

LIMITED TAXING POWER OF LOCAL GOVERNMENT ENTITIES IN POLAND AS A DETERMINANT OF TAX COMPETITION AT THE LOCAL LEVEL

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Abstract

The key determinant of revenue financial autonomy of local government is the local taxing power. A wider range of fiscal autonomy usually translates into a higher degree of financial autonomy of territorial entities in a given country. At the same time, the wider the range of powers of local authorities in terms of deciding on tax matters, the greater the probability of occurrence of tax competition at the local level. The aim of this article is to demonstrate that the scope of local taxing power of local government entities, unduly restricted in Poland, hinders the implementation of the local tax competition mechanisms in the sub-national government sector, which in turn prevents the optimal allocation of public goods provided by territorial communities. The article was prepared on the basis of literature studies and analysis of relevant legislations. Statistical data used in the empirical analysis were derived from the OECD database and reports of the Polish Ministry of Finance. The study confirmed that Polish local finances require systematic changes involving the strengthening of the tax autonomy of the local government.

The local tax autonomy and the related greater freedom of the local governments in deciding on taxes is a necessary condition for the emergence of local competition, which will allow more efficient use of public funds in the sub-national governments sector. To achieve this, the Authors of this work propose introduction of specific deregulatory solutions and changes expanding the tax powers of the local governments into the Polish legal system.

Key words: Sub-national Government's Revenue and Expenditure Autonomy, Taxing Power, Local Taxes, Local Taxes Autonomy, Tax Base, Local Tax Competition

Note: Earlier version of this paper was presented at the Conference of Association for Public Economic Theory - PET 15, The University of Luxembourg, Luxembourg, July 2nd-4th, 2015.

INTRODUCTION

The key value of the local government is financial independence (autonomy) of local government entities. Its scope is different in different countries and results from the advancement of the decentralization processes, being a derivative of the function performed by the public authority and the manner and proportions of their distribution between the central and local government. Financial independence is manifested in two basic aspects, i.e. revenue and expenditure. The key determinant of independence understood in the revenue aspect is undoubtedly local taxing power. In the opinion of the authors of this paper, its scope is too limited in Poland. This is in a way an effect of historical circumstances – for over forty years Poland was a socialist country, where there was no room for self-government and the state monopoly was omnipresent in all aspects, including taxation. It was only in 1990, along with the change of regime, when the first phase of decentralization reform was carried out and municipalities as local government entities were brought to life (their current number is 2478). In subsequent years, work began on introducing two additional levels of local government, i.e. Poviats (currently there are 314 country districts and 66 townships) and local government Voivodeships (16). In the current state of the law, generally only municipalities have their own revenue of a tax character. Both Poviats and local government Voivodeships are completely devoid of this attribute. It should be emphasized that the scope of local taxing power of municipalities is to a large extent limited by the state and basically confined to determining rates of some taxes and fees (within statutory limits set by the state), using tax allowances (based on statutory rules) and introducing certain tax exemptions (only objective). The overall picture of excessive reliance of local government revenues in Poland on central tax decisions is also

influenced by the fact that over 21% of the local government revenues in Poland is revenue from its share in the incomings in state income taxes, i.e. personal income tax and corporate income tax, and therefore from the category of revenues completely devoid of the local taxing power component. When analyzing the scope of this power, one should take into account not only the possibilities of the local government influencing the shape of tax revenue, but also fiscal efficiency of individual sources of revenues. In this context, the problem is the low efficiency of the system of property taxation. In Poland, an area taxing system functions, in which the tax base is the area, and not the value of the property, as it is in the cadastral system. Such a solution not only reduces the effectiveness of the tax, but is also associated with a narrower range of local taxing power.

The aim of this paper is to demonstrate that the scope of local taxing power of local government entities, unduly restricted in Poland, hinders the implementation of local tax competition mechanisms, which in turn prevents the optimal allocation of public goods provided by territorial communities.

Financial Independence of Local Government - Theoretical Connotations

Financial independence is the very essence and core value of local government. The essence of the idea of financial autonomy of local government entities results from the state's possibility to share some of the attributes of financial power with other public entities, including local government entities. Of course, the scope of local government autonomy is different in different countries and results from the advancement of decentralization of public administration, being a derivative of the function performed by the public authority and the manner and proportions of their distribution between the central and local government (Kornberger–Sokołowska, 2001). As it is emphasized in the literature, decentralization of implementation of specific functions attributed to public finances, i.e. the allocative, redistribution and stabilizing function, is not and cannot be made in equal measure. R.A. Musgrave assumes that local authorities should be involved in the implementation of the allocative function to the fullest extent, while implementation of the redistribution and stabilizing function should be first and foremost linked to the liability of the central government (Musgrave 1959).

Financial independence of local government concerns two basic aspects, i.e. revenue and expenditure. The concept of revenue autonomy should be understood as a specific scope of decision-making autonomy of local government in the context of possibility of own fiscal policy in a given area, and thus a certain decision-making power as a part of the so-called local taxing power associated with legally guaranteed freedom to shape the size and structure of local taxes and fees by the local authorities. Revenue autonomy understood in this way requires

proper shaping of the system of local government revenue sources by raising its profile in this system of financial resources given for self-disposal of local government entities, i.e. so-called own revenues. Local taxes and fees are undoubtedly a key source of this category of revenues, but nevertheless other sources can be identified, e.g. revenues received from property owned by the local government entity. According to Polish budget reporting, own revenues of local government includes, quite unfortunately, also local government shares in state income taxes. Firstly, those are shares in the personal income tax (municipalities – 39.34%, poviats – 10.25%, voivodeships – 1.6%), and secondly, shares in corporate income tax (municipalities – 6.71%, poviats – 1.4%, voivodeships – 14.75%). Treating them as own revenues is not justified if only because they are central taxes, in principle excluded from the possibility of application of instruments of local taxing power. As a result of the described solutions, a kind of an "official blurring" of the actual picture of the level of financial independence of local government in Poland takes place. The scale of this problem is significant, because the share of revenues from this is substantial. For example, in 2012, local government revenues from its share in the revenues earned within the scope of state income taxes stood at over 35% of the total own revenues earned.

