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# FISCAL CAPACITY OF LOCAL AUTHORITIES IN UKRAINE AND THE EU MEMBER-STATES

## ABSTRACT

This article aims to assess the local governments' fiscal capacity and to determine the revenue decentralization impact on economic growth. The sample includes 27 national economies of the EU member-states and Ukraine over the period from 2011 to 2024. The level of own revenue decentralization in the sampled countries is evaluated, and the interrelation between that indicator and the dynamics of economic growth is highlighted. The institutional peculiarities of the local taxes and fees system, as the basis for ensuring the territorial communities' fiscal capacity, were investigated. Special attention is paid to the periodic real estate tax's fiscal significance and administration features. The level of partial tax autonomy is evaluated. The highest revenue decentralization is recorded for the sub-sample of Nordic countries, while Ukraine belongs to the group of countries with a medium level of the above indicator. It is found that an increase in gross capital formation and in the Human Development Index has a positive impact on economic growth. In contrast, own revenue decentralization had a slightly negative effect. An optimal level of decentralization should be the main target for the fiscal space's institutional transformation. The strengthening of the local taxes and fees' fiscal significance is identified as a prerequisite for an increase in the overall public governance effectiveness. Additionally, it is pointed out that the capacity of local governments to administer the local taxes and fees should be expanded. The priorities for the property taxation reform are systematized. The trend of digitalization in tax administration should be reinforced to ensure the de-shadowing of the economy. It is argued that a fiscal decentralization reform should be approached with foresight and deliberation.

**Keywords:** fiscal capacity, local authorities, fiscal decentralization, tax policy, tax autonomy, local taxes and fees, economic growth, local self-governments

**JEL Classification:** H20, H21, H71, H73, O23, O40, O52

## INTRODUCTION

Economic growth requires prudent and consistent policy in the sphere of public finance. The economic agents make their strategic decisions regarding a plethora of financial, psychological, and political factors as well. Amid the above characteristics, the fiscal space's design is vital. In most cases, local authorities are responsible for the provision of public goods and services. Their quality could be a reason for economic agents to choose a particular territory for living and doing business. Due to the public finance's evolution peculiarities, the central government could delegate (and quite often delegates) some of its fiscal functions to local self-governments to achieve the best performance. The economic agents could "vote with their feet," expressing preferences between different territorial communities in terms of respective fiscal space's advantages and disadvantages. The local authorities should be empowered to create the most preferable fiscal conditions to attract the economic agents and ensure the region's sustainable development.

Over the last decades of the 20th century, the issue of local self-governments' rational transformation became crucial. In 1985, the European Charter of Local Self-Government (hereinafter – Charter) was prepared and opened for signature by the member-states of the Council of Europe. According to the Charter, sufficient financial resources should support local self-governments to implement their decisions in different spheres, from

the regional cultural life to the social infrastructure development. Moreover, in the Charter, the local taxes and fees are described as an obligatory component of the local government's revenue. Each new member-state of the Council of Europe was expected to ratify the Charter at the earliest opportunity. Ukraine ratified it in 1997.

Generally, issues related to local finance, including the budgets of territorial communities, are closely interconnected with fiscal decentralization. The search for a balance in the revenue structure across all components and levels of the budget system forms the core of modern financial science. The fiscal capacity of local governments should be expanded to improve the quality of public goods and services, which should reflect the specific needs and requests of the community's residents. An innovative approach, such as participatory budgeting, allows residents to generate concepts for local infrastructure improvements based on actual needs. That process increases the taxpayers' confidence in the transparency of public funds spending. Local citizens should be aware that their decisions genuinely affect public financial management, which, in turn, raises the standard of living and enhances the image of local institutions. Effective interaction between community residents and local authorities is crucial for adopting optimal development solutions for a given territory, both in the medium-term and from a strategic perspective.

Fiscal decentralization requires a specific institutional framework that enables local authorities to produce the public goods and services needed by their residents. On the one hand, local governments should have sufficient resources to ensure the sustainable development of their region. On the other hand, their fiscal powers must be guaranteed by transparent legislation. Therefore, increasing the fiscal capacity of territorial communities by strengthening the resource base of local budgets is a priority for contemporary financial policy.

## LITERATURE REVIEW

Buchanan & Musgrave (1999) proved that decentralization involved the transfer from the central government to local authorities of the rights to make decisions in the field of regional social and economic development, as well as the power to collect financial resources for the implementation of those decisions. The complex interaction between local self-governments and central executive authorities has social, administrative, and fiscal dimensions. Schneider (2002) investigated the system of intergovernmental relations in Austria, considering its institutional instruments aimed at equalizing the differences in the local budgets' fiscal capacity. The author observed so-called "compensation effects" (when additional revenue from the local government's own taxes was somehow "compensated" by the losses from equalization grants) and argued that the examined local budgets should increase their tax bases. Oates (2005, 2006) pointed out that the greatest advantage of fiscal decentralization was an increase in general economic efficiency and public welfare through the shift of financial powers from the central to the regional governments. The scholar highlighted the problems of sustainability and "self-enforcing" elements in fiscally decentralized economies and pointed out some existential threats (e.g., certain losses in fiscal power at decentralized levels).

Koethenbuerger (2011) highlighted how the central government's policy towards local authorities influenced the way local governments decided on public policy. The scholar proved that local self-governments might choose to optimize their expenditures. Liberati & Sacchi (2013) examined the relationship between tax decentralization and the local government's size. They argued that tax decentralization organized on the tax bases exclusively (so-called "tax-separation"), rather than on the tax-base sharing, could prevent the local expenditures' expansion. Bird (2013) pointed out that land taxation was robustly interconnected with development processes in emerging market economies. The scholar noted that property taxation was extremely important for the local governments' fiscal capacity. Turley et al. (2015) investigated needs and resources assessment of fiscal equalization in the Irish local government system. The authors outlined that the main characteristics of territorial communities (e.g., population size, level of economic activity, etc.) should be evaluated properly in order to estimate the local governments' fiscal capacity.

Hodžić et al. (2020) found that in order to strengthen the fiscal capacity of territorial communities, the levels of tax autonomy and fiscal decentralization should be raised. The territorial communities' responsibility for providing public goods to the inhabitants could create a precondition for extended fiscal capacity. Regarding social inequalities of territorial units in Poland, Gałęcka et al. (2020) investigated the relationship between the local governments' fiscal capacity and the central government institutions' expenditures. The above relationship appeared to be statistically weak. Inadequate public funds allocation mechanisms have been labeled as an important reason for the low efficiency of public expenditures. Thus, the local governments' fiscal capacity should be increased significantly. Using the sample of 21 EU member-states and the timescale between 2001 and 2019, Onofrei et al. (2022) analyzed the impact of local fiscal consolidation efforts on regional development. The scholars highlighted the role of sound local public finances in achieving the objectives of economic growth. Kiziltan & Yereli (2023) assessed the impact of local self-government reform on the fiscal capacity of 81 Turkish

provinces over the period from 2007 to 2019. The researchers concluded that – despite the stated goals – reform had a negative impact on the local governments' fiscal capacity. An increase in the intergovernmental grants percentage in the local budgets' revenue has made respective budgets more dependent on the centralized financial resources. That fact reduced the local governments' fiscal efforts as well. Conversely, fiscal decentralization had significant positive effects on fiscal capacity of the local governments. Bucci et al. (2024) examined the association between fiscal decentralization and municipality efficiency in Italy and found that the aforementioned interrelation was robust and positive.

