

# The Role of Decentralization in the Formation of the Budget System in a Federal State

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## Summary

The article analyses the opportunities of budget decentralization in the light of forming and functioning of local self-government system. The author presents factors, determining a correlation between centralization and decentralization. Great attention is paid to the principles of expenditures responsibilities demarcation, to the problem of fixing tax revenues and to variants of regulation of vertical and horizontal inequalities in state budget system. The article exposes the role of local self-government as basis of federal state system. In conclusion, the author proposes a revenues structure on local and regional level with variant of local taxation system.

**Key words:** federalism, budget decentralization, vertical and horizontal inequalities, budget revenues and expenditures, local self-government, local budget, intergovernmental fiscal relations.

**JEL Classification:** H61, H71, H72.

## 1. Introduction

The essence of the federal structure of the state can be reduced to the opportunities for its subjects to make their own decisions as an independent entity within the framework of a single state. This ensures the achievement and preservation of national unity

and the relative independence of the federal subjects with their legal equality in relations with the federal center. The federal government offers the most robust and flexible mechanism for coordinating the interests of the center and the regions, motivating the subjects of the federation for the preservation of national unity.

In a federal system of government the activities of the regional authorities are built taking into account local conditions of socio-economic development, and accountability to the local population, from which the power is mandated. This distinguishes it from a unitary system, which is characterized by decision-making by the central government without adapting the decisions to local conditions and regional authorities accountable to central government. The differences in the principles of accountability provide important background for the organization of a regional control in federal state structure in comparison with unitary system.

Federalism creates prerequisites for the effective organization and functioning of finance at various levels of government, including the budget process. The practice of management of the public finances in a country with few budgetary levels is called fiscal federalism. Its essence lies in the effective functioning of the organization and interaction of the budgets at all levels, providing the interests of all participants in the budget process.

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The article deals with the principle of decentralization, which is the basis for budget federalism. Particular attention is paid to the ratio of centralization and decentralization in public administration. In addition, we consider the principles and criteria for the distribution of revenue and expenditure responsibilities, as well as features of the distribution of transfers for sub-federal budgets. And finally, we outline the basic principles of the structure of local taxation system.

## 2. The Principle of Decentralization - the Basis of Budget Federalism

The basis of the existing models in the world practice of fiscal federalism is the principle of decentralization, which is reflected in the form of government; in the structure of the federal, regional and municipal law; in the schemes of distribution of powers between different levels of government and in the construction of uniform, but multilevel fiscal systems.

Decentralization has both advantages and disadvantages, which are identified by comparing the social costs and benefits. It should be borne in mind that if the decentralization does not affect the costs, the decentralized control is more effective, or at least it is not inferior from the point of view of efficiency. Decentralization is effective, if the rise in costs is covered by profits.

Fiscal decentralization is designed to achieve two main objectives: to improve allocative and productive efficiency of the budgetary system. By decentralizing public services, they can be organized to provide in such a way as to best suit the preferences of local residents, providing an increase in allocative efficiency or quality of the sharing of resources between their allocations. Along with this, decentralization is accompanied by increased productivity of the budget system, ensuring accountability

of local authorities to the population. Also the number of instances, in which solutions have to be coordinated, is reduced, as more powers are given to local authorities, which better know the local context and local needs.

Thus, decentralization in its broadest sense involves the transfer of greater powers to local authorities, so that they can make their own decisions on the formation of revenue, expenses, and legal regulation. Local authorities are closer to the people, know better their needs and thus are able to meet their needs better than the central government. The proximity of the local authorities to the population also contributes to increased civic participation, transparency, and increased government accountability to the public.

Another important argument in favor of decentralization is the fact that the various public goods have unequal coverage. For example, the services of national defense are enjoyed by citizens of the country, and the benefits of inland waterways or the availability of forest goes only to residents of specific regions. Public services, such as garbage collection and disposal, street lighting, etc., are addressed to residents of specific communities, and the need for them is different in various regions. Since the central government cannot account for such a variety of preferences in each region or country, the production of various public goods should be carried out by the different levels of government. This means that for the lowest level of government all the tax (revenue) expenditure responsibility and authority for statutory regulation should be secured, with the exception of those powers for which convincing evidence that fixing them for the lowest level of government is inefficient may be presented. Provision of public goods only by institutions under the central government is associated with

significant costs for a uniform approach to all areas (in some areas there will be an overproduction of public goods, in others - their underproduction) [Oates, 1972; Tanzi, 1996]

