CONCEPTUAL FRAMEWORK OF FORMING LOCAL TAXATION SYSTEM IN INDUSTRIAL CITY

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Abstract

The article seeks to determine the conceptual framework of forming local taxation system in an industrial city. The special set of the main principles suitable for forming the local taxation system in an industrial city is given (principles of tax autonomy, localization, compliance, self-determination, earned income, certainty, and direction) with the proposed scientific and methodological method of identifying an industrial city among the others.

Keywords: Local Taxes and Fees, Local Taxation System, Principles, Industrial Cities

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1 Introduction

Functioning under the state financial policy any administrative-territorial unit has to be provided with certain economic leverages and financial resources to solve a wide range of issues at the local level that are specific to each of them. Thus, considering the industrial cities of Ukraine, the main problems of their development may be determined as the operation of outdated equipment and technologies and the associated environmental pollution, which is a consequence of the absence of the required investment in industry. One of the most powerful financial leverages of economic growth are the tax ones, which at the local level are represented in the form of local taxation. The aim of the article is to define and justify the conceptual framework of forming the local taxation system in an industrial city with the aim of strengthening its financial support to address the specific development challenges.

2 Related literatures

The foundation of local taxation and local finance in general is based on the theory of fiscal federalism developed by R. Musgrave and W. Oates that considers the problems of the allocation of public sector functions between different levels of government, including the provision of local public goods and services through the mechanism of local taxation (Bird, 2010, p. 4). One of the main principles of fiscal federalism is the principle of fiscal equilibrium, proposed by M. Olson (1969, p. 482-483), according to which the expenditures and corresponding revenues must be in the competence of one and the same authority. If we consider local taxation as a response to the need of meeting local needs, the use of a separate local taxation system by each community is quite reasonable, because there are no two absolutely identical local communities. In OECD countries fiscal federalism is considered in the aspect of tax competition of different territorial communities, which have the authority to set their own taxes and fees (Blöchliger, Pinero-Campos, 2011).

Depending on the functional feature of the local community (municipality) it is expedient to explore the possibility to transfer the relevant taxes and fees with granting them the status of local to the competence of municipal authorities considering the characteristics of the local economy. It is important to find appropriate instruments and methods as to sort out the proper characteristics of municipalities and local taxes and fees for these municipalities. Thus, considering industrial cities foreign and domestic authors have marked out different characteristics that can be used in determining a city as industrial one (Meyer, 2000; Vlasova, Dvoryankina, 2005; Ushakov, 2010; etc). As well different researchers have worked at selecting appropriate principles concerning local taxation (Olson, 1969; Bird, 2010; Blöchliger, Pinero-Campos, 2011; etc). In the article a special set of principles suitable for forming the local taxation system in an industrial city is given with the proposed method of identifying a city as industrial one.

3 The local level case

In practice there are many varieties of decentralization in different countries and a variety of responsibilities within the city for expenditures and revenue resources to finance its operation. Different cities have different financial needs and financial resources that meet these needs, making it difficult to generalize the finances of a city. Despite the fact that the transfers and local taxes and fees make up a substantial part in the financing of the budget of most cities in the countries of OECD, the proportions of these revenue sources are very different: in a set of 18 cities Amsterdam receives less than 5 % of revenues from local taxes, while Stockholm receives 74 %. Drawing attention to the fact that each source of income has its faults, for each city it is very important to have an ability to levy own taxes in order to be always able to adapt to changing economic circumstances (OECD, 2010, p. 180-181).

According to foreign scientists, the research on local development issues should be focused exactly on the economy of the city and the circumstances that can be used to stimulate economic growth. However, the benefits of local agglomerations have their limits in the form of negative externalities expressed in problems of crowd and deterioration of environment that are most acute in an industrial city. To identify a city as industrial one it is necessary to evaluate its main characteristics. Scientific and methodological method used to assign a city to industrial ones is functional and includes both qualitative and quantitative criteria. The qualitative criteria are as follows: a limited number of external functions; high level of diversification of the economic structure of the city, rated provided the exclusion of basic city-forming enterprises; high level of industrial specialization of employment in the city's economy exceeding the average in the country; limited number of basic city-forming enterprises that implement industrial functions of the city, and their significant dominance over the other city-forming enterprises; higher levels of implementation of industrial function of the city (national and international) (Ushakov, 2010, p. 11-12).

As quantitative criteria for identifying the city as industrial one the indexes of presence are proposed (Vlasova, Dvoryankina, 2005, p. 86) based on calculating the ratio of specific indicator and the proportion of the population. A value greater than 1 is an evidence of excess of a city share in the respective national indicator over the share in the population. To these indicators in an industrial city it is advisable to include those that are directly related to industrial production and its development: the volume of industrial products, the availability of assets in industry, the average number of employees in industry, investment in fixed assets in industry, etc. The index of presence is calculated separately for each indicator as follows:

$$n = \frac{m}{l},$$

where m is a share of a city in the national indicator; l is a share of a city in the national population.