Buryachenko & Filimoshkina (2018) concluded that fiscal capacity implies the territorial community's financial resources sufficiency to ensure the proper level of service provision in education, public healthcare, social protection, culture, housing and communal services, etc. Ljutyj & Spasiv (2019) noted that the territorial community's fiscal capacity was associated with the ability of the local government to provide an appropriate level of financial resources and fiscal autonomy. Moreover, the observed phenomenon formed the preconditions for the territory's social and economic development and an increase in the community residents' welfare (using the local budget's resources). Pasichniy et al. (2019) investigated the impact of fiscal decentralization on economic development in 27 advanced and emerging market economies in Europe from 1992 to 2017. The scholars found that high indicators of revenue decentralization were associated with rather low real GDP per capita growth rates and proposed statements for local authorities to develop the methodical bases for their fiscal policy design. Kaneva et al. (2023) examined the influence of fiscal decentralization on public services efficiency and economic growth and found no evidence of a robust interconnection between the above phenomena. The authors figured out that the countries of Central and Eastern Europe have had rather moderate fiscal decentralization levels, while their expenditures' decentralization indicators were significantly higher than the revenue ones. Vdovichen et al. (2024) evaluated the level of revenue fiscal decentralization and tax autonomy in the EU member-states and Ukraine. The scholars proposed to increase the local self-governments' financial capacity through the improvement in property taxation and expansion of the local tax digitalization process.

## AIMS AND OBJECTIVES

The article aims to assess the local governments' fiscal capacity in Ukraine and the European Union member-states, and to determine the impact of revenue decentralization on economic growth.

The main objectives of the study are:

- to assess the level of own revenue decentralization in Ukraine and the EU member-states and to determine the relationship between that indicator and the dynamics of economic growth;
- to identify the institutional peculiarities of the local taxes and fees system as the basis for ensuring the fiscal capacity of the territorial communities;
- to investigate the periodic real estate tax's fiscal significance and administration features;
- to evaluate the level of tax autonomy in the EU member-countries and Ukraine.

## METHODS

Compson & Navratil (1997) suggested that there could be two general categories for the estimation of fiscal capacity. The first is broader and involves the evaluation of the relative economic resources or income indices. The second focuses exclusively on measuring indices of the relative revenue that can be raised under a standard fiscal policy. In this article, we will adhere to the second approach. Under financial capacity, we consider the ability of a territorial community to generate a certain amount of budget revenue that meets the established criteria for financing public goods and services and promoting social and economic development processes as well. Thus, this study is focused on the issues of revenue decentralization. According to Gemell et al. (2013), there are several types of revenue decentralization. The first type concerns own revenue and can be expressed by the formula below (1):

$$RD_{own} = \frac{R_{lb} - Gr}{R_{gg}} * 100\% \quad (1)$$

where  $RD_{own}$  – own revenue decentralization;  $R_{lb}$  – local budgets' revenue;  $Gr$  – grants and subsidies received from the other budgets;  $R_{gg}$  – general government's revenue (including social contributions).

According to Blöchliger & King (2006), tax autonomy is one of the most important indicators of the local authorities' fiscal

capacity, which has been estimated by the Organisation for Economic Co-operation and Development (hereinafter OECD) since the mid-1990s.

The aforementioned indicator's assessment methodology is rather specific, regarding the OECD local governments' assigned taxes codification (Table 1). According to the OECD methodology, there are two main types of tax autonomy: absolute and partial. An absolute tax autonomy is associated with the categories  $a_1$ ,  $a_2$ , and  $b_1$ . A partial tax autonomy combines the categories of discretion on rates and reliefs ( $a_1$  and  $a_2$ ) and on rates exclusively ( $b_1$ ,  $b_2$ , and  $b_3$ ). The indicators of absolute and partial tax autonomy are the ratios of respective categories and the total amount of tax revenue. The general government tax revenue combines the tax revenue of the central budget and the tax revenue of sub-national budgets. Mathematically, the tax autonomy indices can be expressed by the system below (2):

$$\begin{cases} TA_a = \frac{a_1 + a_2 + b_1}{TR_{tot}} * 100\% \\ TA_p = \frac{a_1 + a_2 + b_1 + b_2 + b_3}{TR_{tot}} * 100\% \end{cases} \quad (2)$$

where  $TA_a$  – absolute tax autonomy;  $TA_p$  – partial tax autonomy;  $TR_{tot}$  – total tax revenue (including social fees).

**Table 1. Typology of the local government's powers in the field of taxation.** (Source: built by the authors, based on the OECD Fiscal Decentralization Database, 2025, data)

Category of discretion	Code	Description
Discretion on rates and reliefs	$a_1$	The local governments set the tax rates and incentives without any limitations and restrictions from the central government
	$a_2$	The local governments set the tax rates and incentives, taking the limitations of the central government into account
Discretion on rates	$b_1$	The local governments set the rates, disregarding the maximum rates set by the central government
	$b_2$	The local governments set the tax rates, considering the thresholds set by the central government
	$b_3$	The local governments set the rates, but the central government sets a limit on the local budget revenue's annual growth
Discretion on reliefs	$c$	The local governments set and regulate the tax incentives
Tax sharing arrangements	$d_1$	The local governments determine the parameters of revenue sharing
	$d_2$	The sharing parameters can be changed only in agreement with local authorities
	$d_3$	The sharing parameters are guaranteed by the law and do not change more than once a year
	$d_4$	The sharing parameters are determined annually by the central government
Rates and reliefs set by the central government	$e$	The local governments do not have any authority to determine the tax rates and incentives
Other	$f$	Does not belong to the codes a, b, c, d, or e

According to the Wicksell / Cobb–Douglas productive function, labor and physical capital are imperfect substitutes. That can be described by the formula (3):

$$Y = A * L^\beta * K^\alpha \quad (3)$$

where  $Y$  – annual total production;  $L$  – annual labor input;  $K$  – annual capital input;  $A$  – total factor productivity;  $\alpha$  ( $0 < \alpha < 1$ ) and  $\beta$  ( $0 < \beta < 1$ ) – output elasticities of capital and labor, respectively;  $\alpha + \beta = 1$ .

