

THEORETICAL PROBLEMS OF CENTRALIZATION AND DECENTRALIZATION OF LOCAL BUDGETS

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Abstract---*The article examines the problem of centralization and decentralization of the budget. Budget decentralization is interconnected with the processes of geographical decentralization and decentralization of the system of administrative decision-making. Decentralization of the system of making and executing administrative decisions implies a wider delegation of authority to local divisions of the central executive authority. The article also states that the main goal of decentralization is to create a closer relationship between the control system and the population, and this requires strengthening the financial system of local governments. The task of decentralization is to provide the regions and local governments with certain powers in the field of taxation and expenditure of funds, as well as the ability to independently determine the parameters and structure of the budget expenditures. The article substantiates the advantages and disadvantages of budget centralization. Attempts were made to cover all arguments for and against decentralization.*

Keywords---*decentralization, fiscal decentralization, macroeconomic stability, investment activity, region, income, expenses.*

The increased attention to the problem of "centralization - decentralization" in the last decade has been caused by a serious practical interest, which is connected with the transition from unitary to federal government, and the vigorous development of relations of fiscal federalism.

Scientists involved in this problem express the opinion that "... always politically tinged problems become finding a balance of benefits and disadvantages of centralization and decentralization. It does not require evidence of the serious consequences of a bias in one direction or the other. If "everything" is decentralized (in fact, the "center" disappears or becomes nominal), then the former system is completely deformed: instead of the former "center", several new ones

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appear. According to this scheme, for example, the disintegration of complex states takes place: the unitary - federal - confederation - several new ones. In any integral system, decentralization is appropriate only for as long as there is a "center". If "everything" is centralized (disappear or put nominal "subjects of decentralization"), then a unitary, totalitarian organization of management (ultimately - in spirit) of the state arises "(Лексин, 2002, С.4).

At the same time, different countries with a federal structure (USA, Canada, Germany, etc.) are getting closer to the optimal level of balance between centralization and decentralization, and this happens not only because of their financial and budgetary well-being, but also due to using politically correct, socially and economically justified rules, and mechanisms for coordinated distribution of powers and resources across different levels of the state-territorial structure. This indicates that in these countries they have learned to use the advantages of fiscal decentralization in public finances, leveling its shortcomings with the help of these instruments.

The optimum criterion at each time point is the presence (or absence) of sustainable territorial socio-economic development, the minimization of subsidized and depressed territories, and the growth of citizens' well-being. This optimum is dynamic, its mobility, monitored in the monitoring mode using a set of socio-economic indicators, can be the basis for realistic assessments of the effectiveness of the degree of decentralization.

The term "decentralization" is used quite widely, but its meaning is not always understood in the same way. Fiscal decentralization is interconnected with the processes of geographical decentralization and decentralization of the system of administrative decision-making, however, it has a number of differences. «A distinctive characteristic is that the concepts of "centralization" and "decentralization" do not completely exclude each other. They appear only in different ways to solve this management problem through a different degree of distribution of rights and responsibilities along the "vertical" of management» (МуминовН.Г., МелибаеваГ.А., 2019, С. 118.).

Geographic decentralization is used in many countries to boost economic development mainly in rural areas, with the help of subsidies and tax breaks to achieve a reduction in relative costs for business development and thus make these territories more attractive. This kind of decentralization does not necessarily imply strengthening the financial base of local governments. Decentralization of the system of making and implementing administrative decisions implies a wider delegation of authority to local units of the central executive power. This strategy is designed to provide technically more efficient management by reducing the multistep process of executing decisions and increasing, thereby, the efficiency of the work of government bodies. To achieve these goals, it is also not necessary to strengthen the financial system of local governments.

As you know, decentralized management, even in its most rational form, is an order of magnitude more complicated than a centralized one, and decentralized organization of a complex system (for example, the federal structure of the state) requires efforts to maintain its integrity and sustainable development immeasurably larger than in the version of a unitary organization. At the same time, it is the federal structure that is often the only way to preserve the integrity of a country, since territorial decentralization in the form of a federation remains the most significant alternative to disintegration and political disintegration of the country. Therefore, the federation, being the newest evolutionary peak in the development of the state; most appeared only in the twentieth century(<https://cyberpedia.su/17x2627.html>).

