emigration, and business closures. In this context, the researchers emphasize the need to expand the tools for stimulating communities' own development, but do not support their conclusions with empirical data.

The problem of the impact of local taxes on the financial capacity of communities under decentralization has been widely studied by the researchers from different regions of the world. Li & Du (2021) studied the impact of transfers on the fiscal sustainability of local governments in China under fiscal decentralization. They found that the current fiscal behaviour of local governments is unsustainable. Belmonte-Martin *et al.* (2021) found that managing local taxes based on supramunicipal delegation, using the example of Spain, will not lead to increased efficiency. Accordingly, the creation of special self-government bodies at the provincial level to perform tax collection tasks is not appropriate. An assessment of international experience in local taxation under decentralization is useful, but the conclusions of scholars should be tested taking into account regional specifics.

Haptari *et al.* (2022) and Adhim *et al.* (2023) examined how fiscal decentralization can increase regional financial independence using the example of municipal governments in Indonesia. The researchers analysed the impact of indicators of the volume of balancing funds, local revenues, general and special appropriation funds, etc. At the same time, their studies lack an in-depth assessment of the role of expenditures and other factors in ensuring financial independence. This observation is taken into account in the studies of Ervina & Hidayah (2024) and Delang & Sitorus (2024), which revealed a positive impact of local taxes on local revenues and capital expenditures.

In turn, Tejaarief & Husni (2025) noted that the financial autonomy indicators of individual regions of Indonesia remain rather low. Therefore, the researchers' conclusions require an extended analysis in order to clarify the key determinants of financial autonomy. Khan *et al.* (2025) confirmed the positive impact of fiscal capacity, in particular the level of decentralization, on reducing regional disparities. However, the work focuses mainly on the impact of decentralization on regional economic convergence, paying less attention to financial self-sufficiency. The studies that consider the case of Indonesia may be useful for Ukraine in the context of considering the risks of rapid decentralization. However, the specific economic conditions in Indonesia may limit the applicability of this country's experience to Ukraine. Ladner & Keuffer (2021) proposed an approach to measuring local autonomy that takes into account political, financial, and organizational factors. The approach is universal, as it covers data from 39 countries, but it may lack consideration of local specifics.

The review shows that Ukrainian studies lack empirical evidence, and the relevance of the findings of foreign authors should be carefully checked against local conditions. Our study fills the existing gaps in research by identifying key factors that determine the financial capacity of territorial communities in Ukraine. The study also assesses the impact of local taxes and fees on the example of five clusters of territorial communities ranked by the level of financial capacity.

2. Methodology

2.1. Research Design

The preparatory stage of the study involved collecting, cleaning, and structuring data on Ukrainian territorial communities. The main stage of the study involved conducting factor analysis, regression analysis for all territorial communities of Ukraine, and regression analysis by community clusters. The final stage involved comparing the findings with the results of other studies, as well as drawing conclusions and providing recommendations.

2.2. Sample

The study was conducted on the basis of data from 1,437 territorial communities in Ukraine. Community indicators were determined in accordance with the methodological approach developed within the framework of the implementation of the ULEAD with Europe Programme (Decentralization, 2024a; Decentralization, 2024b). The indicators used comprehensively characterize the financial capacity of territorial communities, taking into account financial revenues and financial expenditures, as well as demographic and territorial characteristics (Table 1).

Table 1. Selection of Indicators for the Study

Parameter	Description	Measurement unit
Population	Number of community residents	thousand people
Area	Community territory	km ²
General fund revenues	Average income per inhabitant	UAH per capita
General fund expenditures	Average expenses per inhabitant	UAH per capita
Subsidization level	Share of subsidies in total budget revenues	%
Share of transfers	Share of external revenues in the revenue part of the budget	%
Share of local taxes and fees	Share of community's own revenues in the revenues of the general budget fund without transfers	%
Administrative expenses	Average administrative expenses per inhabitant	UAH per capita
Capital expenditures	Average community investment expenses per inhabitant	UAH per capita
Share of administrative expenses	Share of administrative expenses in community financial resources	%
Share of budget expenditures for wages	Wages in community budget general fund expenditures	%
Share of budget capital expenditures	Share of investments in total expenditures	%
Expenditures for culture, education, and sports	Funding of cultural and sports events per inhabitant	UAH per capita
Overall assessment of financial capacity	A comprehensive assessment of community effectiveness	points

Source: Authors' calculations based on Decentralization (2024a, 2024b),

The last-mentioned indicator (Overall assessment of financial capacity) characterizes the level of financial capacity of communities. Financial capacity refers to the efficiency of using both external and internal sources of financing, and therefore includes financial self-sufficiency. The Share of local Taxes and Fees in total revenues used in the study and its comparison with the volume of external revenues indicates financial self-sufficiency to the greatest extent. Therefore, special attention was paid to these indicators during the study.

