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TAX REVENUE REDISTRIBUTION, HARD BUDGET CONSTRAINTS AND LOCAL FISCAL STABILITY IN UZBEKISTAN

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Abstract: This article examines Uzbekistan's 2026 fiscal reform package not as an isolated revenue-sharing decision, but as a combined governance mechanism that links greater local revenue retention with harder budget constraints. The paper focuses on Resolution of the President of the Republic of Uzbekistan, dd 26.12.2025 № RP-387 and analyzes it together with the Budget Code, procurement rules, and official fiscal indicators for 2019-2026. It is indicated that local budget revenues increased from 31.1 trln soum in 2019 to 76.0 trln soum in 2026, while local expenditures rose from 38.9 trln soum to 95.6 trln soum over the same period. The vertical fiscal gap therefore persisted at around 19.6 trln soum in 2026, despite revenue growth, and regulatory transfers remained a key equalization tool (Law No. 1105, 2025). At the consolidated level, 2026 budget revenues are projected at 515.4 trln soum, expenditures at 567.0 trln soum, and the overall fiscal balance at -59.9 trln soum, which is about 3.0% of GDP (BUDJETNOMA, 2026). These figures suggest that expanding local fiscal space without strict expenditure discipline would risk soft budget constraints, arrears, and non-priority spending. The article's main contribution is to show that RP-387 dd. 26.12.2025 (RP-387, 2025) should be interpreted as a dual reform package: revenue decentralization on the one hand and a discipline anchor, embodied in sections, on the other. Because the official post-reform time series is still short, the paper relies on descriptive quantitative diagnostics rather than causal econometric claims; however, it also formulates a panel-ready specification for future testing. The results imply that the effectiveness of revenue reassignment depends on transparent revenue assignment, commitment control, procurement integrity, and disciplined use of savings from staff optimization.

Key words: fiscal decentralization; intergovernmental transfers; hard budget constraints; local budgets; budget discipline; Uzbekistan; RP-387.

INTRODUCTION

Fiscal decentralization is not merely a question of moving money downward. It is also a question of incentives, accountability, and expenditure governance. When subnational governments rely heavily on upper-level transfers, they may have weaker incentives to expand their local tax base or to match spending decisions with sustainable resource envelopes. Conversely, if local governments receive more predictable own and shared revenues but do not face hard budget constraints, decentralization can generate overspending, hidden liabilities, and low-value expenditure growth. (Law No. 1105, 2025; Flynn & Pessoa, 2014).

Uzbekistan's 2026 reform wave is important precisely because it combines these two dimensions. RP-387 dd. 26.12.2025 expands the local revenue base through partial VAT retention and other additional local sources, while at the same time sections 13-15 prohibit financing gaps in protected spending categories, unauthorized staffing expansion, unfunded activities, non-tendered construction and repair works, and the accumulation of creditor debt. This combination makes the reform analytically richer than a simple tax-sharing adjustment. (BUDJETNOMA, 2026; Dougherty et al., 2024).

The core argument of this article is that revenue reassignment can improve local fiscal capacity only when it is combined with enforceable expenditure discipline. The article therefore treats RP-387 dd. 26.12.2025 as a dual reform package rather than as a revenue measure alone. The research question is the following: how can Uzbekistan expand local fiscal space without reproducing soft budget constraints, procurement leakages, and arrears at the local level? (BUDJETNOMA, 2026; RP-387, 2025).

LITERATURE REVIEW

The literature on intergovernmental fiscal relations emphasizes that fiscal decentralization is not limited to revenue reassignment, but also depends on expenditure discipline, accountability, and the institutional design

of subnational finance. Studies show that local governments achieve better fiscal outcomes when additional revenue authority is combined with stable revenue structures and credible budget constraints. In this context, revenue diversification is often viewed as an important source of fiscal resilience, although its effect depends on the structure of the local economy and the volatility of underlying revenue sources (Carroll, 2009; Yan, 2011; Faguet, 2014; Kornai et al., 2003).

Another important strand of the literature highlights the role of transparency and citizen participation in improving local fiscal governance. Research suggests that open budgeting, fiscal transparency, and participatory budgeting strengthen the legitimacy of local budget decisions, improve monitoring, and increase accountability in the use of public resources. Therefore, the effectiveness of local revenue strengthening should be assessed not only through revenue growth, but also through the quality of governance and expenditure control (Dowley, 2006; Esteller-Moré & Polo Otero, 2012; Manes-Rossi et al., 2023).

In the case of Uzbekistan, the existing literature discusses decentralization, local budget revenues, and participatory budgeting, but these dimensions are usually examined separately. Earlier studies pointed to the contradictions between formal decentralization and continued central control, while more recent works focus on strengthening local revenue bases, regional financial resources, and participatory budgeting practices (Noori, 2006; Jumayev, 2023; Imanova, 2024; Khamidov, 2025). However, limited attention has been paid to how greater local revenue retention interacts with hard budget constraints, procurement discipline, and commitment control. Thus, the main research gap lies in the insufficient integration of revenue reassignment, expenditure discipline, and institutional accountability within a single analytical framework. This article addresses that gap by examining local fiscal stability through both the expansion of local fiscal space and the institutional conditions required for disciplined and sustainable local budgeting.