Theoretically speaking, the larger the share of own revenues in total revenues, the greater the revenue autonomy of local government. However, one should agree with the view of E. Kornberger-Sokołowska, that financial independence of local government understood as a synonym for self-financing, which would mean financial management model based solely on own revenues, is a kind of utopia. No country has managed to create such a system of institutional division of public revenue sources, which would ensure that all local government entities fully cover their expenditures with own revenues. One of the given reasons is the uneven distribution of public revenue sources with a relatively even distribution of public tasks and expenditures associated with their implementation (Kornberger-Sokołowska 2001). This imbalance is particularly evident in the case of Polish local government entities. According to the data from the Polish Ministry of Finance for 2013, the highest scale of revenue disparities related to municipalities (revenue disparity between the richest and poorest municipality in Poland was at the level of 21:1). Much smaller scale of revenue disparities related to poviats (4:1), and the smallest – to voivodeships (2:1).

It should also be noted that different regulations in force in particular countries may be included in the group of fiscal instruments directly influencing the revenue independence of local government entities, which limits the size of the allowable budget deficit or debt level (Kosek-Wojnar 2004) in the local government sub-sector. They are so-called fiscal rules that G. Kopits and S.A. Symansky define as a restriction of a quantitative or qualitative character introduced

on a permanent basis, i.e. independent of the changing political and legal situation, imposed on specific economic values of the public finance sector (Kopits, Symanski 1998).

These rules may be international, national or local. Convergence criteria from Maastricht may serve as examples of international rules, specifying the maximum size of the public finances deficit in EU Member States at the level of 3% of GDP and public debt – at the level of 60% of GDP. While as Polish examples of national fiscal rules, the following can be cited: the public debt limit arising from Art. 216 sec. 5 of the Constitution of the Republic of Poland, set at the level of 3/5 of the annual GDP or also the so-called prudence limits arising from Art. 86 of the Public Finance Act, obliging government and local government authorities to take specific and diverse recovery actions in situations of exceeding certain levels of relations of the state public debt in relation to the GDP, i.e. so-called prudence limits 55% and 60% GDP. In contrast, an example of local fiscal rules are new, individual for each entity debt indicators, so-called Individual Debt Indicators - IWZ (Art. 243 of the Public Finance Act) effective for Polish local government entities since 2014. They are calculated based on the size of the operational surplus achieved by a given entity (in Polish conditions: the municipality, poviát or voivodeship) for the last three years preceding the given financial year, in which debt obligations will be incurred. In accordance with these regulations, the ratio of debt servicing costs in a given year to revenues in the same year cannot exceed the average operational surplus calculated for the three previous years (plus revenues from the sale of assets).

It is symptomatic that in the past few years there has been a significant increase in the number of countries using fiscal rules, both quantitative and qualitative. To a large extent this is a response to emerging crisis issues and phenomena in their public finances systems, and such a situation has an impact on the clearly emerging trends of limiting independence not only of revenue, but also expenditure (this will be discussed later in this paper) of local government by central public authorities. It should be added that the tendency of local government to loosen fiscal discipline is higher when the scope of its financial autonomy is higher, and therefore, among others, the following trend is observed: the more fiscal power the local government has (both on the side of revenue and expenditure), that is, the greater the scope of fiscal decentralization, the more central authorities try to restrict actions of local authorities through various rules and fiscal principles (Report 2012).

As previously mentioned, the fiscal rules do not only apply to the revenue aspect of financial autonomy of a local government, but also the expenditure aspect (example: expenditure rules). Expenditure autonomy of a local government can be understood as a specific scope of its decision-making freedom in the context of the size and structure of incurred public expenditure. As P. Swianiewicz rightly observes, even the most significant financial

autonomy on the revenue side may not be greatly significant in a situation when a local government does not have the freedom to make decisions concerning its expenditures (Swianiewicz 2011).

There are many forms of limiting revenue autonomy. One of the most tangible and direct is increasing the share of revenues transferred from the central budget in the system of local finances. To some extent, it is known that the greater the share of these funds in local budgets, the greater the scope of "financial nationalization" of a local government. In Polish conditions, this particularly concerns restricted grants, which are a form of transferred revenues primarily for financing tasks assigned to the local government by the government. To perform them, the local government receives specific resources, which must be spent only for the specific purpose and in a strictly defined manner. The decision-making powers of a local government in this scope are very limited, and it is generally difficult to talk about any financial independence. A little wider scope of this independence concerns a different form of transferred revenue, which is general subsidy. In Poland, it is crucial for the financing of educational tasks of the local government and for mechanisms of levelling the revenues of local government entities.

Another, indirect form of limiting expenditure autonomy, unfortunately very popular in Poland recently, is increasing the scope of tasks of local government without adequate compensation on the revenue side. As a result of these changes there is a systematic increase in current expenditures and, consequently, often financial destabilization. In Poland, this problem primarily concerns financial systems of the largest cities, and the crisis lasting from 2008 has clearly escalated it. Incidentally, it should be added that such practices are not only inconsistent with the postulate of adequacy of the local government's financial resources with the implemented tasks contained in the European Charter of Local Government (Art. 9 sec. 2: *"The financial resources of local communities should be proportional to the powers provided by the Constitution or the law"*) (European Charter 1994), but also with the provisions of the Polish Constitution (Art. 167 sec. 4: *"Changes in the scope of tasks and competences of local government entities take place together with the corresponding changes in the share of public revenues"*) (Constitution 1997).

The diverse range of financial autonomy of local government in particular countries is always the effect/result of the decentralization processes carried out in them, understood as processes of transferring political, administrative and fiscal powers by the central authority onto local government entities. The theory of fiscal federalism, among others, refers to these issues, which focuses on finding the optimal scope/degree of decentralization and the distribution of economic functions in a country in the form of multilevel public finances (government, federal and local) in the context of increasing the effectiveness and efficiency of the public sector and

the optimal allocation of public goods. The precursors of this concept are considered to be Ch.M. Tiebout (Tiebout 1956) and R.A. Musgrave (Musgrave 1959). Whereas the modern development of this theory in terms of local finances was done by W.E. Oates (Oates 1998). Many authors studying these issues believe that decentralization and the associated greater financial autonomy, including in particular tax autonomy of local government authorities not only contribute to greater efficiency in the allocation of public goods, but also have a positive impact on economic development (Ebel, Yilmaz 2002) (Meloche, Vaillancourt, Yilmaz 2004) (Akai, Nishimura, Sakata 2007).