2.3. Methods

The study employed factor analysis using the principal components method to identify key factors that affect the financial capacity of territorial communities. The principal components method was used because of its ability to reduce the number of variables with maximum preservation of information, which is especially important in case of correlated variables. Regression analysis using the linear regression method (1) was carried out to determine the strength and direction of the influence of the studied independent variables on the dependent indicator.

$$Y = \beta_0 + \beta_1 * X_1 + \beta_2 * X_2 + \dots + \beta_n * X_n + \epsilon \tag{1}$$

where: Y - dependent variable; X₁, X₂, ..., X_n - independent variables; β₀ - free term; β₁, β₂, ..., β_n - regression coefficients; ε - random error.

The results of the analysis were checked for validity and reliability using the White, Durbin-Watson, Shapiro-Wilk tests, as well as variance inflation factor (VIF) testing. The tests did not reveal heteroscedasticity, autocorrelation of residuals, or multicollinearity, and confirmed the normal distribution of residuals. The R² values indicate a qualitative explanation of the independent variable in the constructed models. The comparative analysis gave grounds to draw profound conclusions about the impact of the studied indicators on the financial capacity of territorial communities belonging to different clusters.

3. Results

The first stage of the study involved the factor analysis of the main indicators of territorial communities. This made it possible to identify the main factors that affect the financial capacity of territorial communities. Table 2 the results of the assessment of factor loadings. The colour of the heat map cells presented in the table shows the level of factor loadings. The colour intensity increases with increasing loading values, with red indicating positive loadings and blue indicating negative ones.

Table 2. Factor Loadings of Variables

Parameter	Factor			
	General financial potential	Management efficiency and optimization of expenditures	Balance of current and capital expenditures	Spatial factor and territorial specifics
Population, thousand people	-0.128039	-0.638204	0.227698	-0.188530
Area, (km ²)	0.098111	-0.215398	-0.033586	0.922844
General fund revenues per capita, UAH	-0.904806	0.207893	0.183813	0.059160
General fund expenditures, UAH	-0.864230	0.294647	0.093506	0.062332
Subsidization level, %	0.867775	0.257005	0.197922	0.015498
Share of transfers in the budget revenues, %	0.862380	0.268135	0.230443	0.029414
Share of local taxes and fees in the general budget fund without transfers, (%)	0.157504	0.349832	-0.567340	-0.170121
Administrative expenses per capita, UAH	-0.575030	0.570028	-0.244424	-0.019978
Capital expenditures per capita, UAH	-0.628414	0.340229	0.543314	0.051243
Share of administrative expenses, %	0.542212	0.381617	0.387504	0.162529
Share of budget expenditures for wages, %	0.813715	0.236340	-0.053933	0.096803
Share of budget capital expenditures, %	-0.553015	-0.039652	0.458719	-0.041463
Expenditures for culture, physical education, and sports per capita, UAH	-0.669339	0.010104	-0.428455	0.281491
Overall assessment of financial capacity	5.548656	1.487917	1.411655	1.044384
Share total	0.426820	0.114455	0.108589	0.080337

Source: Authors' calculations based on Decentralization (2024a, 2024b), Open Budget (2024).

The results of the factor analysis identified the main factors affecting the financial capacity of territorial communities. The first factor (“General financial potential”) explains more than 42% of the total variance. General fund revenues per capita and general fund expenditures per capita have the highest factor loadings. The level of budget subsidies, the share of transfers in the budget revenues, and the share of budget expenditures for wages also have a significant impact. General fund revenues and expenditures per capita have a negative factor loading, while other variables have a positive one. This may indicate the high dependence of territorial communities on state transfers and the importance of stable revenues in reducing dependence on external support.

