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## **FINANCIAL INDEPENDENCE OF LOCAL SELF-GOVERNMENT BODIES IN UKRAINE: PROBLEMATIC ASPECTS OF ENSURING AND WAYS OF STRENGTHENING**

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**Abstract.** *The article is devoted to the study of the peculiarities of the formation of financial resources of local self-government bodies (LSGBs). The authors analyzed the dynamics of revenues of local budgets in Ukraine over the last five years and also determined the role of inter-budgetary transfers in their structure. The article provides a comparative analysis of the Ukrainian tax revenue structure of local budgets with the corresponding structure of the countries of the Organization for Economic Co-operation and Development (OECD). All this allowed the authors to determine the actual problems of the low level of financial independence of LSGBs and the financial decentralization carried out in Ukraine. The authors have developed a number of measures related to expanding the financial capabilities of local governments, as well as increasing the share of own financial resources in the revenue bases of the local budgets of Ukraine. It was established that in order to strengthen the financial independence of local authorities, it is necessary to increase the role of local taxation and administration. The authors substantiated that the solution to the revealed problems is also possible under the condition of attracting external funding by territorial communities through the activation of financial aid programs. The conclusions formulated by the authors emphasize the need to increase the own financial resources of local budgets to ensure the financial independence of local self-government bodies, and also indicate the relevance of further research in this direction in order to support economic growth and social development of territories by deepening the degree of financial decentralization.*

**Keywords:** *financial resources; local self-government bodies; local budget revenues; financial independence; local taxes and fees; tax authority.*

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## **ФІНАНСОВА САМОСТІЙНІСТЬ ОРГАНІВ МІСЦЕВОГО САМОВРЯДУВАННЯ В УКРАЇНІ: ПРОБЛЕМНІ АСПЕКТИ ЗАБЕЗПЕЧЕННЯ ТА ШЛЯХИ ЗМІЦНЕННЯ**

Толкмітт, Ф., Ігнатенко, Р. Фінансова самостійність органів місцевого самоврядування в Україні: проблемні аспекти забезпечення та шляхи зміцнення. *Вісник соціально-економічних досліджень*. Одеса : Одеський національний економічний університет. 2024. № 1-2 (88-89). С. 103–113.

**Анотація.** Статтю присвячено дослідженню особливостей формування фінансових ресурсів органів місцевого самоврядування. Авторами проаналізовано динаміку доходів місцевих бюджетів в Україні за останнє п'ятиріччя, а також визначено роль міжбюджетних трансфертів в їхній структурі. У статті проведено порівняльний аналіз української структури податкових надходжень місцевих бюджетів із відповідною структурою країн Організації економічного співробітництва та розвитку. Все це дозволило авторам визначити актуальні проблеми низького рівня фінансової самостійності органів місцевого самоврядування та проведеної фінансової децентралізації в Україні. Авторами розроблено низку заходів стосовно розширення фінансових можливостей місцевого самоврядування, а також збільшення частки власних фінансових ресурсів у дохідних базах місцевих бюджетів України. Встановлено, що з метою зміцнення фінансової самостійності місцевих органів влади необхідним є підвищення ролі місцевого оподаткування та адміністрування. Авторами обґрунтовано, що вирішення розкритих проблем також можливе за умови залучення зовнішнього фінансування територіальними громадами шляхом активізації програм фінансової допомоги. Сформульовані авторами висновки підкреслюють необхідність нарощення власних фінансових ресурсів місцевих бюджетів у забезпеченні фінансової самостійності органів місцевого самоврядування, а також вказують на актуальність подальших досліджень у цьому напрямку з метою підтримки економічного зростання та соціального розвитку територій шляхом поглиблення ступеня фінансової децентралізації.

**Ключові слова:** фінансові ресурси; органи місцевого самоврядування; доходи місцевого бюджету; фінансова самостійність; місцеві податки та збори; податкові повноваження.

**JEL classification:** H200; H210; H700; R510

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### **1. Introduction**

The current global trend is to strengthen the independence of local self-government. Financial decentralization in Ukraine, which was a consequence of the reform of LSGBs and changes in the territorial organization of power, contributed to the unification of territorial communities, expanding the powers and financial capabilities of LSGBs, reforming the local taxation system, introducing new types of inter-budgetary transfers, new approaches to budget formation and financial equalization according to national taxes. Nevertheless, a number of important problems remain, from the need to find solutions for the separation of powers according to the principle of subsidiarity to increasing the level of financial support of local self-government to ensure public welfare and the effective functioning of the budget system.