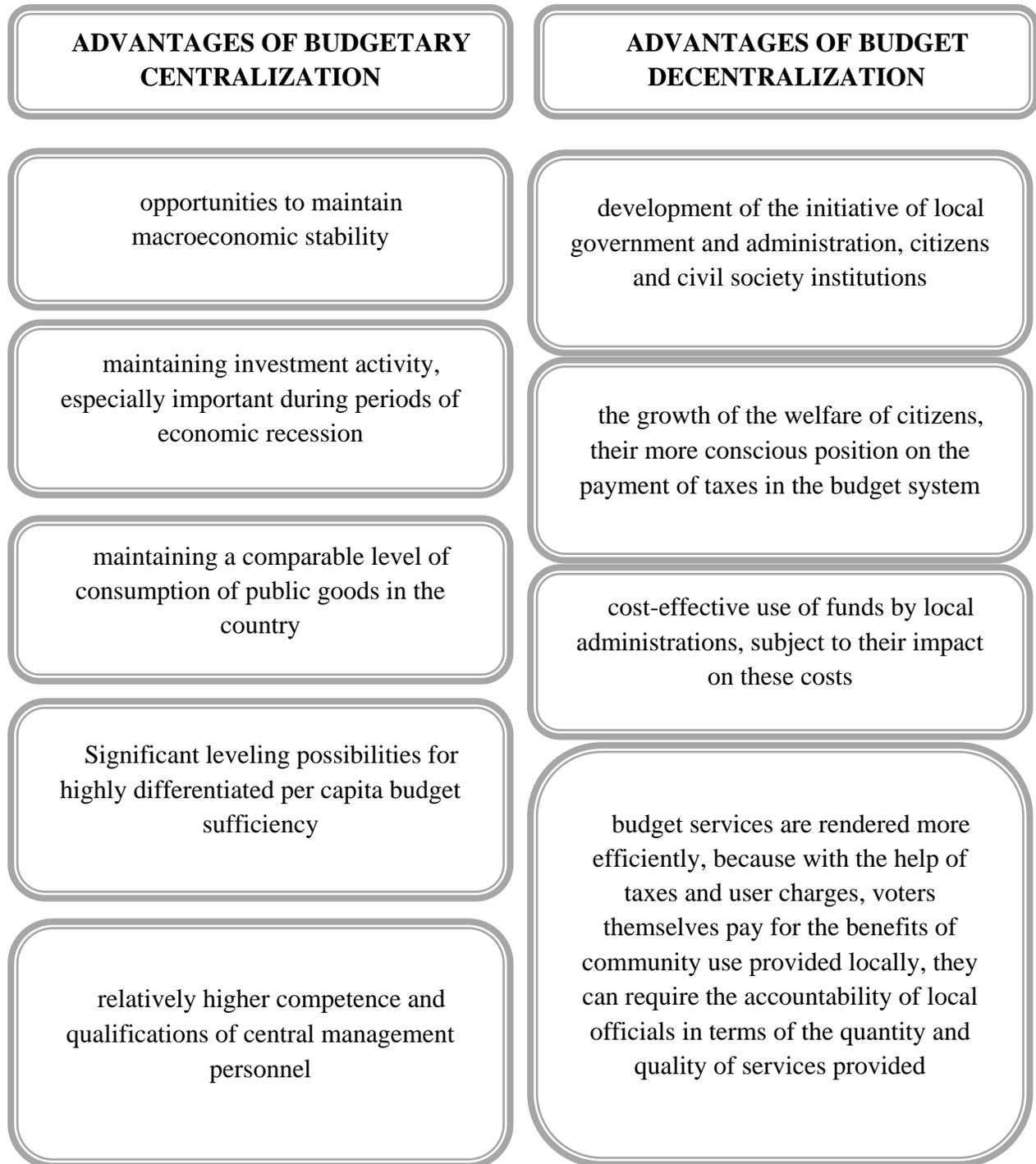


Fig.1. Benefits of fiscal centralization and decentralization

In the field of public finance, fiscal (or fiscal) decentralization has fundamental differences from other forms and methods of delimiting competencies, powers, and resources due to the fact that its subject throughout the world are: a single system of public finances and uniform rules of taxation, development and budget execution. «... it is extremely

important to pay attention to the formation of a flexible system of fiscal relations between the center and the regions, between regions and municipalities» (Савина О.Н., Паздникова Н.П., Шелестова Д.А., 2018, С.135).

In addition, in each state, the unity of the monetary system and external borrowing is obligatory. At the same time, the main goal of decentralization is to create a closer relationship between the control system and the population, and this requires strengthening the financial system of local governments. The task is to provide the regions and local governments with certain powers in the field of taxation and expenditure of funds, as well as the ability to independently determine the parameters and structure of the budget expenditure. Thus, the population will be able to independently determine the composition of local authorities (through elections) and actively participate in the management process.