The second factor (“Management efficiency and optimization of expenditures”) explains more than 11% of the total variance. This factor describes the importance of management aspects for the financial capacity of territorial communities. The variables with the highest factor loadings are the size of the current population, the administrative expenses per capita, and the share of administrative expenses. A negative factor loading for the size of the current population may indicate an increase in the complexity of managing resources and expenditure in communities with a larger population.

The third factor (“Balance of current and capital expenditures”) explains about 10.9% of the total variance. This factor indicates the investment orientation of the budget policy of territorial communities, in particular, regarding the capital expenditures. The highest factor loadings are the share of local taxes and fees in the general budget fund revenues without transfers, capital expenditures per capita, and the share of capital expenditures of the budget. A characteristic feature is the negative factor loading for the share of local taxes and fees in the revenues of the general budget fund without transfers. This may indicate that investment activity and capital expenditures are lower in communities where a significant part of the income is formed by local taxes and fees. It is likely that such communities are mostly focused on financing current affairs, rather than on investments. It can be concluded that this factor shows the distribution of financial resources between investment projects and current expenditures. Factor 3 is important for determining the role of local taxes and fees in shaping the financial capacity of communities.

The fourth factor (“Spatial factor and territorial specifics”) explains about 8% of the total variance. The variable area has the highest factor loading, giving grounds to conclude that territorial features can have a significant impact on the financial capacity of communities. The area has a positive factor loading, so larger communities usually have higher financial capacity.

Analysis of the identified factors reveals that the overall financial potential plays the greatest role in shaping of the financial capacity of territorial communities. In turn, high factor loadings within this factor are such variables as the level of budget subsidies and the share of transfers in the budget revenues. Transfers can expand the financial capabilities of communities, providing resources to finance their needs, but high dependence on transfers reduces the financial self-sufficiency of regions. Other factors indicate the importance of effective management, capital expenditures, and territorial specifics. Increasing the relevant variables contributes to increasing financial capacity.

The role of local taxes and fees in the analysis is ambiguous: they have a negligible impact on the overall financial potential but are negatively related to capital expenditures and investments. A more in-depth study of the impact of local taxes and fees on the financial capacity of the community requires using additional analysis methods, in particular, the linear regression. Table 3 contains the results of the regression analysis for the studied indicators.

The results do not take into account general fund revenues per capita, general fund expenditures per capita, and the share of transfers in the budget revenues as the most aggregated variables. The dependent variable was the assessment of the financial capacity of territorial communities.

Table 3. Regression Results on the Determinants of Territorial Communities' Financial Capacity

Parameter	Coef.	Std. error	LCL	UCL	t-stat.	p	H0 (5%)	Beta
Y- intercept	10.4689	0.6687	9.1571	11.7807	15.6549	0.0000	<i>rejected</i>	
Share of local taxes and fees in the revenues of the general budget fund without transfers, (%)	7.4252	0.6393	6.1713	8.6792	11.6154	0.0000	<i>rejected</i>	0.1289
Administrative expenses per capita, UAH	-0.0009	0.0001	-0.0012	-0.0007	-8.1143	0.0000	<i>rejected</i>	-0.1073
Capital expenditures per capita, UAH	-0.0001	0.0000	-0.0002	-0.0000	-7.5417	0.0000	<i>rejected</i>	-0.0926
Share of capital expenditures of the budget, %	22.0512	0.8913	20.3027	23.7996	24.7400	0.0000	<i>rejected</i>	0.3072
Current population, thousand people	0.0036	0.0011	0.0013	0.0058	3.1445	0.0017	<i>rejected</i>	0.0337
Area, (km ²)	0.0015	0.0003	0.0010	0.0021	5.8811	0.0000	<i>rejected</i>	0.0609
Share of budget expenditures for wages, %	-13.6709	0.8468	-15.3321	-12.0097	-16.1433	0.0000	<i>rejected</i>	-0.2522
Expenditures for culture, physical education, and sports per capita, UAH	0.0071	0.0004	0.0064	0.0078	19.6196	0.0000	<i>rejected</i>	0.2643
Share of administrative expenses, %	0.8548	0.1680	0.5253	1.1843	5.0896	0.0000	<i>rejected</i>	0.0679
Level of budget subsidies, %	-14.8302	0.5573	-15.9233	-13.7370	-26.6123	0.0000	<i>rejected</i>	-0.5111

Source: Authors' calculations based on Decentralization (2024a, 2024b), Open Budget (2024).