Currently and still, the financial independence of local governments in Ukraine remains low, inter-budgetary transfers occupy a significant share in the structure of local budgets revenues, local taxes and fees are not the main tax source of financial resources of local

budgets, according to these taxes, the LSGBs did not receive the appropriate amount of tax powers compared to the powers of the leading countries of the world. All of this ultimately leads to the inhibition of economic growth and social development of the territories.

The policy of further financial decentralization cannot fail to take into account modern conditions and determines the need to find ways to ensure financial independence and stability of the development of local self-government in Ukraine. Since the isolation of the financial policy of the local self-government body from the affairs and needs of the territorial community, the irregularity and unsystematic management decisions regarding the accumulation of financial resources and their use can devalue all the favorable opportunities provided by the decentralization reform.

## **2. Aim and methodology of research**

The purpose of the article is to evaluate the results of the formation of financial resources of local budgets, as well as to identify the financial capabilities of local governments in order to strengthen their financial independence by deepening the degree of financial decentralization.

To achieve the goal, the following general scientific methods were used: analysis, synthesis, comparative analysis, statistical analysis, tabular analysis, graphic analysis, abstract-logical analysis.

## **3. Literature review, shortcomings and problem statement**

The study of the processes of decentralization, the development of local public finances and the problems of local economic development, the sources of the formation of own incomes of municipal entities is the object of research by a number of scientists, among them: R. A. Musgrave, W. E. Oates, O. Ya. Stoiko, D. Moretti, K. Dirk-Jan, J. Thornton, D. Bartolini, A. Sacchi, S. Salotti, R. Santolini, D. I. Dema, O. P. Korylenko, M. O. Yevdokimova, O. D. Vasylyk, V. M. Oparin, S. I. Yuriy, V. M. Fedosov, I. Tsymbaliuk, N. Pavlikha, O. Korneliuk, V. Horyn, S. Savchuk, N. Demchyshak, R. Paslavska, S. Sas, etc.

Despite numerous scientific studies, certain directions in the issue of public finance remain insufficiently researched, namely the issue of increasing the amount of financial resources of local self-government in order to strengthen their financial independence, taking into account the consequences of the decentralization reform. These issues become especially acute during the period of a large-scale war in Ukraine, when the rationality of financial decisions in the field of public finances is extremely important.

## **4. The main material research**

Democracy as an expressed form of government of the people, equality and freedom is characteristic of a decentralized society. One of the main principles of a democratic state is the principle of autonomy. The principle of autonomy, which is usually equated with the principle of independence, is widely used in international legislation. In our opinion, the level of financial independence of LSGBs is an indicator of its autonomy, since in practice, it is characterized by a high level of income autonomy.

Modern budgetary systems in Ukraine and the countries of the world are characterized by the independence of all budgets. The local (regional) budget cannot be included in the local budgets of another level (subregional or basic). In turn, the implementation of the

principle of independence depends on the level of economic self-responsibility of LSGBs and the financial support of territorial communities.

Thus, financial independence is firmly connected with the process of decentralization of power in the state. The consequence of financial decentralization is the definition of such components and the formation of such sources of financial support of LSGBs that will strengthen their financial independence.

Important in this process is not only the accumulation of financial resources, but also the distribution of powers in a logical manner between the levels of government according to the principle of subsidiarity, the origins of which lie in the theory of fiscal federalism by R. A. Musgrave [1; 2] and W. E. Oates [3; 4]. That is, also important to transfer a part of the central government's own and delegated powers (quite often additional expenses too) to the local government, to ensure their ability to implement their own financial policy, which is relatively independent from the center. And this is not possible without the formation of a clear system of providing territories with financial resources.

Among the different opinions of representatives of the Ukrainian scientific community, who focus on the study of financial resources of LSGBs, differentiation is noted in the interpretation of financial resources, which also gives rise to theoretical disputes, distinguishing two approaches to the study of this issue: fund approach – as funds of money [5, p. 10; 6, p. 50; 7, p. 51] and a non-fund approach [8, p. 75–76; 9, p. 80; 10, p. 26] with specification of the genesis and ways of using financial resources.

