TAX ASSIGNMENT INFLUENCE ON BUDGETARY SYSTEMS

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The public budget seen as a balance for revenues and expenditures but also as the main financial instrument of governmental policies, does not reflects simply data, numbers or amounts of income or expenditure. The budget also reflects judgments on criteria, benchmarks and how they come to be included in a budget or another or the way revenues or financing costs from a budget that involves other budget components are targeted. From this perspective, our paper aims to identify the coordinates that relationships between system components are built on, regarding the budget revenues, including the effects of such endeavour.

Keywords: tax assignment, fiscal decentralization, budgetary systems, financial autonomy

Introduction

Intergovernmental fiscal relations are a component of primary importance for the public budgetary system, since it depends on the functionality of the essential links that are established between the public budgets. From this perspective, the revenue allocation of public budgets, along with the award of public expenditures, intergovernmental transfers system and regulation of local borrowing are the basic pillars of fiscal decentralization. Fiscal decentralization process is, for the transition countries in particular, an important component of administrative reform, conditioning through the design and promotion of the overall reform its results. For this reason, we intend to explore possible arrangements for the award of public revenues between public budgets in direct relation with their effects on the provision of public goods at different administrative levels.

Fiscal arrangements theoretical bases

Reasons underlying public budgets revenue allocation joins the issue of fiscal-budgetary policy, because decisions on public financial resources mobilised to the public budgets are in essence a result of the fiscal-budgetary policy decisions. It is recognized as a general rule that to central budgets are mobilized those revenues that have as a source activities throughout the entire state, while the local budgets concentrate resources from economic and social activities carried out within the perimeter of the administrative-territorial unit[189]. Also, it should be noted that income concentrated at central (federal) level come from a consistent base, resulting in substantial revenues, but they also have a more sensitive basis for settlement to economic conjuncture while revenue mobilized at local budgets come from sources that are less consistent, sometimes excessively "shattered", but more stable. We believe that a possible explanation for this customary way of promoting the relationships between the components of the budgetary system when it comes to its income part is the need for a coherent fiscal policy and a wider general political, economic and social one, to be designed as general directions at the central level in a uniform manner and completed within certain limits with decisions left to local authorities. Such a view results from the way some specialists consider the functions of the public budget and, implicitly, the role of central and local authorities. Musgrave expressed the idea that the involvement of authorities throughout the public budget should be "divided" into three functions (branches): macroeconomic stabilization, (equitable) income distribution and efficient resources

189 Filip, Gheorghe, Finanţe publice, Ed. Junimea, Iaşi, 2002, p. 43.

allocation[190]. With regard to macroeconomic stabilization, as a rule, this is a privilege of central authorities[191]. The reason for such an approach is represented on the one hand, by the need for coherent policies and, on the other hand, by the fact that local authorities, having limited territorial jurisdiction, cannot influence macroeconomic conditions.
In these circumstances, it can be considered that revenues source such as income tax revenue of enterprises or the progressive income tax for individuals are to be used as leverage to obtain the expected effects (macroeconomic stabilization), the first one because the profit fluctuates under the economic general conditions and the latter because of differential tax rates allow selective action. This would mean that these sources of income must be always assigned to the central authorities, not necessarily excluding the possibility that local authorities can raise some revenue through income taxes placed on individuals (of copyright, self-employed or seasonal, etc.). However, it is possible that these sources of income should be allocated to local authorities, but under a rigorous control of the central authorities. As a result, local authorities should be acknowledged the right to raise those revenues coming from less sensitive sources to economic conjuncture (taxes on buildings, land, means of transport etc.)
Similarly, the second aspect of the involvement of public authorities throughout public budgets as Musgrave suggests, meaning the (fair) redistribution income is usually associated with the intervention of central authorities, especially due the reason of a consistent approach to the whole society, eliminating the risk of creating distortions in the geographical allocation of resources by different actions of local authorities. In the progressive tax context, those who support higher tax rate may try to avoid charging a higher rate by moving to another administrative-territorial unit (fiscal jurisdiction). This movement reduces the original proportions (equitable redistribution) of the effects that are being watched. Under these circumstances, the author suggests the intervention correlated with the help of public expenditure (for social protection, for example), whose implementation is within the jurisdiction of local governments, but funding to implement them comes from the central level. We believe that the "danger" of mobility of high incomes and capital due to progressive tax rates set by local authorities remains only a potential one, because the decision to change domicile depends on other factors as well, in many cases more powerful than the tax rate (the family, culture, tradition, etc.). Therefore, allocation of income tax of individuals to local levels of government can bear equitable redistribution of income, being corrected, if necessary, with the intervention through forms of public spending (subsidies or aid to the socially challenged individuals).
The third aspect of the involvement of the public budget, resource allocation, aims at satisfying a part of the social needs by offering utilities (services) created with the help of public financial resources. Musgrave believes that the policies promoted at local levels (supported by local budgets) should allow for and reflect the various preferences of people living in a territorial administrative unit. Giving the right to mobilize resources locally is, from this perspective, more efficient than the central allocation (transfers), because local authorities have more specific information on residents' preferences than the central ones.
Following another milestone in the award revenues to public budgets, we believe that treating the issue of revenue mobilization without taking into account the issue of their use, it cannot be fully satisfactory. Thus, it is required that the services provided by public authorities be partially financed through taxes borne by recipients and not always offered for free. This way of promoting the supply of public utilities is likely to lead to an more responsible use of financial resources of the nation. The recipient who once forced to bear a share of service costs will give up the use of services which are not really necessary, services that he would be consuming if they