Methods for Measuring the Financial Autonomy of Sub-National Government Sector

The previously described dependencies motivate economists to seek ways to measure, and thus ways to compare diverse scopes of financial autonomy of the sub-national government (SNG) sector in particular countries (Stegarescu 2005) (Oulasvirta, Turala 2009). Literature emphasizes that comparative analysis in this area is not possible with the use of a single, universal indicator, and usually it is necessary to refer to many different elements referring to the two main dimensions of overall financial autonomy, i.e. revenue and expenditure (Swianiewicz 2011). For this purpose, S. Swianiewicz recommends using a kind of "ladder of financial autonomy", based on the assumption of gradability of this autonomy in four basic aspects. Three of the mentioned aspects relate to the dimension of revenue and they are:

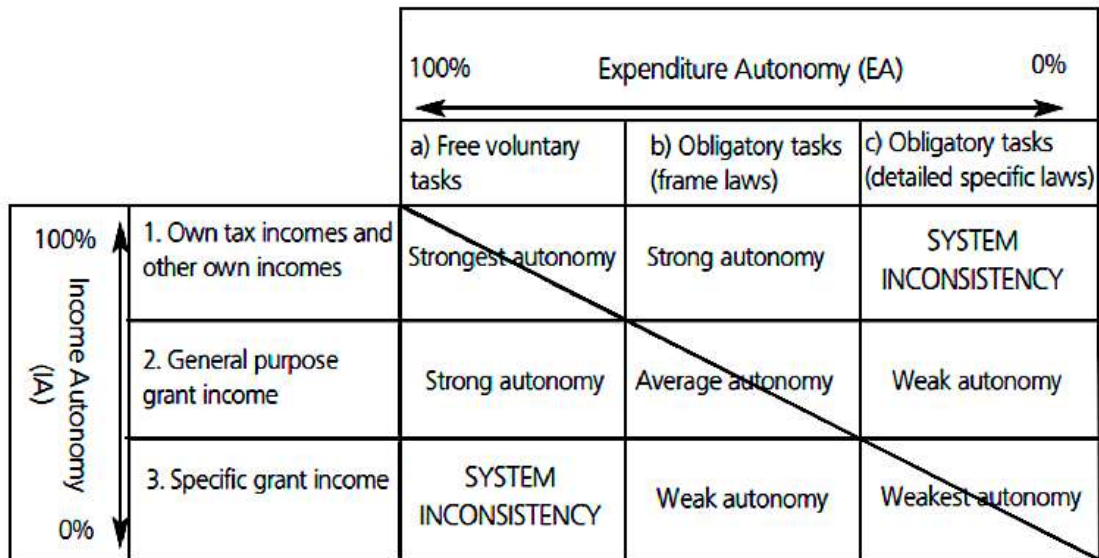
- 1) local taxes (the widest scope of financial autonomy – the local government independently chooses local tax from a broad set of options acceptable in a given country, and independently determines the rate, allowances and other elements of the tax structure; the narrowest scope of financial autonomy – both the rate of local tax and acceptable allowances are determined at the central level);
- 2) transfers (the widest scope of financial autonomy – the local government receives general subsidy, based on a stable and transparent algorithm; the narrowest scope of financial autonomy – the local government receives restricted grant with a detailed method of using it);
- 3) debt (the widest scope of financial autonomy – lack of formal-legal restrictions/limits concerning the debt of the local government, and the possibility of using debt instruments by local government entities are determined solely by market conditions; the narrowest scope of financial autonomy – the local government is deprived of the possibility of borrowing).

According to P. Swianiewicz, it is significantly more difficult to formulate an analogous "ladder" consisting of hierarchically arranged rungs in the case of financial autonomy on the expenditure side. In this case, the author mentions only a few methods of limiting this autonomy (norms and

standards for local public services, which the local authorities must comply with; regulations concerning the salaries of employees of the local government sub-sector; regulations concerning the employment and dismissal of employees of this sub-sector; regulations concerning the assignment of public tasks to the local government by the central administration).

In a similar convention, based on the concept of measuring the varying degree of local financial autonomy, including the dimension of revenue and expenditure, remain the proposals of other authors, including the concept of the financial autonomy matrix of L. Oulasvirta and M. Turala (see Figure 1) and the concept of J.T. Dickovick (see Figure 2).

Figure 1: The Matrix of Financial Autonomy



Source: (Oulasvirta, Turala 2009)

Table 1: Sub-National Revenue and Expenditure Autonomy: Ideal Type Measures

Score	Revenue autonomy	Expenditure autonomy
High	Large amount; constitutionally mandated transfers; Constitutional guarantees for major tax bases; Ad hoc transfers consistently large	Little central government guidance on spending; Extensive freedom to transfer funding across sectors; Black grants, little or no earmarking
Moderate	Large amount; legally mandated transfers; Legal guarantees for major tax bases (income tax, VAT, e.g.); Ad hoc transfers inconsistent or occasional	Central government monitoring; Spending autonomy for large sources of revenue; Earmarking for some/minor sources of tax revenue;

Table 1...

Low	Small amounts of legally mandated transfers; Legal guarantees for minor tax authority (fees, , e.g.); Ad hoc transfers minimal	Spending autonomy for small sources of revenue; Earmarking used for most/large sources of revenue; Binding norms and standards set by center
Very Low	Exclusively voluntary transfers, or no transfers; Subordination to center on taxation matters; Ad hoc transfers minimal	Budgets only applicable in given sector or detailed line item; Spending determined by national formula; Deconcentration, budget execution without decision making; Unspent budgets revert to central government; Binding mandates (funded or unfunded)

Source: (Dickovick 2011)

Taxing Power as the Key Indicator of the Level of Financial Autonomy of Local Government Entities

Financial decentralization (or the decentralization of public finances) means the transfer of appropriate public financial resources and power for their administration to local government entities (Ruśkowski, Salachna 2007). Its essence is primarily the previously described revenue autonomy allowing financing goods and services at the local or regional level (Bukowska 2008). In the opinion of E. Ruśkowski, the concept of the decentralization of public finances, however, should not be equated with the financial autonomy of local government entities. He believes that *"the decentralization of public finances concerns public resources and the rights and obligations in the scope of their development and use, as well as the organization and management of local government entities' financial economy, while financial independence (autonomy) of local government entities primarily deals with privileges (freedoms) of these entities in the formation of revenue and expenditure amounts, as well as in the organization and management of their financial economy. This means that the concept of decentralization of public finances is broader, with the concept of financial independence (autonomy) of local government is a component of this concept. These categories most frequently interact with each other in such a way that the decentralization of public finances can be increased without increasing financial independence (autonomy) of a local government, and the increase of the latter usually means, although not automatically, the increase of decentralization of public finances"* (Ruśkowski 2006). Therefore, the financial autonomy of local government entities is directly linked with taxing power. In addition to the transfer of revenues and power to manage them, in this case it is necessary also to provide powers to their development, especially the development of taxes constituting own revenues of local government entities.