An important advantage of decentralization is the fact that the proximity of the local authorities to the population and the frequent interaction between them allows the creation of channels of communication through which citizens can express their interests. Moreover, such a regular and active communication increases the accountability of local governments to their citizens. Administrative autonomy creates preconditions for learning, finding new approaches to improve the overall quality of governance. Decentralized systems are able to provide greater stability, as local autonomies limit the ability of the central government to conduct fiscal or monetary policy at its discretion. Decentralization contributes to maintaining markets and stimulates their development. Finally, the decentralized decision-making process allows to evaluate the different options for solutions, encouraging the spread of best practices. In this case, it is essential that the powers transferred to the level that can really hold any necessary actions is interested in their results [Khaleghian, 2003; Bahl, 1999].

It should be pointed out that substantiation of decisions about the decentralization of funds in the budget system requires complete and reliable information about the territorial structure and intensity of financial flows. It comes to developing territorial context of revenues and expenditures of the federal and regional budgets, provides an estimate of "upstream" and "downstream" of funds in the hierarchy of the administrative-territorial system of the country. These data help us to understand how much tax revenue comes from each particular area in the federal, regional and local budgets, and, conversely, how much of this budget

is spent on the same site. On the basis of this information one would be able to evaluate the financial self-sufficiency of each territory and its ability to independently provide its own development. Only these assessments will provide solutions for each territory, individual in content, but based on the general rules for the provision or failure of financial support.

Local authorities, having autonomy, on the one hand, get more stimulus to increase revenue within their competence, but they cannot cross certain boundaries of accumulation of resources in view of the openness of the economy [Shvetsov, 2006]. On the other hand, they are spending money more efficiently, because they depend on the taxpayer, and are able to more accurately determine the local needs for public goods and the efficient use of infrastructure capacity gained.

Generally, the effective functioning of fiscal federalism is possible if the decentralized decision-making relates to the delivery of those public goods whose benefits are mainly localized in the area and localization benefits are substantially aligned with the spatial localization costs; also, preferences related to local public goods, mostly differ between regions than within regions.

### **3. Effective ratio between Centralization and Decentralization**

A point of interest is a position, put forward by John Wallace and William Oates about the relation between centralization and decentralization in government, one of the most important levers of which is the budget system. According to these researchers:

- the larger the area of the country is, the less centralized, all other things being equal, should governance be (area factor);
- the larger the population of a country is, the less centralized governance should be (population density factor);

- the higher the proportion of the population concentrated in urban areas, the less centralized state and regional management should be (social infrastructure factor);
- the higher the level of per capita income, the more centralized governance and its participation in programs related to the redistribution of income should be (factor of investment depending on the state of the economy);
- the more diverse the demand for public services is, resulting from the unequal distribution of income across regions, the less centralized, all other things being equal, governance by the state and the regions should be (the factor of social dependence of the state of the economy) [Wallis, Oates, 1988].

In the light of all this, it can be argued that the impact of fiscal federalism is determined primarily by approaches used to consolidate expenses, income-fixing and organizing the movement of funds between the various levels.

### 3. Distribution of Revenue and Expenditure Authority

As the basis of the separation of powers between the expenditure levels of the budget system a set of principles is usually set forth:

- territorial compliance (consolidation of public services for the same level of power, whose jurisdiction covers essentially all consumers of these services);
- subsidiarity (as close as possible to those territorial entities that provided budget services in the public interest);
- proportionality (matching of spending authority to financial resources of various levels of the budget system);
- economies of scale (amount of costs is much better when larger quantities are carried, wherein the provision of public services is assigned to the same level of

- power that can most effectively ensure the implementation of appropriate services);
- taking into account the external effects (the reasons for the higher centralization are high interest of the society as a whole in the proper implementation of the individual regions / municipalities of its obligations and higher overall costs of their possible failure).

Obviously, making decisions about the division of expenditure responsibilities requires a comprehensive approach that addresses all of the following principles.

Fixing revenues (primarily taxes) in accordance with the budget expenditure to a certain extent is of key importance. In general, three options of fixing tax revenues are known [King, 1992; Batkibekov et al., 2000].

In accordance with the first one a local government gets all the tax revenues generated on the territory under its jurisdiction. In this case the revenues should be transferred to a higher level of fiscal systems in order to meet the expenditure obligations of the national government.