The above productive factors are taxed. It could be presumed that an annual economic growth rate is dependent on the actual level of fiscal decentralization as well as the other non-fiscal factors. Thus, we will use the formula below (4) to assess the impact of fiscal decentralization on economic growth:

$$GDPpc_{i,t} = \gamma_0 + \gamma_1 FD_{i,t} + \gamma_2 EC_{i,t} + \varepsilon \quad (4)$$

where  $i$  – country;  $t$  – year;  $GDPpc$  – the real GDP per capita growth rate;  $FD$  – fiscal decentralization;  $EC$  – economic controls;  $\varepsilon$  – statistical error.

In this study, we investigate own revenue decentralization (formula 1) as the main fiscal variable affecting economic growth. We included three more indicators as the economic controls. Firstly, it was pointed out (Nepytaliuk et al., 2024) that an increase in gross capital formation ( $GCF_{gr}$ ) was positively interrelated with economic development. Secondly, in a series of works (Kozlovskiy et al., 2020; Pasichnyi & Nepytaliuk, 2021; Khachatryan et al., 2023), it was proved that demographics affected economic growth crucially. Thus, we examined the working age population stratum annual growth rate ( $WAP_{gr}$ ) and the Human Development Index's growth rate ( $HDI_{gr}$ ) impact on the real GDP per capita growth rate ( $GDPpc_{gr}$ ). Regarding the above, formula (4) can be transformed into model (5):

$$GDPpc_{gr} = \gamma_0 + \gamma_1 * RD_{own} + \gamma_2 * GCF_{gr} + \gamma_3 * WAP_{gr} + \gamma_4 * HDI_{gr} \quad (5)$$

In this article, we focused on a sample of the EU–27 member-states and Ukraine. We considered the time interval from 2011 to 2024. The statistics and forecasts of the World Bank, the International Monetary Fund, the European Commission, the Ministry of Finance of Ukraine, and the State Statistics Service of Ukraine formed the information base of this particular study. We employed theoretical generalization to systematize the factors determining the territorial communities' fiscal capacity. We applied grouping, study of dynamic series, regression, and comparative analysis to examine the indicators' dynamics.

## RESULTS

Oates (1999) argued that a key priority for transforming the fiscal landscape was enhancing the administrative capacity of territorial communities to ensure the most efficient collection of public revenue. Consolidating territorial communities can contribute to this process. Larger administrative-territorial centres can provide sufficient employment, higher salaries, increased labour productivity, and an acceptable quality of public goods and services. These conditions psychologically attract economic actors to those communities, ensuring sustainable social and economic development. A "win-win" scenario is created when the local government employs prudent fiscal management, and taxpayers are responsible and disciplined.

There is a certain trend in the EU member-states associated with the optimization of their administrative-territorial structure aimed at building capable territorial communities. To ensure the social infrastructure development, especially regarding public healthcare and education, the population's demographic parameters should be considered. The mechanism for public services financing must comply simultaneously with the principles of subsidiarity and economic feasibility. According to the 9<sup>th</sup> edition of the Networks of Associations of Local Authorities of South-East Europe Report "Fiscal Decentralization Indicators for South-East Europe", the average population size in the territorial communities in the EU member-countries is about 5 thousand inhabitants, but in some countries, that figure exceeds 25 thousand. The territorial communities vary considerably in size and population quantity, and density as well. About 80 % of the EU municipalities are located in five countries: most in France – 41 %, in Germany – 13 %, in Italy – 9 %, in Spain – 9 %, and in the Czech Republic – 7 %. Generally, the administrative-territorial division and the budget system's structure affect the model of intergovernmental relations and fiscal policy. Decentralization has become a trend in the European fiscal space's transformation since the mid-1980s. Fiscal capacity of the local governments significantly increased in Central and Eastern Europe, the Baltic states, France, and Italy. However, the Great Recession had provoked the reverse process of centralization in Greece and Italy. The central governments of the above countries took on more fiscal powers and collected additional financial resources to counteract the crisis. Kuhlmann et al. (2022) detected a pushback towards fiscal centralization in Hungary induced by the changes in social policy. Certain cases of decentralization reforms in the EU member-states have not ensured a high level of local governments' autonomy and an adequate territorial communities' fiscal capacity. Nonetheless, the general trend in European countries indicates that the priority of their fiscal policy is associated with an increase in the local governments' financial capacity.

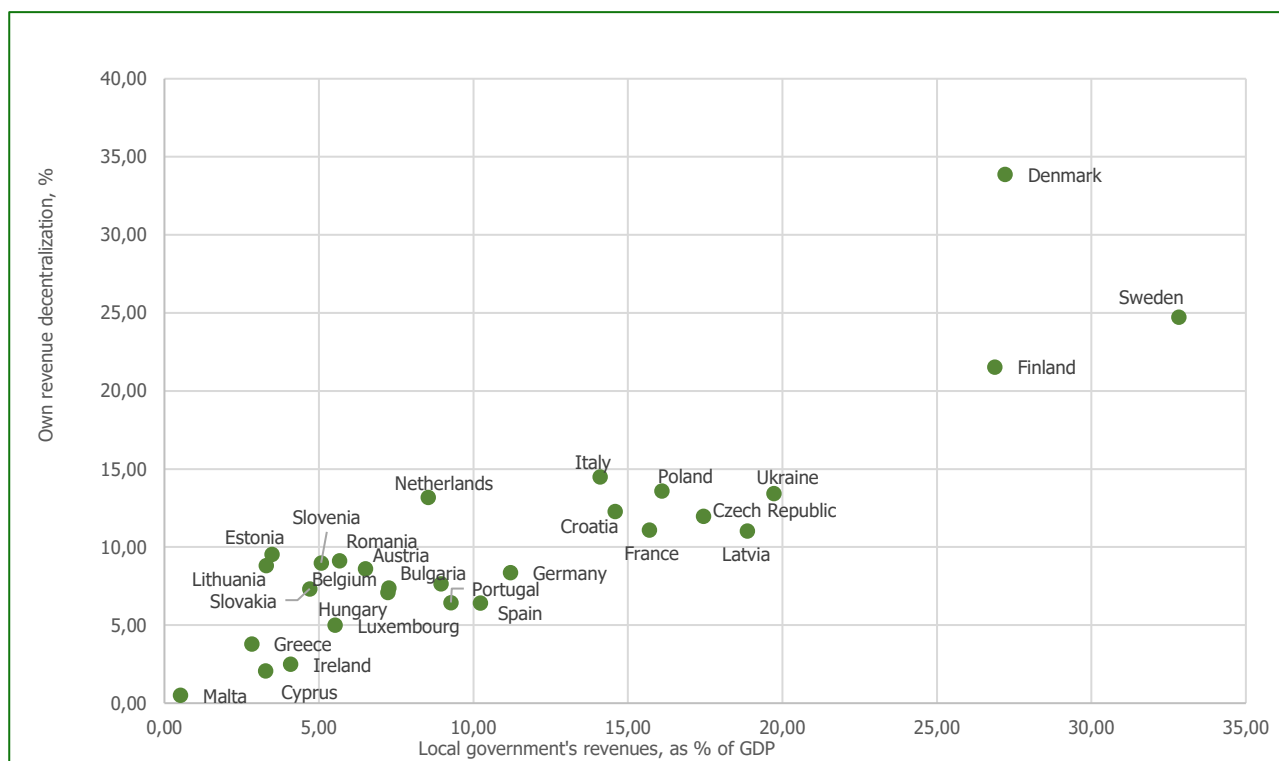
In Ukraine, the systemic and highly successful fiscal decentralization reform began in 2014. The prerequisite for the implementation of the above is a change in the fiscal relations' institutional environment. One of the budget revenue policy priorities is the territorial communities' fiscal sufficiency strengthening, in particular regarding the local taxes and fees.