RESEARCH METHODOLOGY

The article uses a mixed legal-institutional and quantitative policy methodology. First, it applies doctrinal analysis to RP-387 dd. 26.12.2025, Budget Code of the Republic of Uzbekistan, and the procurement framework in order to identify the legal logic of the reform package. Second, it adds descriptive fiscal diagnostics based on official budget figures for 2019-2026 and the 2026-2028 consolidated budget projections. Third, it uses indicator-based assessment to evaluate whether the reform addresses the structural drivers of local fiscal dependence.

The quantitative layer is intentionally compact. A fully-fledged econometric identification strategy would require a longer post-reform panel of regional fiscal outcomes, including own-source revenue, transfer dependency, arrears, procurement compliance, and protected-spending execution by region and year. Such an official panel is not yet available for the post-2026 reform period. For that reason, the article does not make causal econometric claims. Instead, it adds a quantitative strengthening of the argument through trend analysis, ratio diagnostics, and a future econometric specification that can be tested once more observations become available.

The baseline indicators used in this article are: (1) local expenditure-to-revenue ratio, (2) transfer-to-revenue ratio, (3) transfer coverage of the vertical fiscal gap, (4) local budget expenditure share in the consolidated budget, and (5) regional asymmetry in transfer dependence.

ANALYSIS AND RESULTS

Table 1 shows that revenue growth alone has not eliminated local fiscal dependence. Between 2019 and 2026, local budget revenues grew by about 144.3%, while local expenditures increased by about 145.8%. Over the same period, regulatory transfers grew from 7.8 trln soum to 19.6 trln soum. The expenditure-to-revenue ratio remained above 1.0 in every year, meaning that local expenditure assignments systematically exceeded the local revenue base. In 2026, the ratio will remain at approximately 1.26, indicating that local expenditures will be about 25.8% higher than local revenues (table 1).

Table 1. Local fiscal imbalance diagnostics, 2019-2026

year	revenue	Exp.	transfer	Gap	Exp/Rev	Transf/Rev %
2019	31.1	38.9	7.8	7.8	1.25	25.0
2020	30.3	35.4	5.1	5.1	1.17	16.9
2021	29.8	40.2	10.4	10.4	1.35	34.9
2022	43.0	57.2	14.2	14.2	1.33	32.8
2023	55.0	79.2	24.2	24.2	1.44	44.2

2024	58.1	74.9	16.8	16.8	1.29	28.9
2025	65.8	84.3	18.5	18.5	1.28	28.1
2026	76.0	95.6	19.6	19.6	1.26	25.9

Source: Official interbudgetary relations materials for 2019-2026 and (Law No.1105, 2025).

The transfer-to-revenue ratio also remained high. It was approximately 25.0% in 2019 and about 25.9% in 2026, peaking above 44% in 2023. This pattern indicates that, despite substantial growth in nominal revenues, the structural dependence of local budgets on balancing transfers has not disappeared. Equally important, transfer coverage of the vertical fiscal gap remained near one-to-one across the whole period, which means that transfers continued to function as the principal balancing instrument rather than as a residual or exceptional policy tool.

The 2026 consolidated-budget context further sharpens the problem. Local budget expenditures are estimated at 95.6 trln soum, equivalent to roughly 16.8% of the consolidated budget. By contrast, local revenues of 76.0 trln soum amount to only about 14.7% of consolidated revenues. The resulting local fiscal gap of 19.6 trln soum equals about 20.6% of local expenditures and about 25.9% of local revenues. At the macro level, the 2026 overall fiscal deficit of 59.9 trln soum is roughly 3.0% of projected GDP. In such a setting, decentralization without discipline would magnify both local and aggregate fiscal risk (Law No.1105, 2025) (table 2).

Table 2. Selected regional asymmetry in transfer dependence (2025, mlrd soum)

region	rev	exp	Gap	transfer	Transfer/ Revenue %
Namangan	3942.8	6171.2	2228.4	2228.4	56.5
Republic of Karakalpakstan	3346.3	5569.3	2223.0	2223.0	66.4
Andijan	4513.1	6693.1	2180.0	2180.0	48.3
Fergana	6027.6	8171.4	2143.8	2143.8	35.6
Samarkand	5915.3	8008.6	2093.3	2093.3	35.4
Navoi	3384.2	3476.7	92.5	92.5	2.7
Tashkent City	11108.5	11370.7	262.2	262.2	2.4
Tashkent Region	6824.3	7086.9	262.6	262.6	3.8

Source: Official interbudgetary relations materials for 2025.

Regional data underline the unevenness of fiscal capacity. In 2025, the largest balancing transfers were directed to Namangan, Republic of Karakalpakstan, Andijan, Fergana, and Samarkand, each receiving around 2.1-2.23 trln soum. By contrast, Navoi and Tashkent city required only 92.5 and 262.2 bln soum respectively. Transfer dependence was therefore not uniform. It reflected substantial differences in regional tax capacity and expenditure commitments.