A weakness of this option is the possibility for reducing the effectiveness of inter-territorial redistribution of income, as well as restrictions to ensure fiscal stability. In addition, it can create inappropriate incentives for local authorities in respect of the financing of national expenditure commitments.

In contrast to the first option for distribution of tax revenues, the second one involves the consolidation of all the taxes for the national government with the subsequent transfer of funds to lower-level authorities by providing grants or other transfers, either through the establishment of standards for deductions of income for all or certain taxes to the budgets at lower levels.

This option also has some drawbacks, the main one of which is the lack of correlation between levels of government, vested with

the adoption of the spending decisions, and the region within which certain taxes are collected. This undermines the basis for an effective system of intergovernmental relations. Without establishing such a relationship there is the possibility to exceed either the finance the local expenditure needs or unjustified decline in financial resources transferred to the lower levels of the budget system. Both can lead to the inability to create a stable system of financing public services at the local and / or regional level.

The third version of the distribution of revenues gives some of the taxing powers to local and regional authorities, and if necessary - compensation for the missing revenues either by the share consolidation of regulatory taxes or by transfers to the local budget.

This option, which is in-between the two previous ones, is largely free from their shortcomings, as it allows the assignment of taxing powers to the lower levels of government, thus linking the value of the

tax burden and the expense of the received outcomes. However, in their action the local authorities are guided by considerations related to "cost-benefit" analysis, which leads to an increase in economic efficiency. The implementation of this option for the distribution of income, however, requires a coherent selection of taxes belonging to local / regional authorities (local / regional taxes), and the share of federal taxes to the regional / local budgets (shared taxes).

The problem of the distribution of tax revenue is not limited to the full consolidation of specific taxes for local, regional or national level of government. The most often preferred one is a combination of different schemes of fixing tax revenues and tax authorities.

The understanding of the different types of government revenues at a lower level is given in Table 1 which shows that tax revenues of subnational governments can take many forms: own taxes, which are fully credited to the budget of the relevant authority, which has the right to determine

Table 1. Types of fiscal autonomy of subnational governments

Type of lower level of budget revenues	The level of authority to control the revenue
Own taxes	The power to determine the rate and tax base belongs to the authorities at the appropriate level
"Crossed" taxes	The tax base is determined by federal law, the authority to determine the rates belongs to the authorities at the appropriate level
Regulators (shared) taxes	Rate and the tax base are determined by federal law, but a fixed percentage of tax revenue is credited to the budget authority at the appropriate level (aspect ratio can be calculated both on the basis of the share of tax revenues from the territory under the jurisdiction of the authorities at relevant level, and on the basis of other criteria - population, expenditure needs, revenue potential)
Non-purpose transfers	Share or transfer amount is determined by the central government, but the authorities - the recipients of transfer have the right to determine the direction of spending. In some cases, the amount of transfer tax may depend on the tax efforts of the recipient
Targeted transfers	Transfer amount is determined by the central government, authorities - the recipients are required to spend their money on certain programs

Source: [Batkibekov at al., 2000] p. 91.

the tax rate, and in some cases - to influence the procedure for calculating the tax base, and "overlapping" taxes, the base of which is determined by federal law for the entire country and subnational authorities shall have the right to set their own tax rates. [Batkibekov at al., 2000]

The issue of fiscal autonomy of subnational governments depends on their expected role in the economic system of the country. If the economic role of the administrative-territorial units is reduced to the practical implementation of the policies formulated at the highest levels of government, there is no need to provide them with a broad fiscal autonomy. If, on the contrary, it is expected that subnational governments will implement their own spending programs, as well as the independent determination of the amount and quality of the appropriate level of public services, their inability to change the tax rate, and therefore - the amount of budget revenues, is a serious problem arising from the mismatch of expectations, needs and aspirations of the public authorities of the actual revenue opportunities [Batkibekov at al., 2000; Polyak, 2009; Panskov, 2010].

#### 4. System of Grant's Distribution

The use of these schemes of the distribution of tax revenues and spending obligations may lead, however, to the emergence of vertical and / or horizontal imbalances. Vertical imbalance is possible in case of discrepancy between its revenue and expenditure responsibilities at different levels of the budget system and the horizontal imbalance occurs during the differentiation of its own fiscal capacity of subnational governments at the same level of the budget system. To eliminate these imbalances a variety of mechanisms of transfer or borrowing are usually used.