The end result should be an increase in the quality of public services provided by local governments, and greater voter satisfaction. Fiscal decentralization implies a certain degree of autonomy for local governments, allowing them to make independent decisions in the fiscal sphere. In order to reveal the economic content of decentralization as the reverse side of centralization, it is necessary, probably, to weigh their advantages and disadvantages. For evidence of the generalizations put forward, we present some analytical and statistical data. In terms of opportunities for macroeconomic stability, centralization is preferred at the transitional stage. Scientists note that states with developing and transitional economies are unstable in their nature, which is explained by a number of reasons, for example, a significant dependence on a limited number of major export items (agricultural or mineral) (Бол, 2002, С.6). Changes in prices on the world market can have a very negative impact on the economy of such a country. Changes in global economic conditions may also slow the pace of economic growth in such countries. For example, an economic downturn in the global economy could lead to a reduction in the inflow of foreign investment, a drop in export demand, a significant reduction in tourism activities, etc. Thus, even in the most economically developed countries of Latin America, real GDP is 1.5 times more volatile than in industrialized countries, and real exchange rates of national currencies are 3 times more volatile.

Such volatility in the economy is also reported in the public sector, often on a larger scale. Fluctuations in global interest rates and real exchange rates directly affect the size of external debt service. The amounts of indirect tax revenues depend on fluctuations in demand, while expenditures in the public sector depend on the rate of inflation and unemployment. The World Bank report notes an interesting fact: tax revenues in Latin American countries are 2.5 times more volatile than in industrialized countries, and public sector spending is 4 times more volatile.

The threat of instability forces the central authorities to monitor the activities in the fiscal sphere (by reducing government spending, or by increasing taxes) in order to pursue a stabilization policy. Indeed, how can a program to regulate inflation and the budget deficit be implemented, provided that a significant proportion of government spending and taxes are managed by local governments that have no direct interest in the implementation of stabilization policies?

Ministries of Finance in almost all countries seek to control to the maximum extent possible:

- 1) the size of tax rates and taxable base for the main types of taxes. This allows the government to control the level of revenues and the size of the budget deficit. In most developing countries and countries with economies in transition, the rates and taxable base of the main taxes are set by the central government and cannot be changed by local authorities. This is largely due to the need to control macroeconomic parameters.

- 2) The procedure for the allocation of costs and determine their level. In the absence of hard budget constraints, local government spending can reach values that will threaten the size of the budget deficit. For this reason, in many

developing countries and countries with economies in transition, control is exercised over the level of expenditures of local governments. There are several ways to do this: (a) centralized setting of the level of wages of employees of local authorities; (b) the establishment of an upper threshold for employment in the public sector, and (c) the approval of local budgets by higher-level authorities.

3) Regulation of the procedure for attracting loans by local authorities. This can protect the economy from over-investment by local governments. It will also allow the central government to better control the overall level of domestic borrowing in the economy.

Control over revenues, expenditures and borrowings of territorial authorities is a prerequisite for achieving macroeconomic stability, and they are much easier to implement in conditions of fiscal centralization.

Another important argument in favor of fiscal centralization is the need for infrastructure investments, which should be centralized. As a rule, especially in countries with transitional economies, there is a lack of capital, and local governments have very little cash reserves. At the same time, it is well known that the priorities of the state as a whole in the field of investments often do not coincide with the priorities of territorial and local authorities. The central government is interested in infrastructure investments that will benefit both at the regional and national levels: these are main roads, energy, information, transport systems, etc. Local authorities, on the contrary, are more interested in investment projects that are primarily of local importance, for example, the construction of markets, water supply systems for small areas, municipal buildings and recreation areas. Therefore, in terms of focusing on the maximum intensification of economic growth, there are many supporters that large state investment projects designed to ensure the development of a nationwide infrastructure should be given absolute priority, and that the role of local authorities in investment policy should be limited.

An additional argument in favor of fiscal centralization is the fear that local authorities in the process of creating and developing diverse infrastructure will not adhere to the necessary standards (both technological and public services) and will not be able to ensure their functioning at the proper level. As for social investments, social infrastructures, the majority of representatives of the federal center rightly believe that these investments should be implemented uniformly throughout the country. This position is implemented through federal government programs that limit the autonomy of territorial authorities in determining the level of public services in the field of education and health care, as well as housing and communal services. Comparable accessibility to the consumption of basic public goods in the sphere of education, health care, and social protection in the context of centralization is achieved by using the normative method of planning budget expenditures - "spending standards" in budgeting.

In the conditions of centralization, there are more opportunities to equalize financial differences - in the levels of per capita fiscal security. As is known, for most developing countries and countries with economies in transition, there are very large inter-regional differences in income and wealth levels. For "poor" regions, low tax collection and a high level of expenditure needs are typical. Mitigating these adverse financial differences is usually the task of the central government. One of the generally accepted methods of leveling differences is the system of allocation of equalization (equalizing) transfers. In the context of centralization, there are more opportunities to equalize financial opportunities. The central government has the opportunity to pool more funds for the subsequent redistribution among the territorial authorities in order to equalize financial differences between regions.