The general principles of the division of taxes between central and local authorities have been presented in literature on fiscal federalism and locality. According to these principles, the following criteria of this division are assumed (Bukowska 2008):

- the effectiveness of tax administration - the level of power, which has the best information on the tax base, should be responsible for imposing the given tax;
- fiscal needs - tax revenues should be closely linked to needs and assigned to the level of power, which is responsible for the realization of specific services related to the given tax.

However, assigning competences in the scope of determining taxes to various levels of authorities is not an easy task. The distribution of taxes, according to the principles outlined above, should be strictly dependent on the scope of the functions assigned to the different levels of authority; however, increasing responsibility of local authorities is not always accompanied by higher authorities resigning from certain tax revenue resources. The most efficient taxes are often only available to the central government, which often makes financial autonomy of local government entities impossible (Table 2).

Table 2: The Traditional Model of Tax Assignment

Type of tax	Tax rate	Tax base	Administration
Corporate income taxes	C	C	C
Personal income taxes	C	C	C
Capital gains tax	C	C	C
VAT	C	C	C
Excise tax	C	C	C
Property tax	R, L	R, L	R, L
Land tax	R, L	R, L	R, L
Recurrent tax	C, R, L	C, R, L	C, R, L
Capital transfer tax	C, R	C, R	C, R
Environmental tax	R, L	R, L	R, L

Levels of Government: C- central; R – regional; L – local

Source: (Bukowska 2008).

The scope of powers of specific government authorities for imposing or modelling taxes, depending on the functioning institutional system, can be very diverse. OECD distinguishes five levels of tax autonomy (taxing power) at the local level (OECD 2014):

- full powers for establishing tax rates and tax bases (also through the formation of tax allowances),
- powers to establish tax rates,
- power to determine the tax base (also through the formation of tax allowances),
- in the scope of distribution of taxes,
- lack of influence on determining tax rates and bases.

In practice, tax autonomy of local government entities can also be very diverse (Table 3).

Table 3: Classification of Local Taxes by Degree of Local Autonomy

High Revenue Autonomy	SNG sets tax rate and base	Highest degree of own -source revenues. Most often pertains to fees and charges
	SNG sets tax rate only	Necessary and sufficient condition for categorization as “own revenue” (piggybacking, tax base harmonization/conformity permitted)
	SNG sets tax rate, but only within centrally permissible ranges	A typical practice is to cap the top rate
	Tax sharing whereby central/local revenue split can be only changed with consent of SNG	Can result when a local authority collects the tax and remits to the center
	Revenue sharing with share determined unilaterally by central authority	100% control by center; this category is a source of much misspecification of what is a central vs. local revenue (GFS includes this category as a local tax)
No Local Autonomy	Central government sets rate and base of “SNG revenue”	May accompany political decentralization

Source: (Bell, Ebel 2010)

As it is clear from the data presented in the table, full autonomy, which refers to the total financial decentralization in terms of own revenues, is extremely rare and rather affects fees than taxes. Total tax autonomy would occur if the local authorities could determine tax rates and the tax base for all taxes constituting own revenues. In contrast, usually the local taxing power is limited and concerns only a small group of taxes. On the other hand, in a situation where local authorities have no power to establish the tax base and tax rates – tax autonomy does not exist, although we may also be dealing with political decentralization.

The Problem of Limited Local Taxing Power of Local Government in Poland

The presented circumstances show that the key determinant of financial revenue independence (autonomy) of local government is the local taxing power. The dependence is clear and simple: greater scope of the mentioned power or in other words fiscal autonomy usually translates into a higher degree of financial autonomy of local government in a given country. In the context of the undertaken research issue there appears another dependency, namely: the greater the scope of powers of local authorities in terms of deciding on tax issues, the more likely the emergence of tax competition at the local level (it will be discussed later in the paper).

Revenue system of local government in Poland is characterized by poor fiscal performance of local taxes, depriving of local taxes the two over-community levels of local government (i.e. counties and voivodeships) and a high participation in the system of financing

transfer type revenues. Table 4 shows the structure of budget revenues of various levels of local government in Poland considering certain categories of revenue type.

Table 4: Structure of Local Governments Revenues in Poland (%)

Details	Years*	Total own revenues	Including:		Closed-end grants	General subsidies
			Shares in income taxes (PIT & CIT)	Revenues from tax and local fees		
Local governments units - total	2003	43.5	13.0	17.6	16.4	40.1
	2004	51.5	21.9	16.5	14.3	34.2
	2014	50.7	21.4	18.0	22.9	26.4
Gminas	2003	47.3	11.7	23.3	10.5	42.2
	2004	48.2	14.6	22.5	12.5	39.3
	2014	49.3	17.4	23.2	21.6	29.1
Cities with poviat status	2003	52.7	17.2	20.0	12.6	34.7
	2004	60.3	24.7	19.0	12.0	27.7
	2014	62.8	24.0	20.7	17.3	19.9
Poviats	2003	11.3	1.3	X	32.6	56.1
	2004	24.9	11.1	X	24.3	50.8
	2014	31.3	16.7	X	25.9	42.8
Voivodeships	2003	15.9	12.0	X	51.0	33.1
	2004	59.1	55.9	X	22.4	18.5
	2014	36.9	29.9	X	46.9	16.2

* Selection of years in table is connected with the fact that since 2004, Poland began a new system of local revenues, reducing subsidies and increasing shares of income taxes and significantly changing subventions for local government from the State budget.