The intergovernmental relations in the observed sample over the period analyzed from 2011 to 2024 have been improved significantly. Meanwhile, in the EU member-countries, the level of own revenue decentralization has been rather moderate (Figure 1). Our calculations were made based on formula 1. The highest own revenue decentralization level (exceeding 25.00 %) was recorded in three countries of Fennoscandia – Denmark, Finland, and Sweden. It should be noted specifically that those economies have the maximum values of GDP redistribution through the territorial communities' budgets.

The budget systems of Austria, Belgium, Spain, and Germany have three levels. Assessing fiscal decentralization and the fact above, we examined the lowest level of the budget system exclusively. The most centralized in terms of the local budgets' own revenue were the island states – Malta, Cyprus, Ireland, and Greece. In those countries, the local budget revenue-to-GDP ratio was lower than 4.00 %. Geographical factors significantly affect the fiscal reforms' feasibility for ensuring the communities' inherent financial capacity and decentralization efficiency.

There are some exceptional cases. Greece includes nearly 1,400 islands (of which less than 300 are inhabited and only about 80 have more than 100 inhabitants). A priori, in that case, it is impossible to ensure the fiscal sufficiency of the local taxes and fees, and shared taxes as well, to finance the production of public goods and services, considering the unified state standards. Therefore, in Greece, a model of direct state financing of the local governments throughout the Central Autonomous Resources mechanism (aimed to ensure the long-term fiscal sustainability) is utilized.

The average local budget revenue-to-GDP ratio (exceeding 10.00 % of GDP) and the average own revenue decentralization (exceeding 10.00 %) were recorded for Croatia, the Czech Republic, France, Italy, Latvia, Poland, and Ukraine. The Polish experience of fiscal decentralization formed the core of the Ukrainian fiscal system's structural transformations. Low own revenue decentralization was observed in a number of countries under study (e.g., Estonia, Hungary, Lithuania, Romania, and Slovakia). The facts above were due to the significant differentiation of territorial communities in their regional, geographical, demographic, social, and economic development characteristics.



**Figure 1. Own revenue decentralization in the EU member-countries and Ukraine over the period from 2011 to 2024.** (Source: the authors' own calculation based on the International Monetary Fund, 2025, the European Commission, 2025, the Ministry of Finance of Ukraine, 2025, and the State Statistic Service of Ukraine, 2025, data and formula 1)

The main components of the local governments' financial resources are the intergovernmental grants, taxes, and non-tax revenue (e.g., income from capital transactions, local borrowings, etc.). The list of so-called "shared" taxes varies significantly across the countries under study and depends on a plethora of factors, primarily on the economic potential of the territorial communities. Shared taxes often include the personal income tax, profit tax, resource payments, and, very rarely, consumption taxes. Generally, while determining the revenue sources for the different budget levels, the national governments are guided by two main principles. Firstly, the taxes should be assigned to the level of government (central or local) depending on the administration efficiency (regarding the cost of tax administration and control). Secondly, the tax assignment must take the tax base's differentiation into account. Otherwise, the aforementioned divergence could provoke horizontal fiscal imbalances.

Bahl & Bird (2008) propose four basic principles for assigning revenue to the local governments' level. Firstly, the local taxes should not excessively deform the allocation of resources. Secondly, the governments at all levels should carry

exceptional responsibility at the margin for financing the expenditures for which they are responsible politically. Thirdly, the own revenue should be sufficient to enable at least the richest territorial communities to finance all the locally provided goods and services (primarily benefiting the local inhabitants). Finally, the local revenue should burden only the local residents, preferably in relation to the benefits they receive from the local providers.

The local governments' involvement in the process of the local tax administration varies, considering the country under study. In Germany, the local authorities are fully involved in the local tax administration. In Poland and the Baltic countries, sub-national governments are partially involved in the above activities. In some of the EU member-countries and Ukraine, the central government bodies (tax service) carry out the administration of the local taxes and fees.

Local business taxes represent the fiscal tools for regulating entrepreneurial activity. They can be applied to create additional competitive advantages for businesses and provide fiscal incentives during economic downturns or recessions. Moreover, the business entities' fiscal discipline is an essential part of their corporate social responsibility. Municipal tax in Austria represents the above category of fiscal instruments. Although it is collected in the municipalities' budgets, the federal law determines the legislative basis for its administration. Its base is an income in the form of salaries and wages paid to the employees of an enterprise located in the relevant territorial community. Its rate equals 3.00 % of the monthly income received. Advanced territorial communities with high employment, salaries, and wages receive higher revenue from municipal taxes. Moreover, the facts above raise the local governments' motivation to create the most favorable conditions for business and increase employment.

Since 2016, in Slovakia, a local development fee has been collected. In case of that fee, local self-government bodies are authorized to collect it on the respective territories. The object of taxation consists of buildings under construction within the relevant territorial community, for the construction of which a permit has already been obtained. Meanwhile, there is a list of real estate objects exempted from taxation. In particular, those are: the residential buildings with an area up to 150 m<sup>2</sup>; small architectural forms up to 25 m<sup>2</sup>; educational, medical, and religious institutions; the buildings under reconstruction; parking lots; cultural objects, etc. The rates of a local development fee range from EUR 10 to EUR 35 per m<sup>2</sup>, based on the type of the real estate object under construction, and are set by respective local government bodies.

There is a local business tax received by the territorial communities in Spain. It has a form of an annual fixed payment and depends on the type of business activity and the enterprise's location. In Ukraine, since 2011, a flat tax has been included in the local taxes. The individuals and the small businesses' legal entities (who have chosen a simplified system of taxation, accounting, and reporting) pay it.

In different European countries, there are various forms of local taxes and fees, such as the local taxes on hydroelectric power generation or the tourist fees. The latter are fiscally significant for the communities located in resort areas and attractive to the tourists, including the foreign ones. In Greece, a targeted fee for cleaning and lighting services is collected for the municipalities' budgets. Being paid by the real estate users, it is calculated based on the real estate's area; the local councils determine its rate. Its proportion is the highest in the local budgets' tax revenue (exceeding 70.00 %). In Luxembourg, there is a local trade tax (*Impôt commercial communal*), which accounts for over 90.00 % of municipal tax revenue. Its rate varies depending on the territorial community; for example, in Luxembourg City, it is equal to 6.75 %.