The results of the regression analysis give grounds to determine which variables play the most significant role in shaping of the financial capacity of territorial communities, as well as to assess the direction of influence. First of all, it should be noted that the resulting model can explain up to 85.97% of the variation in the dependent variable by the coefficient of determination. All included variables are statistically significant but differ in the direction and strength of influence on the dependent variable.

From an economic perspective, the obtained results can provide several important insights. So, the greatest positive impact on the financial capacity of communities is the share of capital budget expenditures (0.3072). This indicates the importance of investments in infrastructure development, which ensures sustainable long-term development of territorial communities. Expenditures for culture, physical education, and sports are also marked by a significant positive impact on capacity (0.2643), which indicates the need for spending on the social sphere. Such expenditures increase the standard of living of the local population and create conditions for more effective development of human capital.

Local taxes and fees also have a positive impact on capacity, but this impact is significantly lower compared to the above-mentioned factors (0.1289). This indicates that local taxes and fees are an important, but not a determining factor in shaping of the financial capacity of territorial communities. Along with this, high expenditures for wages can reduce the efficiency of budget resources, having a strong negative impact on financial capacity (-0.2522).

This may be a consequence of significant bureaucratization or inefficient management. The level of budget subsidies has the highest and negative impact on the financial capacity of communities (-0.5111). Subsidies increase dependence on external sources of financing and reduce motivation to develop own sources of revenue.

Additionally, a regression analysis of the impact of the studied indicators on the level of financial capacity of communities was conducted in the context of key clusters of communities by level of financial capacity. This gave grounds for drawing important conclusions regarding the difference in the impact of different indicators on communities with high, optimal, satisfactory, low, and critical levels of financial capacity. Table 4 presents the results, which indicates the level of significance of the impact of indicators and standardized Beta coefficients for different clusters.

Table 4. Cluster-Based Regression Results for Territorial Communities' Financial Capacity

Parameter	Level of financial capacity of the cluster									
	High		Optimal		Satisfactory		Low		Critical	
	<i>p</i>	<i>Beta</i>	<i>p</i>	<i>Beta</i>	<i>p</i>	<i>Beta</i>	<i>p</i>	<i>Beta</i>	<i>p</i>	<i>Beta</i>
Y- intercept	0.00		0.00		0.00		0.01		0.00	
Current population, thousand people	0.01	0.09	0.23	-0.06	0.01	-0.20	0.55	-0.04	0.01	-0.16
Area, (km ²)	0.36	-0.03	0.12	0.08	0.84	0.01	0.14	0.08	0.12	0.09
Level of budget subsidies, %	0.01	-0.12	0.02	-0.14	0.00	-0.64	0.00	-0.59	0.00	-0.47
Share of local taxes and fees in the revenues of the general budget fund without transfers, (%)	0.00	0.27	0.00	0.28	0.04	0.18	0.00	0.34	0.00	0.56
Administrative expenses per capita, UAH	0.00	0.17	0.00	0.58	0.23	-0.14	0.00	-0.28	0.00	-0.68
Capital expenditures per capita, UAH	0.00	-0.20	0.90	-0.02	0.82	0.05	0.71	0.03	0.23	0.11
Share of administrative expenses, %	0.00	-0.56	0.00	-0.80	0.12	-0.14	0.77	-0.02	0.03	0.17
Share of budget expenditures for wages, %	0.00	-0.15	0.00	-0.22	0.00	-0.44	0.00	-0.30	0.13	-0.09
Share of capital expenditures of the budget, %	0.00	0.31	0.03	0.35	0.12	0.38	0.00	0.47	0.00	0.39
Expenditures for culture, physical education, and sports per capita, UAH	0.00	0.27	0.00	0.29	0.00	0.38	0.00	0.25	0.00	0.18

Source: Authors' calculations based on Decentralization (2024a, 2024b), Open Budget (2024).