Source: The Ministry of Finance.

The data presented shows that according to official statistics (presenting shares of local government incomes considered as own income in State income taxes) shares of transfer incomes in total incomes is app. 51 %. However, if the shares in the state tax would be treated according to the theory of fiscal federalism as incomes of transfer type, so in that situation index of transfer incomes related to total incomes of the whole sector of local government increases above the level of 70 % (data relevant to year 2014). The system of revenue based on a wide range on incomes not shaped directly by local government, makes the breakdown of relation between local charges and optimal range of local goods and local public services, thereby impeding implementation of the mechanisms of the local tax competition.

In accordance with Art. 217 of the Polish Constitution (Constitution 1997), imposing taxes, other public levies, determining entities, subjects of taxing and tax rates, as well as the principles for granting allowances and remissions, as well as categories of entities exempt from taxes takes place by law. Whereas according to Art. 168 of the Constitution, local government entities have the right to determine the amount of tax and local fees in the scope specified in the act. Therefore, these provisions define the limits of local taxing power of the municipality, not giving its full power in the scope of taxes and local fees, and consequently the legislature, and not the local government decides on the key structural elements of local government taxes. *"In other words, Art. 168 deprives the local government real impact on the shape of the tax system, because abolishing and introducing benefits comprising it, in accordance with art. 84 of the Constitution, is reserved as the exclusive privilege of parliament"* (Dowgier 2007). Therefore, these powers do not apply to the introduction of new levies that may be imposed only in statutory mode, as well as forming these tax elements, which must arise directly from the law regulating the given tax. Consequently, the limits of taxing power in Poland is established by the tax law, which finds its justification in Art. 217 of the Constitution, according to which the only acceptable form of taxation, determining entities, subjects to tax, as well as tax rates and scope of tax allowances is legislation form.

Hence local government in Poland only has the right to use specific elements of tax techniques, clearly indicated in the laws and to the permitted extent (Dolnicki 2012). This right, according to applicable provisions, concerns only certain local taxes (Table 5).

Table 5: Taxing power of Municipalities in the Scope of Developing Taxes belonging to the Local Category in Poland

Type of tax	Taxing power in the scope of			
	imposition or abolishment of taxes	determining tax rates	using allowances	using exemptions
Real property tax	none	limited, only within legally set limits	none	limited, only objective
Agricultural tax	none	limited, only within legally set limits	limited, only objective	limited, only objective
Forest tax	none	limited, only within legally set limits	limited, only objective	limited, only objective
Tax on means of transport	none	limited, only within legally set limits	none	limited, only objective
Tax on civil law transactions	none	None	none	none
Inheritance and donations tax	none	None	none	none
Sole proprietorship tax – fixed amount tax	none	None	none	none

In the current state of the law in Poland, only municipality has their own revenues of a tax character. This means that the taxing power is the domain of only municipal councils and does not apply to bodies of other local government entities (poviat councils, voivodeship parliaments). As a result, one of the demands contained in the aforementioned European Charter of Local Self-Government (EKSL), according to which at least part of the funds at the disposal of the local government should come from local taxes and fees (Article 9 par. 3) (European Charter 1994), is applicable only in respect of municipalities. In literature it is emphasized that depriving poviats and voivodeships of "own" taxes is not only inconsistent with the provisions of EKSL, but also in breach of Art. 168 of the Polish Constitution, according to which local government units (all of them, not just municipalities) have the right to determine the rate of local taxes and fees (Constitution 1997). A suspected reason for this state of affairs is the appointment of a single-level (only municipal) structure of local government in 1990, and thus dividing taxes into state and municipal, and consequently the lack of taxes in the tax system (at the time of appointing poviats and voivodeship, i.e. in 1998), which could be granted to these entities. As a result, poviats and voivodeships do not have "own" tax revenues aside from shares in national tax revenues, i.e. personal income tax (PIT) and corporate income tax (CIT). As already mentioned, Polish local government can do little to increase the efficiency of the fiscal capacity of these revenue sources, for instance in the context that this country (specifically the parliament) establishes key elements of the legal structure of income taxes. The circumstances described practically make it impossible for poviats and voivodeships to use instruments of local tax competition (more on this subject - later in the paper).

Therefore, Art. 168 of the Constitution guarantees only a minimum scope of tax powers of local governments in Poland. As a consequence of such legislation solutions, the scope of local taxing power of municipalities is limited to determining the rates of some taxes and fees (within statutory limits), using tax allowances (based on statutory rules) and introducing certain tax exemptions (only objective). The only possibility granted directly to municipalities regarding the imposition of tax levies on its inhabitants is associated with the category of self-taxation of inhabitants for public purposes (this applies only to natural persons), however, the condition for introducing this tax burden is the acceptance of the local community expressed in a referendum. A local referendum in Poland is valid if at least 30% of the inhabitants of a municipality eligible to vote participated and at the same time at least 2/3 of inhabitants eligible to vote cast valid votes for such an option. However, it should be emphasized that according to Polish law, self-taxation does not have all the attributes of tax. Tax is primarily an obligatory provision, unilaterally imposed by the state or other public-legal entity, and has a general character. In the case of self-taxation, it is difficult to speak of coercion and unilateral act of imposing it. Another

problem is the nature of this provision, all the more that self-taxation concerns the collection of revenues by a given municipality for a specific purpose.

It is also worth mentioning here three other relevant circumstances, limiting local tax autonomy. Firstly, they are limited powers of local tax authorities – only part of the local government taxes is carried out by the municipal tax authorities, i.e. the village mayor in rural municipalities, the mayor in small towns and the president of a city – in large urban entities (e.g. real property tax, agricultural tax, forest tax, tax on means of transport); a significant part of local government tax revenues, for completely unjustified reasons, remains the responsibility of state tax authorities, or heads of tax offices (this concerns e.g. tax on civil law transactions, inheritance and donations tax, sole proprietorship tax paid in the form of a fixed amount tax).

Secondly, it is an anachronistic system of property taxation, having its origins in the socialist system which existed in Poland until 1989. The tax sources associated with it (i.e. real property tax, agricultural tax and forest tax) fully supply municipality budgets. The natural consequence of the fact that it is an areal system (in which the tax base is area, and not property value, as it is in the cadastral system) is without a doubt its smaller fiscal capacity, and thus a narrower scope of local taxing power.