190 Musgrave, R., Musgrave, P., Public Finance in Theory and Practice, 5th Edition, McGraw Hill Book Company, NY, 1989, pp. 6-21.
191 Oates, W., Fiscal Federalism and European Union: Some Reflections, Societa Italiana di Economia Publica, 2002, http://www.unipv.it/websiep/wp/132.pdf, p. 2.

were free of charge. Also we believe that establishing a link between income and funded service (only for services that allow it), such as taxes on vehicles or road taxes included in the price of fuel, is beneficial in the context of the measurement of a cost-benefits analysis results[192].

From the perspective of the link between the mobilized financial resources and the effects of public spending financed by their account, the central authorities should mobilize revenues for those public utilities which have a wide national resonance (e.g.: defence, external affairs etc.) and that practically cannot be offered by local authorities. Similarly, the decision on the right of mobilization of revenue available to the public authorities should take into account that these offers limited services at the level of administrative-territorial unit.

The issue of delimitation of the right of mobilization of financial resources between the various levels of government or public authorities may not however be limited to a review of the alleged economic matters, because specific decisions must take account of other reasons, such as local autonomy and fiscal competition.

First, a rational division of the rights over sources of revenue between central and local authorities is to ensure the control of the latter over its own developments regarding tax and even, according to some authors, "fiscal sovereignty". But it also should be noted that from the perspective of the overall functionality of the public budgetary system, a very strict demarcation can create major vertical and horizontal imbalances and fiscal sovereignty should not be seen as a support of a possible financial independence of local communities just for this reason. Only the discretionary power of subnational authorities must be limited to those revenues which they may establish (independently) in relation to services provided and not extended to all incomes of local budgets. It is important that local authorities should receive benefit from their own resources to finance public services, whether they come from mandatory contributions even established at local level or left it here by central authorities, whether they enjoy these resources in addition to balancing grants (unconditional) from the central authority, granted by a formula that ensures medium or long term predictability. In addition to these two possibilities, balancing revenue can be transmitted (for certain actions to be financed) under certain conditions by the central authority, local autonomy being somewhat diminished.

Where local authorities are recognized the right to establish local taxes and to determine their level, there is the possibility of obtaining marginal income, excluded if practicing revenues sharing between levels of government. A real financial autonomy is exercised only when local authorities can control their “own” income levels.

Another landmark for consideration in establishing the relationships between public budgetary system components is the subsidiarity in taxation. As a requirement imposed by the Maastricht Treaty, subsidiarity means that the decision be taken at the level of government closest to citizens, provided that such an approach does not lead to major distortions. Applied to tax assignment, subsidiarity requires that a tax should be raised from the lowermost administrative level can implement it and is not going to be inadequate. Such an approach would minimize any vertical fiscal imbalances due to the fact that many subnational authorities have difficulties in the implementation of taxes, while the central (federal) can implement any kind of tax (even if it is traditionally regarded as "local taxes").