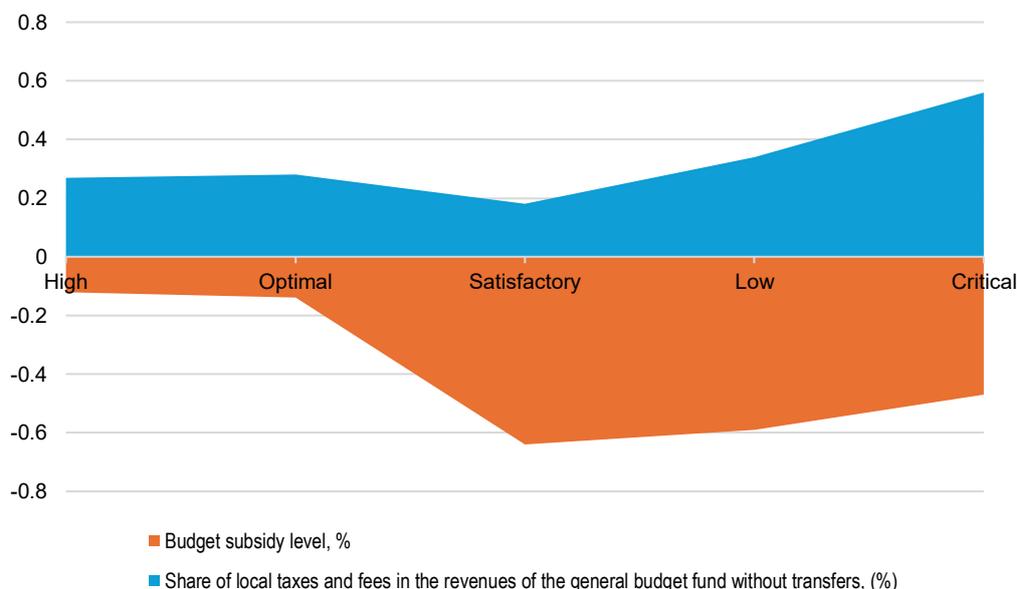
The obtained results show that the share of capital expenditures in the budget has a significant positive impact on all clusters, except for the cluster with a satisfactory level of financial capacity. At the same time, the strength of the impact mainly increases with a decrease in the level of financial capacity – the greatest impact is observed for clusters with a low (0.47) and critical (0.39) level of financial capacity. Expenditures for culture, physical

education, and sports have a positive impact on all clusters. The highest impact is characteristic of the cluster with a satisfactory level of financial capacity, the lowest – of the cluster with a critical level of financial capacity.

Local taxes and fees have a statistically significant impact on all clusters, but this impact is the strongest for clusters with a low and critical level of financial capacity. The Beta coefficient for these clusters is 0.34 and 0.56, respectively, which significantly exceeds the Beta value for local taxes and fees in the case of analysis of all communities simultaneously. This indicates that local taxes play a critical role for communities with low levels of financial capacity.

Significant differences are also observed in the impact of budget subsidies on different clusters. For clusters with a high and optimal level of financial capacity, the negative impact of subsidies is significantly smaller than for other clusters (-0.12 and -0.14, respectively). For other clusters, the negative impact of subsidies ranges from -0.47 to -0.64. Comparison of the impact of own and external revenues on the financial capacity of territorial communities gives grounds for drawing conclusions about their financial self-sufficiency (Figure 1).

Figure 1. Comparative Impact of Own and External Revenues on the Financial Capacity of Territorial Communities



Source: Authors' calculations based on processed data from official statistical and budgetary sources.

Figure 1 shows the difference in the impact of subsidies and local taxes and fees on the financial capacity of territorial communities of different clusters. External revenues play a decisive role for clusters with a satisfactory, low and critical level of financial capacity. Local taxes are more significant for clusters with a high and optimal level of financial capacity, which indicates their ability to ensure financing from their own sources. This indicates a higher financial self-sufficiency of these clusters compared to less capable clusters and the ability to effectively manage the budget without significant dependence on external sources. At the same time, the impact of local taxes and fees is significant for a cluster with a critical level of financial capacity. This may indicate the ability to improve financial self-sufficiency even in cases of limited resources. However, high dependence on external subsidies indicates an insufficient level of financial autonomy for this cluster.

The share of administrative expenses has the greatest negative impact on clusters with high and optimal levels of financial capacity (-0.56 and -0.80, respectively). At the same time, the impact of the share of administrative expenses is statistically insignificant for clusters with satisfactory and low levels of financial capacity. A positive impact of the share of administrative expenses with a coefficient of 0.17 is observed for the cluster with a critical level of financial capacity.