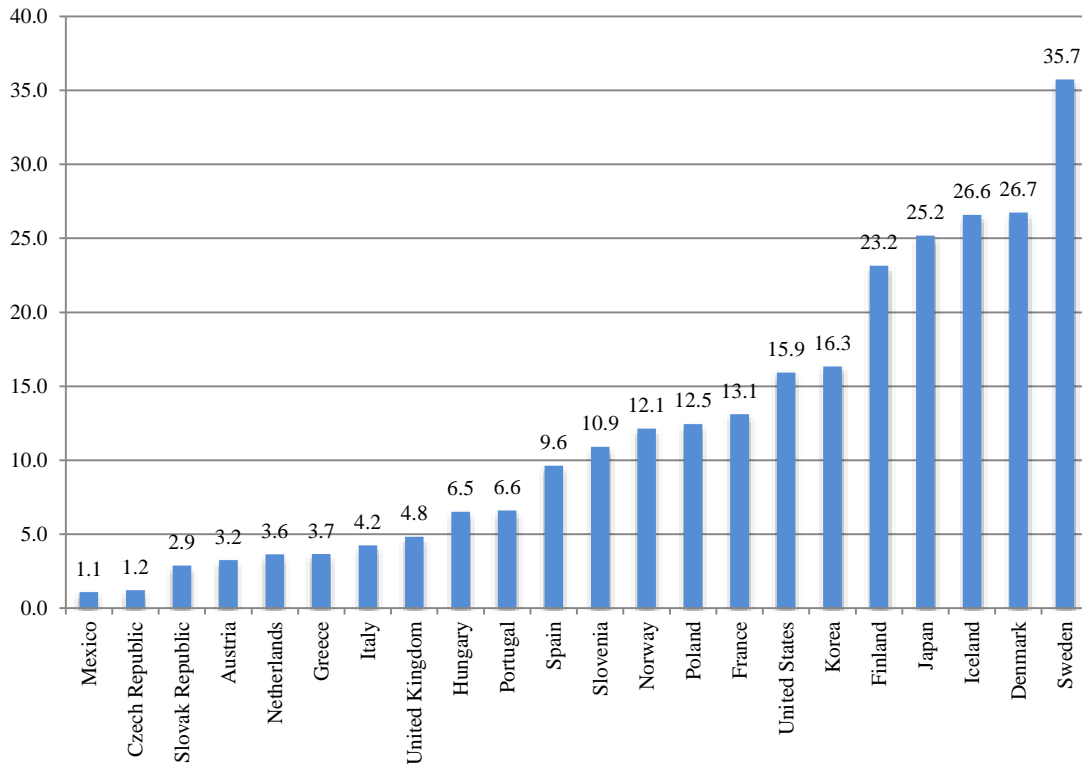
Thirdly, the limited scope of local taxing power is significantly affected by the dysfunctional system of fiscal equalization in force in the Polish finance system of the sub-national government sector. This mainly concerns horizontal equalization, based on the mechanism of making solidarity payments (the scope of this solidarity is obligatorily determined by the state) by entities with a high tax yield for entities with a lower yield. In Poland, this mechanism is called “Janosik” Tax (in other countries it is the equivalent of the "Robin Hood" Tax). Polish municipalities have been making such payments for eighteen years, while poviats and voivodeships – for ten years. And although there is no basis for the total negation of the existence of equalization mechanisms, then it should be noted that in Polish conditions they were somehow "wrongly balanced", as a result creating a system excessively limiting rights to the revenues of payers and rights to independently decide on the manner and directions of spending money for implementing own tasks. This was confirmed, among others, by the Decision of the Constitutional Tribunal of 4 March 2014, as a result of which non-compliance of regulations in this scope with the Polish Constitution were found, and it was stressed that such a system unduly limits the extent of possibility of implementing own tasks by the local government.

The consequence of this state of affairs is the clear weakening of the stimulative nature of own revenues of local government, including tax revenues, as well as reducing the motivation

of local government authorities to work towards increasing the fiscal capacity of local sources of tax revenues (why do it, if any surplus must be transferred to poorer local entities).

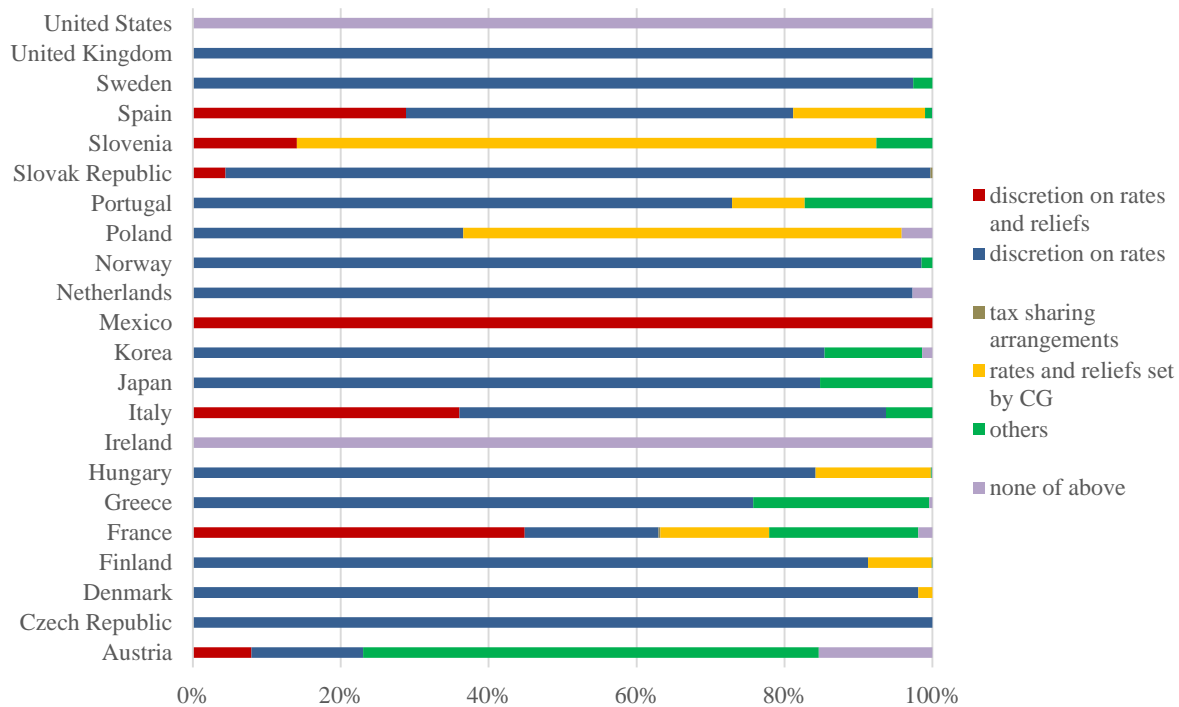
To conclude the digressions concerning the scope of local taxing power in Poland, it is worth looking at the data enabling to compare taxing power (tax autonomy) of the Polish sub-national government sector compared to other countries. The statistical data presented refer to the share of tax revenues of this sector in relation to total tax revenues in selected OECD countries (Figure 2) and rank the Polish local government as an entity with a medium level of autonomy. Whereas comparative analysis of the structure of tax revenues at the local level (Figure 3) clearly indicates the dominant decision-making power in Poland of the central government (CG) sector in this regard.