The transfer of resources from one level of government to another budget is carried

out usually in two ways - through a system of revenue sharing and grants. In this case, revenue sharing can have a number of options such as the division of the tax base or the centralization of tax revenues and their subsequent distribution according to selected criteria.

Allocation of grants may also have two types - non-targeted and targeted transfers, each of which can, in turn, be allocated as a fixed amount or as renewal, be conditional or unconditional, and stand out with co-funding. The selection of a particular allocation mechanism of intergovernmental transfers depends on the objectives of economic and fiscal policies in a given time.

In general, there are three possibilities of the state policy in the field of intergovernmental transfers to align the vertical and horizontal imbalances [Batkibekov at al., 2000; Shvetsov, 2006]:

The use of separate mechanisms align the vertical and horizontal imbalances. Subnational budget deficit alignment is performed by dividing the tax revenue and allocation of transfers from the national budget, while the alignment of fiscal potential is produced by the horizontal payments from regions with high budget level to the regions with low revenues. A similar system is used in the Federal Republic of Germany.

The complex system of equalization transfers. Both vertical and horizontal imbalances are aligned with a unified system of equalization transfers and special grants. A similar approach is used in budget systems in Australia and Canada.

Only the vertical alignment of the imbalance of the budget system. As with the first version of the budget policy, subnational deficits are aligned with the fixing of regulatory taxes and equalization transfers, but there are no specific

measures to equalize the horizontal imbalance. In this case, the movement of capital and labor arises as a result of the difference in revenues in sub-national entities, as well as the net fiscal benefit to the regions (the net benefit of public expenditures and taxes paid). Under this option, fiscal policy may allocate special grants that, among other purposes, can have horizontal leveling effect. This approach is widely used in the USA.

In addition to establishing a relationship between the objectives of the horizontal and vertical alignment of imbalances in the design of the transfer system, it is also required to determine the relationship between the types of transfers. The latter, as mentioned, can be either conditional or unconditional or targeted and untargeted transfer. Conditional transfers are grants, provided on the condition of co-financing, the simple purpose transfers and block grants, each of these types of transfers, in turn, can be allocated as a fixed amount, and with the possibility of extension. Unconditional transfers are allocated in the form of deductions from income tax in the sub-national budgets or in the form of direct transfers as a fixed volume or to be extended.

The construction and functioning of budgetary systems in the federal structure of the state shows that the distribution system transfers must meet the following criteria [Batkibekov et al., 2000; Bukhvald, 2012; Leksin, 2006]:

First, you need to avoid a situation where equalization transfers just cover the gap between revenues and expenditures of sub-national budgets. The distribution system of transfers should be built in such a way that sub-national authorities have not been able to influence the size of the transfer by its solutions in the area of spending policy, tax policy and tax administration.

Second, the application of the system of equalization transfers should not be accompanied by significant costs for the collection and processing of the initial information.

Third, the development of methods of distribution of transfers is necessary to involve representatives of the regional government to reach a political consensus in this area, in the absence of which the system will be ineffective. As a result, there can be a subtle change in the principles of horizontal and vertical alignment in order to avoid sharp fluctuations in the fiscal situation in the regions.

As a result, there should be incentives to conduct rational and responsible fiscal policy, to expand its own revenue base and for efficient use of public funds for the benefit of the local population.

The establishment and operation of an effective system of intergovernmental relations is ultimately aimed at:

- improving the standard of living, social security and ensuring equal access of the population to the public (budget) services and social guarantees throughout the country;
- ensuring the sustainable economic development with the optimal use of fiscal and resource potential of certain areas and the country in general;
- strengthening of government and territorial integrity of the country, preventing the emergence of centrifugal tendencies and conflicts between different levels of government over the allocation and use of resources of the national budget system, the creation of conditions for the development of civil society.

Thus, the purpose of intergovernmental relations is to ensure consistency between revenue and expenditure in the budgets of different levels in cases when its revenue is insufficient to cover the necessary budgetary expenditure.

### 5. Local self-government - the weakest link in the system of power in Russia

The problem of determining and strengthening the revenue base of local budgets remains one of the most acute and urgent element in the inter-budgetary relations in the Russian Federation at the present time. This problem requires a reform of relations not only between the Centre and the Federation, but also relations within the Russian Federation. Without effective local self-government, a country like Russia, with its enormous territory and huge differentiation conditions, is unable to develop successfully in both the short and long term. The budgets of local self-governments finance spending on health care, culture, high school education, kindergartens, public services, housing maintenance, agriculture and fishing, environmental protection. The structure of municipal budgets expenditure (by their main types, i.e. urban districts, municipal districts and settlements) in 2015 in Russia on average is shown in Table. 2.