Local self-governments have the right to set the local taxes and fees specific parameters (e.g., rates, bases, and benefits). Hence, the aforementioned financial instruments are considered the fundamental elements ensuring the local self-governments' fiscal capacity. The classic example of the local tax is the property tax. The recurrent property taxes, especially regarding the taxation of immovable property, are crucially important for the municipal budgets. The advantages of that type of tax are: a) they generate highly stable budget revenue due to the immobile tax base; and b) they do not create any negative effect for economic development.

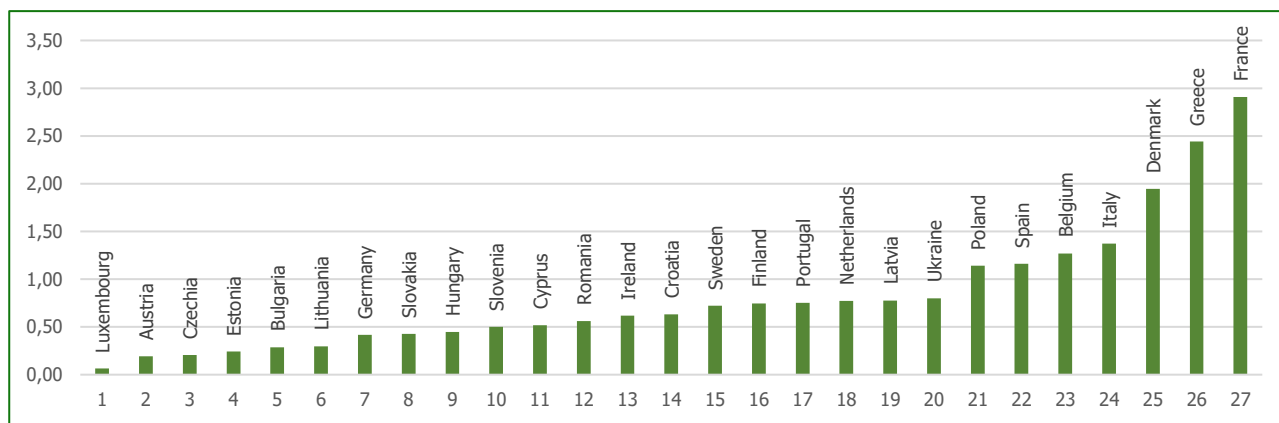
All the EU-27 member-countries, with the exception of Malta, employ the recurrent property tax. In European countries, both the land and the buildings on it (regarding their purposes) are taxed simultaneously. However, according to Mengden (2024), there are some special cases. In Estonia, the land is taxed exceptionally. In Latvia, taxation involves only the buildings and non-building structures, disregarding the value characteristics of the land (on which they are located). The most common form of real estate taxation is a single real estate tax (combining both land and building taxation). In Hungary, a number of laws regulate land and building taxation. Municipalities are empowered to set a tax on undeveloped land, a building tax, and a property tax for recreational facilities.

The average percentage of the recurrent property taxes in GDP for the 26 EU member-countries over the period from 2011 to 2024 is 0.82 % (Figure 2). The highest indicators were observed in Denmark – 1.95 %, Greece – 2.44 %, and France – 2.91%. Meanwhile, the lowest were recorded in Luxembourg – 0.06 %, Austria – 0.19 %, and the Czech Republic – 0.20%. The difference in the property taxes' fiscal significance depends on the country's tax system architectonics, the

priorities of fiscal policy, and the institutional features of the tax administration. Premmer (2020) notes that the property taxes' low fiscal significance in certain countries was due to the use of the cadastral value of the property as the tax base. In a number of cases, it was essentially lower than the market price. In Austria, for example, the cadastral value of the lands has not been estimated since the 1970s and differs from the market value crucially. Despite relatively high tax rates in the EU member-countries, due to the low tax bases, the revenue from the periodic property taxes is underpaid.

One of the most important effective fiscal policy preparation and implementation principles is adaptability. According to the Annual Report on Taxation (2024), in 16 of the EU–27 member-states, in 2022 and 2023, over 50 related to property taxation changes in the legislation were aimed at strengthening its fiscal significance and ensuring its fairness. The most common elements of the property tax reform are the tax base updates (aimed to bring the taxed value closer to the market value) and improvements to the mechanism for automatic revision of the real estate value.

Due to the principle of social justice, in the vast majority of the EU member-countries, the value of the real estate is used as the tax base. The higher real estate values are associated with the higher public welfare, and the ability to pay the higher property taxes amounts to the relevant local budget. The tax base can be either the capital value of the land and improvements or the annual rental value of the real estate. In France, a mixed mechanism that combines the aforementioned approaches is applied. According to Leodolter et al. (2021), in contrast to the other EU member-states, in the Netherlands, the real estate is taxed using the personal income tax system. The real estate's intended purpose and use (e.g., residential, commercial, industrial, agricultural, etc.) are considered as well. The rates of the periodic property tax may vary depending on the type of property. Economic, institutional, social, as well as certain technical factors affect the property's value characteristics essentially.



**Figure 2. The recurrent property taxes-to-GDP ratio in the EU member-countries and Ukraine over the period from 2011 to 2024, percentage.** (Source: the authors' own calculation based on the International Monetary Fund, 2025, the European Commission, 2025, the Ministry of Finance of Ukraine, 2025, and the State Statistic Service of Ukraine, 2025, data)

Economic factors play a significant role in real estate valuation. The level of household income across the territorial community determines the population's purchasing power and affects the real estate market value. The property tax rates also affect it: a significant tax burden can restrain demand fundamentally, while the moderate rates contribute to the market reactivation or could have a neutral effect. In modern conditions, the territorial location of the real estate is one of the key factors in its pricing. The proximity to the business activity centers and the infrastructure facilities contributes to an increase in those objects' value. The quality and availability of public services (e.g., healthcare, education, etc.) create additional attractiveness for the potential buyers or tenants of the real estate.

Meanwhile, in the Czech Republic, Poland, and Slovakia, the tax base for real estate is determined by its area. This approach simplifies the tax administration process, is relatively "cheaper" to implement, and reduces the risk of public dissatisfaction. The latter is a crucial factor in shaping how the taxpayers fulfill their obligations. The periodic property taxes' fiscal significance differs significantly even in the aforementioned countries. The Czech Republic (as an outsider) is ahead of only Austria and Luxembourg, while Poland is among the top 7 of the EU member-countries in terms of the property tax revenue-to-GDP ratio. The above fact is due to the different tax rates and the quality of the administration mechanism. In the Czech Republic, an imperfect structure of the tax base is employed. That structure does not reflect modern realities and is unable even to counteract the inflation impact on the tax revenue dynamics.