Figure 2: Taxing Power (Tax Autonomy) of Sub-National Government (SNG) Varies Widely Across the OECD In 2011 (As % Of Total Tax Revenue)



Source: (OECD)

Figure 3: Taxing Power (Tax Autonomy) Structure at the Local Level
in 2011 (As % of Tax Revenue)



Source: (OECD)

Taxing Power and Tax Competition at Local Level

The problem of local taxing power is in a particular way linked with local tax competition, a term which should be understood as a kind of rivalry between many local government entities, the subject of which is to provide access to public tax cash resources mainly deriving from obligatory collections. The intensity of this competition depends on the ability of local government authorities to stop the source of fiscal revenues in the territory remaining in the tax jurisdiction of a given territorial entity (Walasiak 2014).

Scientific discussion on local government tax competition was initiated in the 1950s by the formerly mentioned American economist Ch. M. Tiebout. The theory he proposed is called Tiebout's model/hypothesis (Tiebout 1956). According to its assumptions, different local entities providing diverse local public goods compete with each other, like companies producing private goods on the market. In the opinion of the cited author, such competition leads to the optimization of both the size and structure of public goods provided. Just like on private markets, on the market of local public goods, there is a possibility to choose the supplier (*shopping*). Residents, in search of an optimal ratio of quantity and quality of local public goods to their paid taxes, make a choice of the optimal territorial community for them. In the same way

somewhat by foot voting, they may decide to move to another local government community that best suits their preferences. Simultaneous emigration of many people (especially the wealthier) means a real threat for local authorities of losing own tax revenues, and this motivates local government decision-makers to provide more public goods of a better quality. Therefore, Tiebout's model assumes that when there are multiple mobile citizens-consumers and many places with different standards of local public goods, then consumers will settle in those local government units, which have their optimal combination of these goods in relation to the taxes paid. Wealthier consumers who wish to receive more public goods in return for higher taxes will choose the local communities where their expectations are met, while poorer consumers, by accepting a smaller amount and a lower quality of public goods and a lower level of tax burdens will choose other local government communities. In this way, the mechanism of "foot voting" leads to differentiation of local communities. Even so, according to Tiebout, this is a positive mechanism, because it not only allows to disclose consumer/voter preferences in a democratic system, but also enables to create a competitive market for public services. At the same time, this mechanism is an argument for those public goods that can be supplied competitively to be delivered by the local level, rather than the central one. In the case of some public goods, there is no choice of a supplier (example: national defence), in which case Tiebout recommends their provision by the central level.

Tiebout's model concerning the issues of local tax competition and the optimal allocation of public goods provided by local communities has been widely developed in a number of scientific studies in the field of public economics, among others, including in the works of authors such as: G. Z. Zodrow (Zodrow 1983), P. Mieszkowski (Mieszkowski, Zodrow 1989), W. A. Fischel (Fischel 2006) and S.H. Lee (Lee 2009). Many of the cited authors have indicated specific weaknesses of Tiebout's model, among others, connected with:

- limited mobility of citizens of local government communities (in the context of globalization this mobility to a lesser extent depends on the level of local public goods, and the dissatisfaction of the consumer-taxpayer only due to the too low/high level of supply of one or multiple public goods is usually not a sufficient incentive to change their place of residence);
- limited knowledge of citizens about public goods;
- inability to provide certain public goods in small local government units (e.g. it is not worth building schools, theatres, cinemas, swimming pools, etc. for them).
- not taking into account the spillover effects occurring between local communities.

There are a number of positive effects of local tax competition. Characteristically, in his theory, Tiebout clearly glorified them, basically ignoring the negative effects. He emphasized, among

other things, that local tax competition leads to more efficient use of public resources, and better alignment of local policies for the distribution of local public goods and services to the preferences of the residents. The specific risks associated with this phenomenon were mainly pointed out by W.E. Oates, listing among them the tendency occurring in local government authorities to under-value budget revenues (the term "race to the bottom" appears) (Oates, 1972). As a result, a serious problem may appear of insufficient supply of local public goods and services, while in the long run – deepening of the level of diversity in socio-economic development of individual areas.

Literature on the subject pays much attention to the issues of factors/determinants affecting local tax competition. For example, B.L. Benson identifies these factors using the following model of fiscal action sequence: 1) social pressure on the increase of public spending, 2) an increase in tax revenues, 3) an increase in the tax rate within the tax jurisdiction, 3) outflow of the local tax base, 4) increased competition among local government units with a limited and mobile tax base (Benson 2001).