The obtained results note differences in the key factors of financial capacity of different clusters of communities. For financially capable communities, the key disincentive is the efficiency of administrative expenses. Local taxes and the level of subsidies play a critical role for less capable communities. Capital expenditures are an important factor in forming the financial capacity of communities of all clusters. This indicates the need for differentiated approaches to budget policy depending on the level of financial capacity of communities.

4. Discussion

Communities with high self-sufficiency are able to rely more on their own revenues rather than on transfers, which strengthens their fiscal sustainability by reducing their dependence on government subsidies. In turn, this contributes to macroeconomic stability at the regional level, ensuring a more predictable and sustainable flow of financial resources for local development and public service delivery. The analysis found that local taxes and fees have a significant impact on the financial capacity of territorial communities, but they are not its key factor. Subsidies have a much stronger and negative impact on financial capacity. At the same time, local taxes and fees can become the main stabilization tool for communities with a low and critical level of financial capacity according to the results of cluster analysis.

The author's conclusions are supported by the findings of Vatamaniuk-Zelinska & Danyliak (2024) and Vozniak & Koval (2023). The researchers noted the low share of local taxes and fees in the total revenues of the local budget and insufficiently effective administration among the key problems of local taxation. Tropina & Klymenko (2021) stated that local taxes have not become a regulatory tool despite high importance of local taxation for the financial independence of communities. They remain secondary to state taxation, which is confirmed by the results of factor and regression analyses conducted in this study. One of the reasons for this situation may be the discrepancy between the amount of the basic subsidy and the real needs of communities, as Vozniak *et al.* (2022). noted in their study. The reason is the imperfect mechanism for calculating the solvency index of communities (based on PIT alone).

Haptari *et al.* (2022) found that the provision of balancing funds can have different effects on the financial independence of cities belonging to different clusters. Such effects can be either positive, negative or neutral. In contrast to this study, our research found a negative effect of subsidies on all studied clusters. However, the strength of the effect varied significantly by cluster, and a less pronounced effect was observed for communities with a high or optimal level of financial capacity. The differences in the findings are explained by the regional context, as the researchers studied the case of Indonesia, which indicates the importance of taking into account local characteristics.

Adhim *et al.* (2023), also referring to Indonesia, found that local revenues do not have a significant impact on the financial independence of regions. At the same time, the efficiency of the use of special funds and profit-sharing funds significantly affects financial independence. Ishak (2021) and Darmayanti *et al.* (2023) obtained opposite conclusions regarding the

assessment of the impact of local own revenues, the researchers found a significant and positive impact on financial independence. As the mentioned studies analyse different regions of Indonesia, the obtained results confirm the author's conclusions. They indicate differences in the impact of local taxes on the financial capacity of communities depending on their cluster affiliation.

Sawitri *et al.* (2020) found that regional financial independence does not directly affect economic growth. The researchers also found that capital expenditures do not contribute to local income growth and financial independence in relation to economic growth. These findings contradict our results on a significant positive impact of capital expenditures on the financial capacity of clusters. At the same time, the paper noted that capital expenditures are inversely related to local taxes and fees. This is inconsistent with the results of Ervina & Hidayah (2024) and Delang & Sitorus (2022), who found that local taxes have a significant positive impact on capital expenditures. This gives grounds to conclude that the impact of local taxes and fees depends significantly on regional characteristics but has the potential for regional development. So, local taxes and fees in Ukraine can increase the level of financial capacity of communities. At the same time, their use should be optimized through the development of effective administration mechanisms and targeting of specific investment projects.

Despite the obtained results, there is significant potential for further research in this area, which will provide a deeper understanding of the mechanisms and factors that affect the financial capacity of communities. In particular, our study relies mainly on financial indicators to assess the financial capacity of local communities. At the same time, the autonomy and self-sufficiency of communities is described using other dimensions (political, organizational, etc.) in some studies (Ladner & Keuffer, 2021). It is also important to investigate how the level of vertical imbalance affects the indicators under study, as implemented in the work of Li and Du (2021). In particular, the researchers have found that budget transfers have a negative impact when vertical imbalance is low and a positive impact when it is high. A more in-depth study and comparison of the advantages and disadvantages of a decentralized and centralized fiscal system deserves special attention.