In Poland, the land, the buildings, and non-building structures are subject to taxation. Land and the real estate, other than land, are taxed separately, based on the real estate area. The local councils, regarding the maximum values' legislative limitations, set the tax rates for each of the property categories. The tax rates are reviewed annually and depend on the

type and purpose of the property. In particular, the residential real estate is taxed at a moderate rate (as of 2025, the maximum rate equals PLN 1.19 per m<sup>2</sup>), while 1 m<sup>2</sup> of commercial real estate is taxed at significantly higher rates (the maximum rate equals PLN 34.00 per m<sup>2</sup>). Non-residential buildings (apartments, logistics hubs, and other non-residential commercial real estate) are taxed at a rate of 2.00 % of their gross tax value (before depreciation).

The real estate tax in the Czech Republic involves taxation of land and the buildings on it. The real estate tax rate could be multiplied by a coefficient (ranging from 1.00 to 4.50). That coefficient depends on the territorial community's population quantity. The higher correction coefficient is associated with the larger population. Additionally, exclusively for certain types of agricultural lands, the municipalities may apply a local coefficient (ranged from 0.50 to 5.00 of the basic tax rate) to regulate the tax revenue. A reducing coefficient could be applied to the unsuitable for agricultural use lands. The land-specific characteristics (e.g., area, location, type of purpose, the owner, etc.) are entered in the register as well.

The land tax rate depends on the type of land plot (agricultural, for the real estate development, commercial forests, woodlands, water bodies, etc.). In the case of agricultural land, the tax base is associated with the value of the land determined by a regulatory act. For the forests and ponds, the tax base may be either the value of the land or the area of those land plots (multiplied by a fixed rate, determined on January 1 of the tax period). For the other types of land plots, the tax base is associated with their area. The tax base for buildings is their area as well. In the Czech Republic, a tax rate increase coefficient (ranging from 1.20 to 1.22, depending on the legislative norms) may be applied. As of 2025, the real estate tax rates range from CZK 3.50 to CZK 18.00 per m<sup>2</sup>. The rate depends on the number of floors in the buildings; the rate increases by CZK 1.4 per m<sup>2</sup> for each additional floor. Analogically, the real estate taxation involves the application of a rate adjustment coefficient (ranging from 1.00 to 4.50) depending on the territorial community's population quantity. In addition, the municipalities may increase the coefficient by their decision up to 5.00.

The changes in the land tenure patterns and the real estate market trends are affecting the transformation of the real estate taxation mechanism in the EU. A shift from taxation of the real estate area to its value is a common trend. Moreover, there is a shift towards using the real estate's capital value instead of its annual rental value as the tax base. The aforementioned approach is applied fully in Belgium, Denmark, Italy, and partially in France.

The tax incentives in property taxation are applied to ensure the principle of social justice and economic feasibility. Collier et al. (2018) define several groups of those incentives: a) an exemption for the real estate that have a socially desirable purpose (e.g., educational, healthcare, cultural, etc.); b) the benefits for the owners of the low value assets (to reduce the inequality); c) the benefits for non-profit organizations and enterprises of public ownership; and d) the benefits for the assets' owners, who cannot be taxed on general terms (e.g., pensioners, people with disabilities, and other socially vulnerable population strata). Generally, considering the residential real estate, the tax incentives for people with low incomes or belonging to a preferential category are applied to the place of their residence.

The fiscal cadastres upgrade – aimed to provide complete information about the real estate objects' parameters and their owners – is the priority for the tax administration improvement. The above is necessary to ensure the tax liabilities' calculations for the relevant objects of taxation. The typical and mandatory information (contained in the fiscal cadastres) should contain:

- the intended purpose of the land plot/building (non-building construction); b) the geographical records (e.g., the object's location and boundaries);
- the information required to calculate the tax liability (e.g., the area/value, the year of construction, completion, improvement, etc.);
- the owners/tenants;
- the tax incentives application prerequisites.

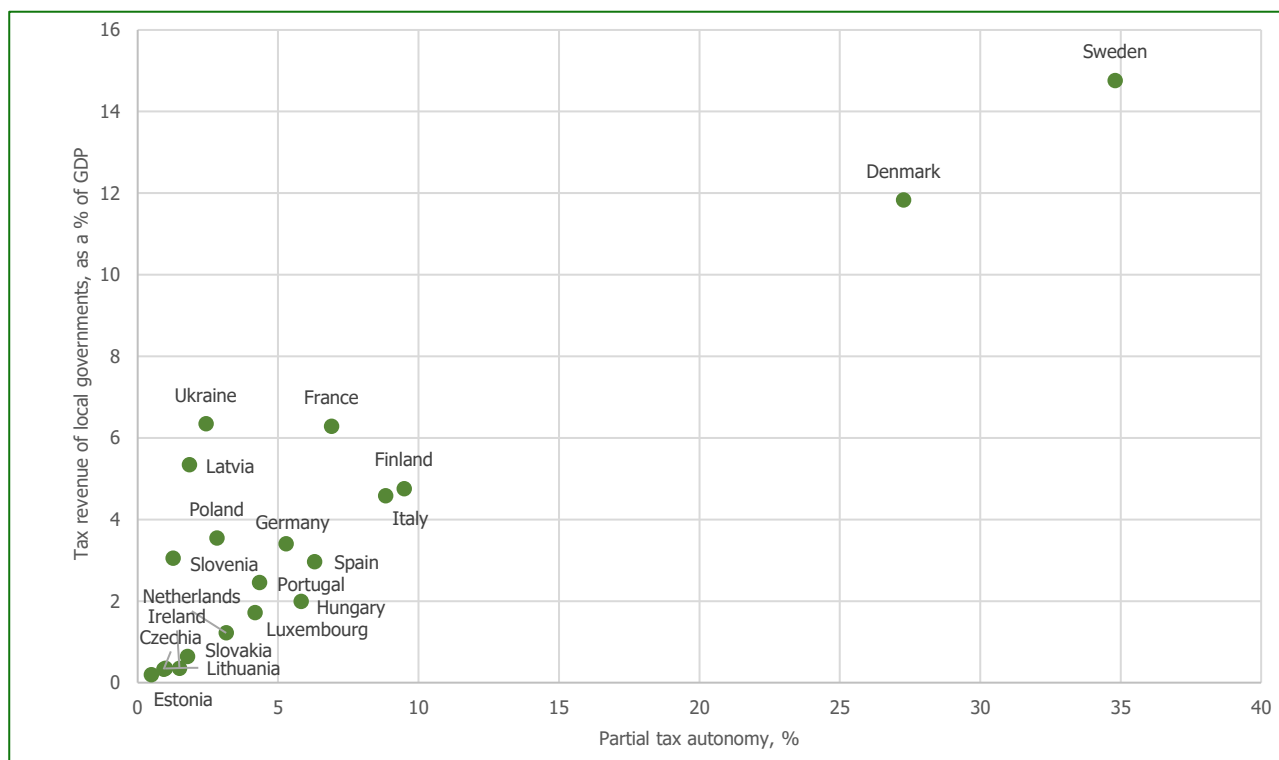
A modern trend is associated with the formation of a single electronic cadaster (including a cadastral map and other records), integrated with the geographic information systems (GIS). The central executive power institutions are the responsible executors of the fiscal cadastres' formation and maintenance.