Budget decentralization actually prevents alignment. When local governments are given the authority to tax or independently determine the structure of expenditures, as well as some possibilities for borrowing, regions with higher levels of income will usually take advantage of the benefits of the new status. These territories have a sufficient tax base for introducing new taxes, are distinguished by higher tax collection, have infrastructural capabilities that allow them to provide more social services, as well as sufficient potential for repayment of loans, which makes it possible to use loans to increase investment activity. Thus, with the decentralization of the budget system, we can expect further growth of differentiation between the “rich” and “poor” regions.

Among the main advantages of fiscal decentralization are not only traditional - economic and social, but also “integrated”, which can be formulated as the development of initiatives - local authorities and administrations, citizens and civil society institutions - various non-profit organizations lobbying interests of both the population and entrepreneurship in power structures.

Among the economic advantages of decentralization are the growth of citizens' well-being, their more conscious position about paying taxes to the budget system, more economically efficient spending of funds by local administrations, subject to their influence on these expenses. This is beneficial for the state as a whole for several reasons.

First, if citizens get a tax cut, an increase in social spending, or a change in spending structure in accordance with priorities, etc., their well-being increases. Secondly, if the quality of the services provided meets their needs, people are more willing to pay taxes. Decentralization, therefore, should lead to intensification of tax policy and to overcome resistance when introducing targeted taxes or user charges as a means of cost recovery, which is less likely in a centralized management system.

Thus, the decentralization of powers to provide public goods increases the efficiency of budget spending, as it brings power closer to the population, makes it accountable to voters, and allows for a more complete account of the preferences of the population.

The decentralization of authority to form budget revenues makes it possible to more accurately take into account the specifics and composition of the tax (income) base and thereby ensure a higher collection of taxes and other revenues to the budget. As for the integrated effect, designated by us as the development of a local initiative, it, in fact, expresses the qualitative increment that can be achieved in a balanced development of decentralization, providing a way out of the crisis, sustainable socio-economic development and economic growth.

Budget decentralization brings the government closer to the population, since the responsibility for making part of the decisions regarding a certain level and structure of taxes and budget expenditures lies with the local authorities. The use of administrative resources in conjunction with certain economic powers contribute to increasing the tax base and mobilizing revenue revenues to the local budget.

In the context of decentralization, there is a stimulation of the active formation of civil society - various non-profit organizations representing the interests of numerous groups of people and economic entities, through which state-public control over the activities of regional and local administration, including in the fiscal sphere, becomes real.

The most significant question in this regard is whether the real conditions have matured in order to take advantage of decentralization? The international experience, analysts' conclusions regarding the necessary conditions for successful budget decentralization are generally similar and are as follows.

Representatives of regional and local governments should be elected by the people. If leaders are appointed by direct instructions from above instead of being elected in a nationwide vote, voters cannot express their preferences through the institution of elections and do not have the right to replace those who do not represent their interests.

Local authorities should be given some authority in tax matters. Local governments, independently determining the rates of certain taxes, can regulate both the level of the budget and the amount of financing social services. If the only source of income is transfers from the center, then in fact the size of the budget in this case is determined by the central (or regional) authorities. In many developing countries and countries with economies in transition, local governments do not have the authority to set tax rates independently, with the exception of the smallest local taxes.

Local authorities should have some responsibility for spending budget funds. Until local authorities are transferred to the responsibility for providing services that are important to local voters, local officials will remain unaccountable to their electorate.

Local governments should be granted a substantial degree of autonomy in determining the structure of public services provided. They should have some freedom of choice when distributing their own funds among various items of expenditure.

Local governments should be given adequate administrative authority to collect taxes to carry out the revenue side of local budgets. Often this is a difficult problem, since local taxes are often difficult to collect, and local tax authorities do not have a sufficient number of experienced tax professionals. In addition, it is also important that the distance between local officials and specific taxpayers is minimal, and therefore tax collection is largely determined by political considerations. It is not difficult to imagine how difficult it will be for an official elected by the local population to decide on the confiscation of property in the event of non-payment of, for example, property tax. In transition countries there is another problem. Tax collection is often a function of central government, that is, centralized tax collection, although carried out on behalf of local authorities, implies only “the most indirect” of their participation.

If all the above conditions are not complied with or are not ready for effective fiscal decentralization, its drawbacks are fully manifested - the prevalence of “parochial” interests as opposed to region-wide or national, duplication of management functions, growth of management expenses, and inefficiency of budget expenditures in general, etc.

In assessing the advantages and disadvantages of both centralization and decentralization, the most difficult thing is finding a balance between these two competing approaches. The key fact, if it is necessary to systematically evaluate the set of parameters, is probably the fact of the indissolubility of their existence in the conditions of progressive development of federative relations as a whole, obliging to search and find the optimal combination for each specific moment of development.

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