Another aspect that should be discussed in connection with the fiscal arrangements is local accountability and fiscal competition between municipalities. Accountability requires that assignment of revenue sources to local authorities to be made so as to get the authorities interested in obtaining new sources of income, to identify, to stimulate and to exploit them. Competition implies that capital holders will invest where the size of the tax determined by the size of local benefits exceeds their costs incurred in the local budgets (or is very close to it) and

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192 Moşteanu, T., Iacob, M., Fiscal Federalism, Theoretical and Applied Economics, 2007, vol. 11, p. 21, http://econpapers.repec.org/.

will channel resources to other local jurisdictions, where this relationship is more beneficial. Similar, but not only for the stated reason, workers may carry out work in other administrative-territorial units than those in which they live, but consuming public utilities (at least partially financed by the state) where they live (e.g.: children are receiving education in administrative-territorial unit where domiciled and not where they parents work and pay taxes). These issues are likely to have some shortcomings in the economic and social development of local communities, by the lack or the decreasing of investment, unemployment, etc. Also, similar to mentioned phenomena require a wider involvement of authorities (for example, to support disadvantaged categories), which will lead to an increase in public expenditure, entailing greater imbalances.

Alternatives of public budgets revenue allocation

In relation to the landmarks treated above, we conclude that there cannot be an optimal method, an universally valid tax assignment between the public budget system components, but we can identify several possibilities, taking into account how the decision-makers (the central authorities) place more emphasis on some of the judgements shown above.

To construct alternatives of allocation of financial resources to the components of the public budgetary system, we take into consideration the following reasons:

- Which level of government decides from which charges the local authorities will obtain income?
- Which level of government establishes the settlement of tax?
- Which level of government sets the tax rate?
- Which level of government administers the tax in question?

Compared to the degree of local financial autonomy, the ability to set rates (quotas) of the tax is the most important aspect because it enables local authorities to autonomously establish the level (size) of public utilities offer. Be noted that local authorities cannot be left with the absolute choice to set the required contributions needed to be mobilized, since it would create failures for the entire budgetary system (for example, if local authorities would raise customs duties). Similarly, an excessive discretion in determining the tax base or revenue management can create an undue administrative complexity and disparities or distortions in resource allocation.

Therefore, as a first possibility of substantiation of the relationships between the central budget and local budgets concerning the revenue sector we may have achieve the highest degree of financial autonomy for local governments. Such an approach will allow local governments to choose the taxes they impose, to determine the tax base and the tax rate and to administer the revenues obtained. The most convincing example for such an approach is, in general, the federal state that specifically gives a broad autonomy to subnational authorities, especially in the U.S., where the federal states have almost unlimited possibilities for a decision on the four aspects previously discussed. However, we emphasize that such an approach taken to extremes can create failures, because some authorities may establish fees radically different from those established by other authorities (for example, in some jurisdictions to determine taxes on retail while in other VAT), define the tax base in radically different ways or administer the same charge in different ways. Within certain limits, the inequities and economic distortions created may be admitted if decentralization is to benefit, but in a situation where they record increased levels, central authorities must intervene by setting common rules (e.g.: for assessment of the tax base). This happened in the U.S. in 1957, when was proposed the adoption of the federal act that included rules for assessment of corporate income tax, which is presently applied (with some changes) so far in 25 states. Even so, it can still be found substantial differences in the taxation of profits between federal states; the act in question is not quite comprehensive. The situation is similar in the case of taxes on sales, where each of the 46 U.S. states (including DC) defines the tax base in full freedom.

A second choice for substantiation of the relationship between public budgetary system components related to revenues which can be promoted in parallel with the first option presented, in order to avoid its potential negative effects, is enabling local authorities to collect such called "extra-quota" taxes due to some central budgets (surcharges). In this case, the top authority sets the tax base and collecting both its own revenue, as well as those from additional allowances established by local authorities due to budgets managed by them. Basically, the situation may be diametrically opposed as well, in the sense that subnational authorities can mobilize and manage additional-quotas added to central taxes previously raised by local authorities. An example can be found in Germany, where resources from value added tax (income entitled to federal state) are administered by the Länder[193]. Practicing additional quotas due to the central budget from local authorities has the effect that the latter have the power considered most important from the perspective of financial autonomy (setting tax rates) and top authorities will define the tax base in a global/unitary manner and they will manage in a similar manner the mobilized resources, avoiding the shortcomings of the first option exposed. An essential element for additional quotas practice is that, in general, it should be established "jurisdiction" of the taxation of income. This is a relatively simple thing in the case of taxes such as tax on wages, but it is more complicated if the taxation of income represents profits. This occurs because corporate income is obtained from a wider area (market) of territory, which includes several jurisdictions, but without being able to monitor and impose in a distinct manner the corresponding "parts" of income. For such a situation, the literature has been advanced as a possible solution the creation and application of a formula that divides the tax base between jurisdictions, but without reaching a concrete result. However, we think that this solution is not entirely impossible, and it may be fully satisfactory, as it should be based on variables of orientation (e.g.: average income per capita, population etc.) without being able to exactly quantify the “part" of profit that should become tax base for a certain jurisdiction.