For the emerging market economies, the degree of information completeness in the fiscal cadastres forms a serious challenge. Due to the absence of a real estate object or its parameters in the cadastre, it becomes impossible to calculate the tax liability. In some European countries, the fiscal cadastre and the State Register of Real Rights are integrated into a single multifunctional database. In those cases, the institutional powers of the administrators are delimited (restricting the access of fiscal institutions). In the EU member-countries, there is a practice to include local governments in the administration of the local taxes and fees. The above gives local governments limited access to the cadastres. Partial powers in the field of the local tax administration have been granted to the local authorities in Poland and the Baltic states.

There are some advantages of involving the local institutions in the administration of the property tax. Firstly, this contributes to a higher motivation for accumulating the tax revenue for the territorial community's budget. Secondly, the residents of the particular territorial community (the taxpayers) are better aware of the collected resources' usage. Thirdly, a higher level of financial accountability to the territorial community's inhabitants could be provided. Finally, the local budget management efficiency could be increased. Meanwhile, there are special prerequisites for successful fiscal policy transformation, highly dependent on the central government bodies. In a series of studies (Chugunov et al., 2019; Chugunov et al., 2021), the role of monetary and security factors affecting fiscal policy is disclosed.

The introduction of digital technologies into the tax administration forms a tendency in the EU member-states. The application of digital products simplifies the procedures for the taxpayers, corresponding to the principle of convenience, and provides an automatic and comprehensive tax data analysis. Additionally, the above optimizes both the channels and the interaction methods between the authorities and the taxpayers. The positive digital decisions' implementation experience in the field of real estate taxation in the EU member-countries contributed to the improvements in the respective assets' identifying processes as well as their subsequent registration and the tax liabilities' calculation. The implementation of digital solutions in the sphere of taxation has increased the municipal budgets' revenue significantly. Due to modern technical decisions, the tax services automatically receive the information from the State Register of Real Rights through the digital taxation ecosystem. Digitalization provides the option to issue the tax notices to the payer using personal tax offices. That option significantly saves time and subsequent costs for the taxpayers. Moreover, the tax digitalization simplifies the procedures for verifying the correctness of the property tax calculation. Additionally, the digital products and technologies allow the real estate tax administrators to diagnose the intended use of the assets and their technical condition as well.

To investigate the local self-government bodies' powers and restrictions, their tax autonomy indicators should be analyzed comparatively. Regarding the period under study, the local authorities' absolute tax autonomy in the EU was insignificant. In a number of the EU member-states, the above indicator's value equaled zero. The aforementioned situation was common for the Czech Republic, Hungary, Ireland, Latvia, Poland, and Slovenia. Therefore, to compare the tax autonomy in the EU member-countries and Ukraine, the partial tax autonomy indicator was investigated. Figure 3 represents the partial tax autonomy indices for the sampled countries. A high level of tax autonomy (exceeding 25.00 %) was recorded for a pair of Scandinavian countries – Denmark and Sweden.



**Figure 3. The partial tax autonomy and own revenue decentralization in the EU member-states and Ukraine over the period from 2011 to 2024, in percentage.** (Source: the authors' own calculation based on the International Monetary Fund, 2025, the European Commission, 2025, the Ministry of Finance of Ukraine, 2025, and the State Statistic Service of Ukraine, 2025, data)

That fact correlates with their significantly high own revenue decentralization. The remaining sampled countries are characterized by essentially lower partial tax autonomy. However, in six more countries under investigation, that indicator exceeded 5.00 %. The aforementioned countries included Finland (9.50%), Italy (8.80%), France (6.90%), Spain (6.30%), Hungary (5.80%), and Germany (5.30%). Considering the fact that their budget systems consist of three levels, we studied the lowest level associated with the territorial communities in Spain and Germany. For most of the EU member-states, the partial tax autonomy indices were low and did not exceed 5.00%. There were three countries with an index less than 1.00%. These countries were the Czech Republic (0.90%), Estonia (0.50%), and Lithuania (just under 1.00%). Thus, the budgets of territorial communities in these countries depend on both shared national taxes and transfers from the central budget.

To verify the above-proposed model (5), we applied ordinary least squares regression. The summary statistics for the investigated sample are provided in Table 2. During the study, we collected a total of 392 observations for the entire time interval from 2011 to 2024.

**Table 2. Summary statistics.** (Source: the authors' own calculation based on the World Bank, 2025, 2025a, 2025b, the International Monetary Fund, 2025, the European Commission, 2025, the United Nations, 2025, the Ministry of Finance of Ukraine, 2025, and the State Statistic Service of Ukraine, 2025, data)

Variables	Observations	Mean	Standard deviation	Max	Min
GDP per capita growth rate (annual, %)	392	1.86	3.95	23.44	-22.75
Own revenue decentralization (%)	392	11.10	8.18	34.34	0.30
Gross capital formation growth (annual, %)	392	2.65	11.58	99.69	-37.95
Population ages 15–64 growth rate (annual, %)	392	-0.16	1.21	4.77	-8.32
HDI growth rate (annual, %)	392	0.30	0.49	2.20	-1.40

The obtained regressive model appeared to be valid and adequate. The adjusted coefficient of determination was equal to 0.346 (Table 3). Unexpectedly, the interconnection between own revenue decentralization and economic growth for the sampled countries was negative and statistically significant. An increase in the above indicator by 1 percentage point resulted in a slight decline in real GDP per capita growth, which was equal to 0.054 percentage points. That may be due to ineffective financial policy and rather low fiscal capacity of territorial communities. Meanwhile, the gross capital formation indicator had a significantly positive impact on economic growth. An annual increase in gross capital formation by 1 percentage point resulted in an increase in economic growth by 0.157 percentage points.

The relationship between economic growth and the working-age population was controversial and negative. Hypothetically, an expansion in the working-age group should boost development processes. However, an increase in the working-age population by 1 percentage point was associated with a considerable decline in GDP per capita, which was equal to 0.342 percentage points. Regarding the sample under study, an increase in the HDI by 1 percentage point fostered economic growth by 2.172 percentage points.