Selected indicators characterizing features of industrial development have been quantified as the notion of development itself is mainly associated with progressive changes primarily in economic sphere.

4 The basic principles

The principles of forming local taxation system in industrial cities have to allow for the specific features of their development, but also to be as universal as possible for use concerning other cities. Based on the theoretical foundations of the allocation of tax powers in view of the approach from the standpoint of public sector economics and public choice, positively oriented views on the allocation of tax powers and requirements to local tax systems, the following principles are recommended as suitable for use in the formation of the local taxation system in industrial cities.

The ***principle of tax autonomy*** is based on the concept of tax autonomy and provides for the right of local authorities to set local tax rates and fees for local services provided adequate control of overall tax burden by state tax authorities. The principle emphasizes that local authorities should, where it is possible, less depend on the financial resources of higher level authorities as taxes imposed directly by local authorities constitute a solid basis for their policy and planned activities at the local level. According to the principle, local taxes should cover at least half of local expenditures (Rybak, 2000, p. 16). Furthermore, the principle provides predictability of local taxes and fees receipt within a certain time interval.

The implementation of the ***principle of localization*** means that tax revenues deriving by local authorities should be localized, i.e. geographically fixed. Implementation of the principle makes it possible to establish a direct link between tax revenues in a particular area and the activities of local authorities concerning the introduction of taxes, fees, payments, and determination of their size and benefits (incentives). This principle is based on the ideas that the tax burden should not be exported outside the territorial unit, whose residents benefit from the provision of local public services financed by local taxes and fees, and that the authorities of different levels of government provide an effective level of production of those public goods the spatial pattern of the benefits of which are geographically limited by the area of a community.

By the ***principle of compliance*** those required payments should be local that have a base less affected by changes in economic conditions and cyclical fluctuations, as the central government has additional instruments except for taxes, such as national monetary policy, internal and external loans, etc., which local government does not have. In addition, according to the rules discussed by Oates within the approach from the standpoint of public sector economics, the tax base should be relatively immobile if the taxation is not provided on the basis of the benefit principle. Local taxes should be neutral with respect to the tax base, so that cause the least possible distortion.

The ***principle of self-determination*** suggests that local authorities should have the right to determine the directions of expenditure of received funds as permitted by law, based on selected local priorities for economic and social development. Self-determination of spending is a prerequisite for control from the voters' side over the productivity of the local authority according to the view on local taxation within the second generation theory of fiscal federalism and resonates with the ideas of Buchanan on the allocation of tax powers from the standpoint of public choice. The principle involves the match of costs and benefits and the use of hard budget constraints.

According to the ***principle of earned income***, local taxes and fees, which are the sources of own funds of local governments, have to consist of compulsory payments, which are more related to earned income in the territory. This principle emphasizes the receipt of public services in different communities in proportion to their contribution to the budget in taxes for inter-territorial differences in the amounts of income received and taxes paid can depend both on the labor quality of members of the community and on the more favorable initial conditions. In the first case, the amount of income received has to relate to the expenditure required to restore resources, including at the expense of public services; is the second case, the income from the use of more favorable conditions can be considered as a differential rent and removed provided the possibility of its separation (Rybak, 2000, p. 18-23).

The ***principle of certainty*** emphasizes that specific local taxes and fees have to be significant for the area, clear for taxpayers, largely traditional and logical. Local taxes should be grounded by the features of local development and objectives of local tax policy. Thus, in the community located in an industrial zone it is logical to introduce local taxes related, for example, to industrial environmental pollution. The principle is related to the demand of the reduction of taxpayers' resistance to the taxes because of its unfair perception, provides evidence of the tax base and rates and funding through fees of those benefits that can be estimated, and through taxes of the others. With minimum exemptions it is permissible to introduce tax benefits (incentives) to achieve certain goals at the local level.

According to the ***principle of direction***, forming local taxation system should contribute to the development of trend of raising a share of local taxes in revenues of local budgets. This principle applies more to the developing countries, since the tax authorities in these countries is five times less than in developed taking into account adjustments to the income level. Among the causes of such differences in the allocation of tax powers are the performance of tax administration, the historically established tendency to centralization, and the issues of macroeconomic policies (Bahl, 2010, p. 2).

The proposed set of principles allows for the requirements to local taxation from the position of normative approaches and from the experience of the real existing local taxation systems according to positive approaches.

Conclusion

Taxation is one of the most powerful instruments of government influence on economic processes including local ones. The proposed set of principles suitable for forming the local taxation system in an industrial city can be used in process of forming local taxation policy and selecting local taxes and fees from the variety that is used in the world according to specific features of different administrative-territorial units of Ukraine. As to improve the scientific and methodological method of identifying a city as industrial one the list of indicators of industrial development in the index of presence may be supplemented with some indicators that concern more the financial side of the city development. The formation of local taxation system in an industrial city is called on increasing the sources of local financial funds as to have sufficient financial support for the local authorities in implementing the functions concerning their own local development problems which for the industrial city may occur in environmental pollution and lack of investment in industry.

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