This asymmetry matters for the interpretation of RP-387 dd. 26.12.2025. A single revenue-sharing rule does not operate on a neutral fiscal landscape. A 20% VAT retention norm in fiscally weaker regions may improve marginal fiscal space but is unlikely, by itself, to eliminate dependence where expenditure assignments remain structurally high. Therefore, the effectiveness of revenue reassignment should be judged not by nominal revenue growth alone, but by whether transfer dependence, financing gaps, and protected-spending risks begin to decline. (Law No. 1105, 2025; Flynn & Pessoa, 2014).

The central analytical contribution of this article is to interpret RP-387 dd. 26.12.2025 as a package that links fiscal incentives and budget discipline. On the revenue side, the reform widens the local resource envelope through VAT retention and other additional sources. On the expenditure side, sections 13-15 establish a hard-budget-constraint architecture. This includes the prohibition of financing gaps for wages, food, medicines, and utilities; the prohibition of maintaining additional staff without a normative-legal basis; and the prohibition of funding activities that lack identified sources or that bypass procurement requirements. (RP-387, 2025).

These prohibitions matter because they directly target the classic channels through which decentralization may fail. The first channel is protected-spending compression: when short-run fiscal stress emerges, politically easier items are often protected while essential items accumulate payment delays or shortages. The second channel is rigid current expenditure growth, especially through unjustified staffing expansion. The third channel is non-competitive contracting and unfunded construction, which generate arrears, cost overruns, and weak

value for money. RP-387 dd. 26.12.2025 addresses these three channels through enforceable local budget discipline rules. (BUDJETNOMA, 2026; RP-387, 2025).

From a public finance perspective, this means that RP-387 dd 26.12.2025 does more than shift revenues. It attempts to change local budget behavior. That is why the discipline provisions should not be treated as ancillary clauses. They are the institutional precondition that makes revenue decentralization fiscally credible. Without them, the reform could strengthen the revenue side while leaving intact the expenditure practices that generate soft budget constraints. (Law No. 1105, 2025; Flynn & Pessoa, 2014).

The evidence points to a clear policy conclusion: Uzbekistan's challenge is not simply to increase local revenues, but to convert additional revenue into credible and disciplined local budgeting. The quantitative indicators show that local revenues have risen substantially, yet the vertical fiscal gap has remained persistent. This implies that revenue decentralization, while necessary, is not sufficient. (BUDJETNOMA, 2026; RP-387, 2025).

Three implementation priorities follow from this conclusion. First, the article proposes a transparent revenue assignment dashboard that distinguishes between shared taxes, fully local sources, and balancing transfers, making it easier to monitor whether fiscal autonomy is actually increasing. Second, the treasury system should operationalize section 13 as a commitment-control rule, especially for wages, medicines, food, and utilities. Third, procurement discipline should be treated as a fiscal rule, because expenditure legality depends not only on line-item authorization but also on competitive and transparent contracting.

A fourth implication concerns staff optimization. Savings from redundant or low-efficiency staffing should not be automatically converted into new recurrent obligations. Their most defensible use lies in one-off infrastructure repairs, maintenance backlogs, and productivity-enhancing digital tools. This would align the reform with a spending-review logic rather than a simple internal redistribution of recurrent spending.

Finally, a credible reform requires monitoring indicators that go beyond nominal revenue growth. The article proposes that the Ministry of Economy and Finance and local councils monitor the expenditure-to-revenue ratio, transfer dependency, protected-spending compliance, procurement violations, and any re-emergence of creditor debt. Without such indicators, local revenue growth may appear successful on paper while fiscal risks continue to accumulate in practice.

CONCLUSION AND RECOMMENDATIONS

This article has shown that Uzbekistan's 2026 fiscal reform should be interpreted as a combination of revenue reassignment and hard budget constraints. The quantitative evidence demonstrates that local budgets entered the reform period with a persistent vertical fiscal gap: revenues rose from 31.1 trln soum in 2019 to 76.0 trln soum in 2026, but expenditures increased from 38.9 trln soum to 95.6 trln soum, leaving a 19.6 trln soum local financing gap still covered by transfers. At the aggregate level, the reform is embedded in a broader fiscal environment marked by a projected consolidated deficit of 59.9 trln soum in 2026. (Law No.1105, 2025).

For that reason, the main contribution of RP-387 dd. 26.12.2025 lies not only in the fiscal space it opens, but in the discipline architecture it imposes. Sections 13-15 are best understood as the legal mechanism that prevents revenue decentralization from degenerating into soft budget constraints, arrears, and non-priority expenditure growth. The article therefore argues that the success of the reform should be assessed by whether transfer dependence, financing gaps, and expenditure risk decline over time - not simply by whether local revenues increase in nominal terms. (RP-387, 2025; Budget Code of the Republic of Uzbekistan, 2014).

Future research should move from descriptive diagnostics to regional panel estimation once post-2026 observations become available. For now, the available evidence is already sufficient to support one central conclusion: revenue decentralization in Uzbekistan will be effective only if it is governed through transparent revenue assignment, hard expenditure limits, procurement integrity, and disciplined use of fiscal savings.

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