Based on this model, another author, A. Walasiak, distinguishes three categories of factors affecting the intensity of tax competition, i.e. economic, fiscal and demographic factors. In this context, discrepancy between expenditure recognized as reference, i.e. expenditures to which a given local community aspires is essential (considering the fact that the needs of local communities are largely determined by demographic conditions, then the level of reference expenditures shall be determined on the basis of expenditure in territorial entities, identified on the basis of characteristics/parameters of demographic structures of similar values) as well as revenues actually realized. "Competitive tension" in a given local government entity, and thus a tendency for competition increases along with the growing deviation of the actual level of expenditure in relation to reference expenditure, and is the result of a mismatch of tax revenue sources to the level of expenditure. In the opinion of the cited author, in a situation when "poorer" entities catch up with "richer" ones, the importance of the imperative of local tax competition decreases. On the other hand, when "richer" entities somehow "flee" from "poorer" entities and differentiation in this area deepens, then one should expect an increase in the intensity of local tax competition. In addition, the said intensity is in a direct proportional way influenced by demographic factors. This intensity typically increases together with the number of inhabitants of a local government entity (Walasiak, 2014).

The studies conducted by the authors of this paper suggest that local tax competition in Poland has a very limited scale. This is mainly due to the fact of the small range of local taxes and the freedom to determine them left to local government authorities. What is symptomatic, the said freedom in a very limited way concerns only municipalities, while it does not occur at all

in relation to other types of Polish local government entities, i.e. poviats and voivodeships. The limited impact of tax competition at the local level is also confirmed by the results of empirical studies carried out in 2014 by P. Swianiewicz and J. Łukomska (Swianiewicz, Łukomska 2014) on a sample of 496 Polish municipalities. The cited authors were able to find statistical evidence of the occurrence of local tax competition, especially in relation to agricultural tax and real property tax. However, their studies show that it is rather a "yardstick competition", used for building or maintaining political capital in which municipalities adjust their tax rates to the rates adopted in the neighbouring municipalities, so as not to lose political capital, than "classical competition" for a tax base. In the authors' opinion, due to the small range of local taxing power, these cases do not have a decisive impact on the revenue potential of local government in Poland and on macroeconomic factors of development.

CONCLUSIONS

Polish local finances require systemic changes involving the strengthening of fiscal autonomy of local government. Local tax autonomy, and the greater freedom of local government authorities in the scope of deciding on taxes associated with it, is a necessary condition for the emergence of local tax competition and, consequently, more efficient use of public funds in the sector of sub-national governments, increase of local tax base translating to an increase in local government budget revenues, as well as a better match between the supply of public goods and services to local preferences. Based on the previously presented assumption that the specific *sine qua non* condition, necessary for competition to "function", is suitable, real (and not symbolical) level of local financial autonomy, including its key determinant – local taxing power, one should above all focus on the methods/possibilities of broadening the scope of that power. In this context, it seems necessary to introduce certain deregulation solutions and changes expanding the tax autonomy of local government entities in Poland.

Firstly, one would need to consider the appropriateness of continuing to maintain a monopoly of the state in regard to determining maximum local tax rates, and especially real property tax. Consequently, it is the legislature, not the local government that decides on unquestionable key structural elements of local government taxes, i.e. their rates. This approach significantly reduces local taxing power, consequently translating into fewer opportunities of local government in the context of its use of local taxes as an instrument of effect on a varied environment and the size of its own revenues. It also introduces an unjustified, somehow mandatory unification of local tax policies (for example, identical maximum real property tax rate oblige both local government authorities constituting large cities, as well as small towns). A legitimate question arises whether the decisions on tax rates should be the exclusive domain of

bodies constituting local government and which result from the individual, diverse conditions of socio-economic development, and the situation on local real estate markets in these units?

Secondly, it seems necessary to make complex changes in the Polish tax system in the context of the distribution of tax revenues between the different levels of local government. In the current legal status, neither poviats nor voivodeships have local taxes and, consequently, these entities have been completely deprived of the opportunity to use the instrument of local taxing power. One should consider the possibility of equipping these entities with particular tax sources.

Thirdly, the scope of local tax autonomy in Poland may also be extended as a result of certain institutional changes relating to the strengthening of the capacities of local tax authorities. As previously mentioned, the only part of local government taxes is implemented by municipal tax bodies, while its significant part for completely unjustified reasons, remains the responsibility of the state tax bodies. This should be changed, because it is difficult to find any arguments for taxes going in full to the municipal budget to remain the responsibility of the central fiscal administration.

Fourthly, strengthening of local taxing power requires a thorough reform of the property tax system in Poland. It seems essential to eliminate the anachronistic and areal tax system, and replace it with a new cadastral system. Despite the fact that such a concept appeared in Poland already in the first half of the nineties, it has not yet been achieved. The main argument against the reform is that it would be a difficult solution to implement for political reasons.

Fifthly, an important instrument for increasing the scope of the tax decision-making of local government authorities, thus expanding the scope of local taxing power in Poland could be the introduction of the separation of part of the tax base for personal income tax (PIT) and transfer it to the "possession" to local government entities. This would mean implementing the postulate for replacing the currently binding shares of local government in PIT tax – which is by the way deprived of the component of local taxing power – with a so-called municipal PIT, in which this component exists. Such a solution will not only broaden the scope of local tax instruments in Poland, but also enable to more closely connect taxes with local public goods and services provided by municipalities.

Sixthly, the systems of fiscal levelling in the Polish system of local finances should be verified, which are based on the mechanism of making solidarity payments by local government entities with a high tax revenue for entities of a lower revenue. "Bad balancing" of these mechanisms in Poland weakens the motivation of local government authorities to work towards increasing the efficiency of fiscal sources of budget revenues located within the territory

remaining within their tax jurisdiction. Consequently, such a system not only reduces local tax autonomy, but also the tendency for local tax competition.

The last, seventh postulate is perceived in Poland as very controversial. It concerns the increase of the scope of local taxing power in the form of introducing shares of local government entities in the goods and services tax (VAT). In Poland, revenues from VAT account for nearly half of the state budget revenues. The Polish Ministry of Finance is officially of the opinion that due to the specific structure of this tax (its multiphase character, deductibility, zero taxing rate, the problem of returns, etc.) it is impossible to directly determine the share of local government entities in revenues derived from this on the territory of the given local government entity (Odpowiedź, 2014). However, it should be noted, that in some countries such a solution was successfully introduced (examples: Spain, Germany) and in this context it is a proposal for consideration.

The obtained results will contribute to the further researches and discussion on the impact of the limited tax powers on the scope of local tax competition, especially in the context of optimal allocation of local public goods and adjustment of their size and structure to diverse needs of local communities. Research in this regard will be continued by the authors in the future.

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