Given the origins of the distributive and fund concepts, financial resources, in our opinion, should be understood as a set of funds formed in the process of distribution and redistribution of the gross domestic product in the relevant funds formed by LSGBs and directed to the creation of public goods. This material carrier of financial relations of local authorities is usually accompanied by the movement of funds in the form of income, accumulation, deductions, and receipts and accumulated in special funds.

It is impossible not to agree with the opinion that «the financial independence of local budgets is largely determined by the structure of their incomes» [11, p. 33], and we believe, that it is the volume of the revenue part that reflect the efficiency associated with the accumulation of financial resources necessary to meet the social needs of the residents of administrative-territorial units.

In order to identify key problems in the formation of financial resources of local budgets in Ukraine, we will analyze their structure (Table 1).

Table 1

Structure of revenues of local budgets of Ukraine during 2019–2023, %

Indicator	Year				
	2019	2020	2021	2022	2023
Tax revenues including:	48,3	60,6	59,7	70,9	66,6
local taxes and fees	13,1	16,1	15,5	15,2	15,3
Non-tax revenues	4,7	4,6	4,7	4,0	5,6
Income from capital transactions	0,5	0,7	0,6	0,4	0,6
Trust funds	0,1	0,1	0,1	0,1	0,1
Interbudgetary transfers:	46,4	34,0	34,9	24,6	27,2

Continuation of table 1

Grants from the state budget	4,6	4,6	3,9	4,0	7,7
Subventions from the state budget	41,8	29,4	31,0	20,6	19,5

*Source: calculated by the authors based on [12]*

According to Table 1, since 2019, there has been a decrease in the share of inter-budgetary transfers in the revenues of local budgets of Ukraine. At the same time, the lion's share of transfers is occupied by targeted transfers at the level of 84,1% during 2019–2023, the rest – 15,9% were subsidies. Due to legislative changes in 2015 and a new system of inter-budgetary relations, subventions almost completely replaced subsidies. The predominance of targeted transfers in the structure of inter-budgetary transfers is unacceptable in the conditions of financial decentralization, since subventions are determined by the central government for specific purposes, and this, in turn, deprives LSGBs of the right to freely dispose of financial resources.

A significant role is played by tax revenues, the specific weight of which increased from 48,3% (2019) to 66,6% (2023), which became possible thanks to the financial decentralization processes started in 2015. However, over the past five years, almost 76% of tax revenues of local budgets are formed at the expense of national taxes, mainly at the expense of the national tax and personal income tax (64,1% on average for 2019–2023).

It is worth noting, that the inclusion of national taxes and fees in the local budgets of Ukraine is carried out centrally and in the appropriate proportions, that is, local authorities have no influence on the rates and tax benefits of national taxes and fees. It is clear that in terms of local taxes and fees, LSGBs have certain autonomy. LSGBs have the right to set local fees, local taxes are levied regardless of the decision of the territorial community authorities, and local tax rates can be changed only within legally established limits.

Thus, against the background of a decrease in transfer dependence, fixed incomes have become the main source of income for local budgets of Ukraine, which deprives LSGBs of incentives to form their own financial base.

The structure of tax revenues of local level budgets differs significantly in countries. Individual countries of the OECD provide themselves with one or more tax revenues (Fig. 1).

As we can see from the presented diagram in Fig. 1, tax revenues in UK are completely formed at the expense of one property tax – real estate tax. Also, real estate taxes play a major role in providing tax revenues to the local budgets of Greece (91,4%), Belgium (60,5%) and the Czech Republic (58,8%). In OECD countries with the highest standard of living and relatively high taxes, income taxes play a significant role: in Sweden, they account for 97,5% of tax revenues, in Finland – 92,4%, in Denmark – 89,6%, in Germany – 81%.

In general, in OECD countries, local budgets are filled mainly by such tax revenues as property tax (real estate tax) and income tax. However, in contrast to federal states, in the structure of tax revenues of local budgets of unitary countries, revenues from taxes on goods and services also have a significant specific weight.