Götze & Hartmann (2021) concluded that both a decentralized and centralized fiscal system can stimulate growth. The researchers analyse the examples of Germany and the Netherlands as decentralized and centralized fiscal systems, respectively. In the Netherlands, development is ensured by the benefits of grants, high efficiency of investments in infrastructure, and income from land use. In Germany, local taxes on business and profit play a large role, stimulating the development of infrastructure.

The obtained results partially confirm the hypothesis of the study, as local taxes and fees play a critical role mainly for clusters with low and critical levels of financial capacity. The practical consequences of the study are to identify key factors influencing the financial capacity of territorial communities. This can contribute to improving approaches to the formation of budget policy at the state and local levels. Important areas may be optimizing the volume of transfers, focusing on capital expenditures as a prerequisite for long-term development, and reviewing the directions of using local taxes to maximize their potential.

The limitations of the study relate to its focus mainly on financial indicators of the capacity of territorial communities. This corresponds to the research area, but has a weakness of omitted influence of political, organizational and other factors. Recommendations for increasing the financial capacity of communities should take into account the following areas:

- reducing dependence on state transfers through the activation and optimization of local taxation;
- strengthening the investment orientation of budget policy by increasing the share of capital expenditures;
- optimizing administrative expenses and labour costs;
- increasing the share of social expenses and expenses for culture, physical education, and sports;
- developing a differentiated approach to management taking into account the level of financial capacity of communities.

Conclusions

The efficiency of collecting and using local taxes and fees is a determining factor that shapes the financial self-sufficiency of communities, increasing the level of their financial independence. This is in line with the practices of countries such as Poland and Romania, where local taxes are actively used to stimulate community development and ensure the autonomy of local budgets. Factor analysis based on the case of territorial communities in Ukraine revealed that the key factor that determines the financial capacity of communities is their financial potential. However, transfers and the level of subsidies made the greatest positive contribution to the financial potential of communities, which can simultaneously reduce the level of their financial self-sufficiency.

The role of local taxes and fees is ambiguous: they have an insignificant impact on the overall financial potential and are inversely related to capital expenditures. Regression analysis found that local taxes and fees have a positive impact on the financial capacity of communities (Beta = 0.1289). However, this impact is significantly lower compared to the impact of capital expenditures and expenditures for culture, physical education, and sports (0.3072 and 0.2643, respectively). The greatest negative impact on the financial capacity of communities is exerted by the level of subsidies (-0.5111), as well as wages (-0.2522). The analysis for clusters revealed that local taxes and fees have the greatest positive impact on the financial capacity of clusters with a low and critical level of financial capacity. Accordingly, local taxes and fees can become an important stabilization tool for such communities. The possibilities of using local taxes and fees to stimulate capital expenditures and implement investment projects are also worth considering.

Further research may focus on assessing the impact of non-financial indicators on the level of financial capacity of communities. The focus may also be on expanding the sample, analysing dynamic changes, and considering the impact of macroeconomic factors on the financial stability of communities.

Credit Authorship Contribution Statement

Mazur, H. contributed to the conceptualization of the study, data curation, formal analysis, and drafting of the original manuscript. Shkurat, S. was involved in the development of the research methodology, statistical analysis, and validation of the empirical results. Tsap, V. contributed to data interpretation, visualization, and the structuring of the results and discussion sections. Samsin, I. provided expertise in the theoretical framework, legal and institutional analysis, and contributed to the critical revision of the manuscript. Bukhanevych, O. contributed to supervision, overall coordination of the research process, and final editing and approval of the manuscript.

Conflict of Interest Statement

The authors declare that there are no conflicts of interest regarding the publication of this paper.

Acknowledgments/Funding

The authors did not receive any specific funding for this research.

Data Availability Statement

The data supporting the findings of this study are derived from publicly available sources, including official government and open budget databases. Additional information regarding the data and methodology is available from the corresponding author upon reasonable request.

Ethical Approval Statement

This study does not involve human participants, individual-level personal data, or experimental procedures requiring approval from an institutional ethics committee. The research is based exclusively on secondary data obtained from publicly available administrative and statistical sources, including official government and open budget databases. All data are aggregated at the level of territorial communities and do not contain any confidential or personally identifiable information. Therefore, in accordance with internationally accepted research ethics standards, formal ethical approval was not required for this study.

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