A third option for substantiating the relationship between public budgetary system components regarding the choice of sharing some taxes between various components of the budgetary system. This possibility is considered[194] less attractive to local authorities than the previous because they would have fixed proportions of income from central budget, without the possibility of any influence regarding the amount of these incomes. In most cases, the shares of revenues of the central authorities that would be allocated to the budgets of local authorities are established without any distinction for the latter. The advantage of such ways of delimiting the relationship between budgets is that of absence of extreme differences as exposed in the first option. Certain independence is registered in determining the sources of income by local authorities but also local financial autonomy is restricted. Although local authorities have the freedom to decide how these resources will be spent, they cannot influence the size (the amount of) mobilized resources, so that they cannot control the size of any future local expenditures. Moreover, especially in less developed countries or transition countries (Romanian case)[195], the amount of such income is not predictable, even for shorter terms, preventing the application of consistent and continuous local policies. However, in developed countries, the experience shows that trough the collaboration of all subnational authorities it can be achieved a certain stability both on tax sharing (and hence, predictability) and also on reconsideration of the amount of revenues shared between various levels of governance and budgetary components managed by them.

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193 Hoorens, D., Local Finance in the Twenty Five Countries of the European Union, Dexia Editions, 2004, p. 31-45.

194 McLure, Ch., Vazquez, J.M., The Assignment of Revenues and Expenditures in Intergovernmental Fiscal Relations, www.worldbank.org/decentralization, p. 13.

195 Oprea F., , Lazăr, S., Local Financial Autonomy In Romania: Challenges And Options For Reform”, CD of the VI International Scientific Conference “Management, Economics and Business Development in the New European Conditions”, Brno, 2008, p. 9.

The last option for substantiating the relationships between central and local budgets reveals the choice for some revenue sharing, using a distribution formula based on variables such as the average income per capita, population, fiscal capacity, public establishments etc. Unlike the options discussed above, this time there is not connection between the origin (place of origin) of the tax base and the entity that is receiving the revenues from taxation, but it is done simply a redistribution of resources among different authorities subnational. Thus, there is a more direct way to report the level of incomes that will come from local authorities budgets and their general needs, not only to their economic situation. Such a way of substantiation of the relationship between the components of budgetary system implemented without adequate "corrections" may have some negative effects. One of this is the lack of participation or interest of local communities with a weak economic development in obtaining new sources of income. On the other hand, from the perspective of provided financial autonomy the only freedom of local authorities is to decide how they will use these resources. For this reason, we believe that the redistribution formula should include an index of weighting tax efforts' that will reflect the size of the marginal revenue derived from their own sources of income.

Conclusions

In conclusion, one can appreciate that the foundation of the most balanced relationships between the components of public budgetary system is the additional fixed-rates established by local authorities for some taxes of central authorities, placing it at the intersection of local autonomy requirements with the need to avoid major imbalances or distortions.

Any way of background to these reports, however, leaves room for the emergence of horizontal or vertical fiscal imbalances (between levels of government or between components on the same level). Vertical imbalances are determined by the fact that some taxes have to be administered by central authorities (such as VAT) and horizontal imbalances have as source different economic realities that local communities are confronted. It is obvious that the size of tax base determines, in an objective manner the level of resources that can be mobilized, especially that the setting of higher tax rates for less economically developed communities, in order to obtain higher returns would be an action with adverse effects. Thus, the only relevant solution is to implement a system of equalization grants from the central budget to local ones, designed to also reflect the efforts of local communities for obtaining additional incomes.

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