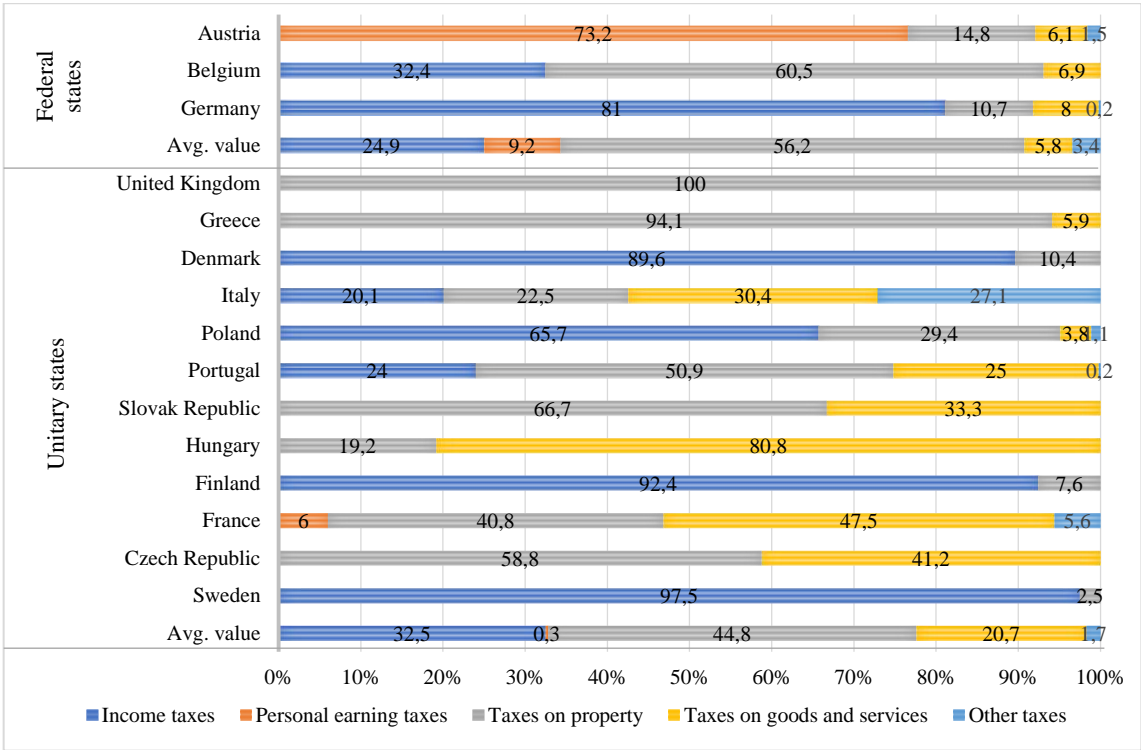


Fig. 1. Structure of tax revenues of local budgets of the OECD, %  
Source: developed by the authors based on [13]

Despite the state of war in Ukraine, the personal income tax remains the strongest, as it plays a leading role in the formation of local budget revenues (Fig. 2). Firstly, this is caused by the increase in deductions from the salaries of military personnel, and secondly, the increase in the rate of personal income tax deduction to local budgets from the beginning of 2022, from 60% to 64%, played a significant role. It is worth noting that the Law of Ukraine dated 08.11.2023 No. 34-28-IX «On Amendments to the Budget Code of Ukraine on Ensuring the Support of the State's Defense Capability and the Development of the Defense-Industrial Complex of Ukraine» [14] from October 1, 2023 year personal income tax on military personnel and senior officials was removed from local budgets, which negatively affected the growth of this national tax in November-December 2023. It should be noted that budget centralization is characteristic of wartime, but in examining the structure of income accumulation at the local level in Ukraine, we can say that this has been a problem even before the war.

As can be seen from Fig. 2 local taxes and fees also have a significant potential, revenues from the collection of which increased from UAH 73,6 billion in 2019 up to UAH 100 billion in 2023 (on average, during 2019–2023, the share of local taxes and fees in the total tax revenues of local budgets is almost 25%). In general, such changes are positive, however, if we turn to the experience of foreign countries with a longer and more thorough experience of financial decentralization, such a percentage is a critical indicator [15].