As can be seen from Table. 2, the main items of budgets expenditure in municipal districts and municipal areas are education

and social policy. The largest share of municipal budget expenditures are housing and communal services.

In developed countries with well-functioning systems of intergovernmental fiscal relations, local budgets, as a rule, are not running deficits. The Russian system of inter-budgetary relations is characterized by the practice of setting fixed revenues at federal level above the level of fixed expenditures. Therefore, domestic government spending on education, health care, social policy, and other items, are laid down at the lower levels of the budget system. The situation at the subnational level is the same. As a result, local governments are the most vulnerable link in the budgetary system of the country and unable to adequately complete their mandate.

The situation in Russia, where the share of tax and non-tax revenues to municipality budgets account for about 20%, and the rest are financial resources of higher-level budgets, represents a significant deviation from a condition characterized by fiscal autonomy of local governments. The quality and completeness of financial support of municipalities are seriously affected by the volatility of the federal budget and

Table 2. Local self-government - the weakest link in the system of power in Russia

Expenditure items	Urban counties	Municipal districts	.
General state issues	7,65	7,82	23,10
National defense	0,01	0,09	0,63
National security and law enforcement	0,75	0,44	1,55
National economy	11,80	6,11	14,87
Housing and utilities	13,31	6,57	36,17
Environmental protection	0,11	0,07	0,10
Education	50,23	57,69	1,40
Culture, Film	3,50	4,49	15,21
Health care	0,69	0,44	0,01
Social policy	8,57	9,35	1,62
Physical training and sport	1,92	1,27	2,95
Mass media	0,20	0,18	0,12
Other expenditures	1,27	5,48	2,25

Calculated by the author according to the official website of the Federal Treasury [www.roskazna.ru](http://www.roskazna.ru)



tax legislation that changes annually. This situation does not encourage the area to develop revenue sources assigned to them. A similar picture can be seen at the municipal level. As a result, the state regional policy in the Russian Federation in relation to the level of local authorities has got the following features:

Firstly, insignificant own revenues of local budgets allow them to meet only the current needs of municipalities. This prevents adequate implementation of their own powers, including the development of housing and communal services, education, health and other aspects of the social sphere.

Secondly, the lack of funds in the regions does not allow them to invest in development and improvement of objects of social infrastructure, housing and public utilities, etc.

Thirdly, effective and full implementation of the reform of local self-government, once again encounters the lack of allocated funding.

Also there are problems associated with a large number of subjects of

intergovernmental relations, the status of municipalities and large differences in the approaches to the formation of the local budget revenues.

Revenues of local budgets vary greatly depending on the types of municipalities. At the same time in connection with significant differentiation of socio-economic development of the municipalities' tax revenue distribution by types of municipalities is carried out very unevenly. Thus, urban districts budgets accumulate about 65% of tax revenues, municipal budgets - 30% and rural districts budgets – only 5%.

Tax and non-tax revenues in the budgets of urban districts in the Russian Federation take on average 43.31%, gratuitous receipts account for more than half of budget revenues. Non-tax revenues in the budgets of urban districts account for about 11% of aggregate revenues (Table. 3).

The structure of revenue budgets of municipalities and towns is comprises different items. Thus, the share of tax

Table 3. Structure of revenues of municipal settlement's budgets in 2015, %

Revenues items	Urban counties	Municipal districts	Settlements
<b>TAX AND NON-TAX REVENUES</b>	<b>43,31</b>	<b>25,20</b>	<b>48,47</b>
<b>TAX REVENUES</b>	<b>32,41</b>	<b>19,28</b>	<b>41,09</b>
Income tax	20,10	15,42	15,21
Uniform tax on imputed income	3,14	1,59	0,01
Uniform agricultural tax	0,16	0,18	0,58
The tax on property of individuals	0,87	0,00	2,55
Land tax	5,50	0,01	19,02
<b>NON-TAX REVENUES</b>	<b>10,90</b>	<b>5,92</b>	<b>7,38</b>
Revenues from the use of state and municipal property	5,87	2,98	4,29
Revenues from the sale of tangible and intangible assets	2,37	1,04	1,85
<b>GRANTS</b>	<b>56,69</b>	<b>74,80</b>	<b>51,53</b>
Dotations	4,62	10,95	19,13
Subsidies	15,11	14,33	18,08
Subventions	34,40	45,32	1,11