**Table 3. Regression of economic growth on fiscal decentralization and controls, the sample of 28 countries, 2011–2024, panel data.**

(Source: the authors' own calculation based on the World Bank, 2025, 2025a, 2025b, the International Monetary Fund, 2025, the European Commission, 2025, the United Nations, 2025, the Ministry of Finance of Ukraine, 2025, and the State Statistic Service of Ukraine, 2025, data. Notes: The numbers in parentheses are the standard errors of the estimated parameters. \*\* denotes significance at the 1 percent level. R<sup>2</sup> is the adjusted coefficient of determination)

Own revenue decentralization (%)	-0.054*
	(0.020)
Gross capital formation growth (annual, %)	0.157*
	(0.014)
Population ages 15–64 growth rate (annual, %)	-0.342*
	(0.136)
HDI growth rate (annual, %)	2.172*
	(0.334)
R <sup>2</sup>	0.346
N	392

## DISCUSSION

Revenue fiscal decentralization aims to increase the financial capacity of local self-governments (Kiziltan & Yereli, 2023). Considering institutional constraints and socio-economic disparities in regional development, European states are striving to ensure a sustainable and equitable fiscal base for local authorities. Granting local governments more responsibility in providing public goods to the population would create a precondition for their increased fiscal capacity (Hodžić et al, 2020). The desire to strengthen the fiscal role of the local taxes and fees, as opposed to intergovernmental grants and shared taxes, is intended to increase the overall governance effectiveness. The results of the analysis showed that own revenue decentralization might restrain economic growth in the sample of European countries. That correlates with the findings of a study by Kaneva et al. (2023). The research by Carniti et al. (2019) indicated that decentralization was not always a direct contributor to economic growth. Their findings also pointed to a crucial threshold beyond which continued decentralization could yield adverse results. Consequently, any fiscal decentralization reform should be approached with significant foresight and deliberation.

In contrast to the results of Hung & Thanh (2022), we found a slightly negative effect of own revenue decentralization on economic growth. The above fact could be due to rather imperfect local authorities' fiscal policy mix. Hence, the revenue structure of local governments requires modification. Regarding the fact that most of the analyzed countries had advanced economies, we found no positive impact of own revenue decentralization on GDP per capita (in contrast to the results obtained by Sima et al., 2023). Mladenovska & Tashevska (2024) pointed out that revenue decentralization appeared to be more effective than expenditure one in terms of stimulating economic growth. In this study, we obtained an opposite result. Local taxes should not significantly distort resource allocation and must be sufficient to finance basic public goods and services (Bahl & Bird, 2008; Sakti et al., 2024; Matić & Pečarić, 2025). An analysis of fiscal autonomy indicators in the EU countries and Ukraine shows that the fiscal role of local taxes (for which local governments regulate the rates and base) is insufficient. It is essential to enhance the capacity of local authorities for local tax administration.

## CONCLUSIONS

The fiscal capacity of local governments is a vital prerequisite for providing residents with high-quality public goods and services. At the lowest level of the budget system, we could see that taxes are the price of living in a civilized society.

In the study, the key indicators characterizing the fiscal capacity of local authorities were calculated. Those indicators were own revenue decentralization and tax autonomy. The highest level of revenue decentralization was recorded for the Nordic countries, while Ukraine belonged to the group of countries with a medium decentralization level, alongside the countries in Central Europe and the Baltics, namely Poland, the Czech Republic, and Latvia. It was determined that in the sample of the EU-27 countries and Ukraine during the period of 2011–2024, an increase in gross capital formation and in the Human Development Index had a positive impact on economic growth. In contrast, own revenue decentralization had a slightly negative effect. That highlights the importance of ensuring an optimal level of decentralization and developing the institutional environment of fiscal space.

The main elements for ensuring the fiscal capacity of local authorities are the local taxes and fees, whose rates and bases those authorities can establish and regulate. The study paid crucial attention to analysing the fiscal role of the local taxes and fees in the EU member-states and Ukraine. It was proved that in the sphere of the above parameters' regulation, the local self-government powers were strongly dependent on the type of the state's economic model. Moreover, the higher standards of living were associated with deeply decentralized local finances. In many European countries, local business taxes are an essential element of the local taxation system. Those taxes and fees are vital elements of the ecosystem for regulating the entrepreneurial activity and economic development of territories.

In the course of our investigation, it was found that a basic element of the local tax system had been the recurrent property tax. The study identified the peculiarities of its collection in European countries. The average recurrent property taxes to GDP ratio for the EU member-states from 2011 to 2024 equals 0.82%. Among the EU member-states, the vast majority use the value of real estate as the tax base, which aligns with the principle of social justice. The most common element of the property tax reform is updating the tax base to market value and improving the mechanism for its automatic re-evaluation. That issue is also a focus of Ukrainian fiscal policymakers, as stated in the National Revenue Strategy.

The highest level of tax autonomy among EU countries was found in Denmark and Sweden. The analysis showed that Ukraine had an insufficient level of tax autonomy for local governments. It is vital to strengthen the fiscal role of the local taxes and fees by expanding the capacity of respective local governments to administer them. It is also crucial to advance the trend of digitalization in tax administration and to ensure the de-shadowing of taxation.

Further research will focus on the justification of approaches to enhance the fiscal role of the local taxes and fees in Ukraine and the introduction of co-operative administration of property tax. That is aimed at raising the fiscal capacity of local authorities and fostering the growth of public well-being.

## ADDITIONAL INFORMATION

### AUTHOR CONTRIBUTIONS

All authors have contributed equally.

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### CONFLICT OF INTEREST

The Authors declare that there is no conflict of interest.

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## ФІНАНСОВА СПРОМОЖНІСТЬ ТЕРИТОРІАЛЬНИХ ГРОМАД В УКРАЇНІ ТА ДЕРЖАВАХ-ЧЛЕНАХ ЄС

Метою цього дослідження є оцінювання фінансової спроможності територіальних громад і визначення впливу децентралізації доходів на економічне зростання. Вибірка охоплює 27 національних економік країн-членів ЄС та України за період із 2011 по 2024 рік. Оцінено рівень децентралізації власних доходів та висвітлено взаємозв'язок між цим показником і динамікою економічного розвитку. Досліджено інституційні особливості системи місцевих податків і зборів як основи забезпечення фіскальної спроможності територіальних громад. Особливу увагу приділено фіскальному значенню та особливостям адміністрування періодичного податку на нерухоме майно. Оцінено рівень часткової податкової автономії. Найвища децентралізація доходів зафіксована для підвибірки скандинавських країн, а Україна належить до групи країн із середнім рівнем вищезазначеного показника. Установлено, що збільшення валового нагромадження капіталу та індексу людського розвитку позитивно впливають на економічне зростання. Натомість децентралізація власних доходів у державах вибірки мала дещо негативний вплив через недосконалий механізм адміністрування податків. Оптимальний рівень децентралізації має бути головною метою інституційної трансформації фіскального простору. Посилення фіскальної значущості місцевих податків і зборів визначено як життєво важливу передумову для підвищення загальної ефективності державного управління. Зазначено, що можливості місцевих органів влади щодо адміністрування місцевих податків і зборів слід розширити. Систематизовано пріоритети реформи оподаткування майна. Наголошено на необхідності посилення тенденції цифровізації в податковому адмініструванні для забезпечення детінізації економіки. Указано, що до реформи фіскальної децентралізації слід підходити помірковано та систематично.

**Ключові слова:** фінансова спроможність, місцева влада, фіскальна децентралізація, податкова політика, податкова автономія, місцеві податки та збори, економічне зростання, органи місцевого самоврядування

**JEL Класифікація:** H20, H21, H71, H73, O23, O40, O52