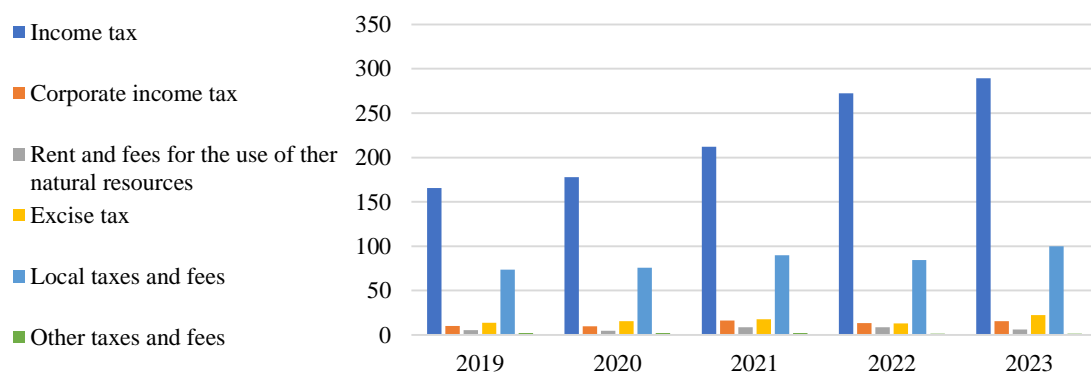


Fig. 2. Dynamics of tax revenues of local budgets of Ukraine during 2019–2023, billion UAH

Source: developed by the authors based on [12]

Compared to the OECD countries, property tax has significant unrealized fiscal potential among local taxes in Ukraine. There are reasons for such failure [16, pp. 16–17]:

- 1) the quantitative approach to establishing the real estate tax base, which contradicts the European experience, destroys the regulatory influence and fiscal potential of the tax;
- 2) improper inventory of property in the community (lack of registers and updated documents, especially in rural communities), which reduces the prospect of generating additional financial resources for budgets;
- 3) shortcomings in the definition of the elements of the transport tax (circles of payers, tax bases and the size of the tax itself) lead to a decrease in the fiscal effect for local budgets.

Local taxes and fees are very important in the context of achieving a high level of decentralization of financial resources, as well as the independence of LGUs, since they form their own financial resources.

The experience of leading countries has many reasons for decentralization of fiscal administration: tax accumulation can be carried out at one level, and tax administration can be fixed at another level of management. The OECD conducted a study of the tax administration system in 58 countries, as a result of which it was found that the tax authorities are responsible for collecting only 47% of the total amount of property taxes. In other cases, there is either a joint responsibility with the local government, or the local government is independently responsible for collecting these taxes for local or regional budgets [17, p. 29]. On the one hand, centralized implementation of these functions has better technical capability, and there are also economies of scale in such activities. On the other hand, LSGBs have greater incentives and have more information about local culture and conditions for collecting tax revenues accumulated in their budgets.

According to the current legislation of Ukraine (Article 10 of the Tax Code of Ukraine), LSGBs are empowered to set the rates of a single tax and property tax (in terms of transport and land tax, except for land tax on forest land). At the same time, the administration of these taxes and fees is entirely within the authority of the State Tax Service, not LSGBs, i.e. local authorities have the ability to influence the formation of revenues from local taxes and fees to local budgets, but do not have any tools to control

their collection and administration. Thus, the budgets of territorial communities suffer significant losses due to the imperfection of the local tax administration mechanism.

In Ukraine, the issue of expanding the powers of local government organizations to administer local taxes and fees has been actively discussed by the scientific community and representatives of local government organizations in recent years, but it was not resolved in the pre-war period. Therefore, problematic issues that do not give local authorities a solid financial foundation, as well as independence in decision-making, remain open.

Taking into account the motivation of LSGBs in Ukraine to increase their own revenues at the expense of local taxes, the most justified at this stage of financial decentralization seems to be giving them the opportunity to perform separate control functions in relation to administration, in particular in terms of: organization and control over the payment of local taxes and fees; acceptance and accounting of taxes and fees from payers of local taxes and fees, ensuring the timeliness and completeness of the transfer of the specified amounts to the budget; keeping records of taxes, fees, payments; control over timeliness, reliability, completeness of calculation and payment of local taxes and fees. It should be noted that a mandatory condition for the performance of the local self-government body's functions in the administration of local taxes and fees must be the adoption of the relevant decision by the local council.

We fully agree with the proposals of scientists regarding the importance of digitalization in the field of taxation (in particular, the development of online services) [18, p. 173–174], which will contribute to increasing the fiscal efficiency of the administration system, as well as improving the interaction of payers with the bodies of the State Tax Service for the convenience of not only receiving electronic services, but also the ease of paying taxes, as well as curbing corruption, significantly minimizing bureaucracy.