Calculated by the author on the official website of the Russian Federal Treasury [www.roskazna.ru](http://www.roskazna.ru)

and non-tax revenues in the budgets of municipal areas is much smaller and amounts to about 25.20% of total revenues. The bulk of budget revenues in municipal areas - 45.32% - is allocated for subventions. This high figure is due to the transfer of central powers and the powers of smaller settlements to the municipalities. Part of this process can be evaluated as an attempt to rectify the separation of federal legislator powers between different levels of the budget system. Gradually the model of "dependent" municipal district is formed: dependent in the performance of its own powers from grants and from additional (differentiated) regulations on tax deductions, dependent on subsidies granted during the exercise of delegated authority. As for delegated powers, the local governments execute them within transferred subventions.

The revenues of urban and rural settlements account for more than half of gratuitous receipts (51.53%). Grants and subsidies constitute the major share in the structure of gratuitous receipts in the budgets of the settlements.

The practice of fixing differentiated rates of contributions from regional taxes on long-term basis to local budgets, used in many areas nowadays - is an imposed measure, due to the sharp discrepancies in the economic development of the territories. Another negative aspect of using differentiated charges regulations is reducing the value of predictability of revenue sources of local budgets, because these deductions are changed every year, and the final regulations governing tax deductions from the local budgets in some areas do not reflect the real needs in them [Lobkin, 2007].

The adopted version of the consolidation of the municipal budget and the status of the major cities with

the capital cities of the Federation (first of all cities with a population of 1 million people or more) should be regarded as a major miscalculation. This decision is contrary to the basic hypothesis of the reform setting out that is in the course of ongoing reforms local governments should be brought closer to the people. In some regions of the Federation 35-40% of the population will live now in a single municipality (the regional capital), and the rest (almost the other half of the population) - at about 300-400 more municipalities [Bukhvald, Trukhov, 2006]. In addition, one can doubt the very principle of a universal regulation and management of expenditure liabilities as in towns (with 30-40 thousand inhabitants) as in megacities on local issues.

Another problem highlighted by the municipal reform is related to the weakness of local government personnel. Everywhere there is a shortage of qualified managers, economists and lawyers, as well as specialists able to competently carry out the work on the formation of databases, including the collection, processing and analysis of social, economic and other problems.

The disadvantage of the reforms in the sphere of local self-government is the removal of the structure of complex local problems of the socio-economic development of the municipality. Municipal property may be used to address issues of local importance, ensuring the activities of the authorities and employees, as well as the performance of certain state functions. It consists in the withdrawal from municipal property of their so-called non-core assets. Production functions of local government are limited to the construction of roads, bridges within the boundaries of the settlements; organization of collection, processing and recycling of household waste and garbage. Competence in the

field of finance is limited to the formation and execution of the budget. Everything is connected with the division of tax revenues and intergovernmental fiscal transfers. No shift in the direction of strengthening the link between the state of the local economy and the financial resources occurs [Shvetsov, 2007].

Thus, the development of inter-budgetary relations in terms of regional and local budgets should be based on a sound financial basis, which is largely determined by the relevant legislation, fixing the legal guarantees of financial independence of local self-government. This condition requires that the formation mechanism of intergovernmental relations was going to strengthen the direction, first of all, the local budget level by increasing its own tax potential, activation of independent fiscal policy.

It does not rule out the need for alignment of budgetary security of municipal unions by raising funds of higher budgets. However, financial assistance should be provided only if the failure of the tax revenues in the territory is based on objective reasons. In general, only the self-reliance seems a reliable guarantee of achieving real independence of local budgets.

### Conclusion

In all countries using the principles of fiscal federalism, the scope of fiscal relations is the subject of a thorough legal study. The development of an appropriate legal framework is in the detailed and comprehensive coverage of the legislative differentiation between different levels of government expenditure and revenue responsibilities, as well as the use of budgetary procedures alignment.

An essential element of social structure in many countries is the local government. Its range of competence usually includes

the implementation of the main share of social functions of the state, public safety, land improvement, promotion of entrepreneurship, etc. In recent years, local authorities have received a significant level of autonomy [European Charter of Local Self-Government, etc.], and in some cases, local authorities are independent from the governmental institutions.