At the same time, important directions in the field of property taxation can become:

- 1) intensification of work on updating the normative monetary valuation of land and databases of the State Land Cadastre, carrying out periodic monitoring of the effectiveness of tax benefits, focusing on the rationality and restorative nature of the country's land potential;
- 2) creation of real estate registers, on the basis of which forecasts are made, as well as to ensure fairness, taking into account the market value of the real estate object;
- 3) development of a program to improve the level of qualification of representatives of local self-government, etc.

Taking into account that the programs of inter-budgetary transfers for investment purposes in Ukraine were suspended in the current military conditions, it is not considered rational to focus on the development of postwar recovery programs only on budgetary sources (in particular, on tax revenues). And indeed, many international organizations have created special support programs for Ukraine and this assistance has been a record since the beginning of the implementation of the financial decentralization reform: due to grants and receipts within the aid programs of the European Union and international organizations, receipts to the local budgets of Ukraine have significantly increased from UAH 36 million (in 2021) to UAH 197,7 million (in 2023). These programs are aimed at helping to restore the destroyed infrastructure of territories, which



opens up new prospects for attracting external sources of funding for local governments in Ukraine.

However, attracting external sources of funding for territorial development was an actual problem in the pre-war period as well. The fact is that the development of investment and grant projects, the search for donor organizations and investors, grants and support funds, and the conclusion of cooperation agreements – all this requires experience in such activities, which was and remains the main obstacle for representatives of local authorities and qualification of the local public administrations in Ukraine. Therefore, it is necessary to increase the skills of representatives of LSGBs regarding the effective implementations of development projects, which have the potential to become a significant source of additional resources for the budgets of territorial communities in the conditions of war and post-war reconstruction.

## **5. Research results**

Empirical studies prove that if financial decentralization is provided by general tax revenues, the powers of which are fully controlled by the central governing body, then its influence does not have any positive significance on economic growth [19]. In turn, greater tax autonomy of local governments will improve the budgets of all levels of government, assuming that more effective financial decentralization will increase financial discipline, especially in adverse financial conditions [20].

Our research makes it possible to assert that the financial independence of municipalities as a whole depends on several factors, including the fiscal system, budgetary powers and the redistribution of financial resources between the central government and LSGBs. In today's conditions, it is important to focus on increasing tax efficiency. This doctrine is inextricably linked to issues of public trust in state institutions and their implementation of fiscal-budgetary policy. It is important to expand the financial capabilities of local governments in order to ensure economic growth and social development of the territories.

## **6. Conclusions**

The conducted study of the peculiarities of the formation of financial resources of LSGBs, the analysis of the structure of revenues of local budgets of Ukraine and the experience of formation of local budgets of leading countries allowed us to identify actual problems of financial independence of local self-government and financial decentralization in Ukraine, among them we can highlight the following:

- an increase in the share of national taxes and fees in the aggregate revenues of local budgets. Also, the share of inter-budgetary transfers remains high, in particular the predominance of targeted transfers;
- low fiscal role of local taxes and fees in view of financial decentralization;
- limited tax powers of LSGBs compared to OECD countries;
- low level of experience of attracting donor aid and grant activities of representatives of local self-government.

Given the challenges of today, an important task for LSGBs is to find an opportunity to strengthen their financial independence by:

- 1) cooperation of LSGBs with the bodies of the State Tax Service regarding tax administration (declaration, accounting of income and taxpayers, control of offenses);
- 2) intensification of work on updating the normative monetary valuation of land and databases of the State Land Cadastre, carrying out periodic monitoring of the effectiveness of tax benefits; arrangement of real estate registers, on the basis of which forecasts are made, revision of the tax base on a market basis;
- 3) activation of the development of further reforming of inter-budgetary relations (reduction of the amount of subventions affecting the degree of independence of LSGBs to implement their own budget policy in favor of basic/reverse subsidies);
- 4) development of programs to improve the level of qualification of LSGBs regarding grant and investment activities.

The implementation of the above-mentioned measures will contribute to increasing the fiscal role of property taxation, increasing the own financial base of local budgets in Ukraine, which will ultimately allow LSGBs to strengthen their financial independence and better conduct policy in territorial communities.

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