The system of local self-governance as a fundamental element of a federal state structure is designed to provide a combination of national interests and the interests of each individual territory. Therefore developed and effectively organized local government is an essential element of the state government, allowing the latter to concentrate on solving national problems, thereby optimizing the entire system of government. Local governments carry out the implementation of local issues and are responsible for creating conditions for meeting the daily needs of the population. Obviously, for the effective implementation of their functions and powers the local authorities should have sufficient economic and financial base.

In modern conditions, Russia (ever since the late 90's to the present day) has been strengthening the centralization of control, including in the area of fiscal policy and the overall state of regional policy. To a certain extent this was justified in terms of solving the most acute crisis and conduct basic market reforms. However, the current centralized model has exhausted its constructive possibilities and is turning into an obstacle to territorial development. The preservation of this trend in the future is fraught with further intensification of existing problems in regional development. One of the most actual ways to overcome these problems is the decentralization of the budget

system, including the decentralization of resources and authority, autonomy in decision-making, competition and strategic marketing.

In accordance with the above proposed we can focus on the formation of the following structure of revenue sources at the level of regional and local budgets [Sumskeya, 2010]:

- taxes, the proceeds of which are sharply reduced during periods of economic downturn and rising during economic recovery (for example, the corporate income tax), should be assigned to the regional budget and local budgets should get the most stable tax sources;
- taxes, the base of which are distributed unevenly (taxes on some natural resources, etc.), should be fixed in the regional budget;
- taxes, the base of which can easily be moved to another municipality (by re-registering the parent company, etc.) or the burden of which can be passed on to the population in another municipality (excise on vodka imposed on the manufacturer and the like), should be centralized into the regional budget;
- taxes on immovable property, must be directed to local budgets (property taxes);
- tax revenues that directly depend on the well-being of taxpayers registered, or living in the area (income tax, sales tax on consumer goods, etc.) should be attached to local budgets;
- fees for budget services (fees, administrative fees) are due to the budget authority providing these services.

In conclusion, we can state the following provisions on which to build a system of local taxation:

Tax revenues should primarily satisfy the needs of the local budget. If local autonomy is an economic and political purpose, the local authority should not, if possible, be dependent on subsidies from higher-level authorities. Taxes collected by the local authorities, are a more reliable base of long-term planning and development, particularly in terms of costs. The system of local taxation should not be the only source of local budget. There are many unusual costs, especially in the municipalities performing the functions of regional centers, which should be compensated by subsidies for general use.

Local authorities should have the right to set the rates of one or two major taxes. This would enable local authorities to determine their expenditure program in accordance with the desire of the population to pay taxes. The financial autonomy of local governments has the advantage that taxpayers may authorize the local authority action by voting in elections and to control the decisions and activities of the local elected officials and administrative offices.

Taxes should be transparent and comprehensible to citizens and businesses, which bear the tax burden. This transparency is a prerequisite for the efficient allocation of resources according to individual requirements. Ultimately, it could allow people to "vote with their feet" by taking the decision to move on the basis of differences in local taxation, which is a characteristic of highly developed countries.

Providing income growth and thus satisfaction of its growing needs is impossible without establishing correspondence between economic development and local tax revenues. In addition, tax revenues should not be directly linked to the cyclical nature of

business activity in the territory. From a formal point of view, the elasticity of tax revenue must be equal to one. The reason for this requirement is that the ratio of costs and revenues of local authorities should be stable over time. Stabilization policy is the responsibility of the central government because of its external action and requirements for flexibility in spending and income. If there is a need to promote the stabilization policy of the local authorities, it is desirable to encourage them with grants for special purposes. Positive attitude of citizens and businesses to local authorities influences the distribution of the tax burden between the local population and the business sector, although the fear of environmental pollution often makes the local authorities act against the creation of new industries. However, the system of local taxation should be neutral without any "drag" on the population and the businesses. This rule has been called "the principle of equalization of interests."

The establishment and the balance between the consumption of local services in the territory and the distribution of the tax burden are a requirement. This equilibrium does not only have a positive effect on the distribution of resources, but also accompanied by political advantages, because the obligation to distribute the tax burden among all consumers of public services does not allow the use of certain groups through political decisions.

In the municipalities, roughly equal in size, the difference between the proceeds from local taxes per capita should not be significant. Otherwise, you need an active implementation of measures aimed at balancing between local authorities with a view to preventing violations of their financial autonomy. Since differences in the tax revenue are often associated with inequality of regions, the non-observance

of the principle of building a system of taxation further aggravates it.

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