FINANCING LOCAL INFRASTRUCTURE INVESTMENTS IN ROMANIA AND OTHER NEW EU MEMBER STATES

Bilan Irina

Alexandru Ioan Cuza University Iaşi, Faculty of Economics and Business Administration, Office address: Carol I Boulevard, No. 11, Building C, 6th Floor, C806b, Email: irina.bilan@uaic.ro, Telephone Number: 0232-201569

Rusu Elena

Alexandru Ioan Cuza University Iaşi, Faculty of Economics and Business Administration, Office address: Carol I Boulevard, No. 22, CP 700505, e-mail: elena28072001@yahoo.com, Telephone Number: 0232-201652

Abstract: In the context of European Union integration, the effort of European Union countries is oriented on reaching the same occidental standards in local public administration. Therefore, the reforms of local public administration are concentrating on local public investments, and especially on infrastructure projects and the sources of financing them. This paper presents these sources of financing local public investments in Romania and other new EU countries from Central and Eastern Europe.

Key words: European Union, local infrastructure investments, budgetary revenues, EU grants, private financing

1. Necessity of local infrastructure investments and the role of local authorities in financing them

The scientific literature admits the existence of a direct relationship between the level of investments in infrastructure (transport, telecommunications, environment etc.) and the performances of economic growth of a country. In this context, the increasing of investments is recommended as a precondition for sustaining the potential of a state's economic growth.

The necessity of massive infrastructure investments is specific not only to European states, but to the international level, too. At this level, it is manifested in a context characterized through three historic importance phenomena as follows: globalization, which imposes to create a competitive infrastructure, the decentralization process, which sometimes is not accompanied by authority or resources transfers and urbanization, which imposes the assurance of some basic services withought precedent.

In the European context, big infrastructure investments are important especially for the new member states of EU (from Central and Eastern Europe) for sustaining the real convergence program. A study made in 2005 estimated the necessary of investments in infrastructure in the new EU member states in 1995 – 2010 at 505 billion euro (44 billion for roads, 37 for railways, 63 for telecommunications, 180 in the water/sewage sector, 110 in the energy sector and 71 in environment) [Brenck and others, 2005].

The lack of investments in infrastructure, especially in transport, is a reality for Romania too. In accord with Ernst & Young Research „Investments attractivity in S-E Europe in 2008", although Romania is the main destination of investments in South-Eastern Europe, improvements are still necessary, from the foreign investors perspective, in some areas such as communications, transport, logistics, social environment and the quality of life.

In this context, the financing of investments in infrastructure, in EU countries and on international level, too, seems to be "one of the most important challenges of the millennium" [Sierra, 2005].

The decentralization process generates the implication of local authorities in local infrastructure investments, as a result of exclusive competences and, so, the necessity of ensuring the financing sources for them. At the same time, the statute of EU member state imposes restrictions on local authorities, but, also, offers them the opportunity to access new financing resources for local infrastructure projects.

2. Financing local infrastructure investments through budgetary revenues

In the traditional way, the financing of local investments projects in infrastructure should be made only with *ordinary resources of local budgets*. From this point of view, article 9 of the European Charter of Local Self-Government suggests, at least implicitly, that the structure of local authorities' resources should

be broken into two broader concepts as follows: *own resources* and *transferred resources* or *financial transfers*.

The own resources, of which they may dispose freely within the framework of their powers, are from the local community territory and mean: local taxes, fees. Transferred resources are financial transfers from central budget with the help of tax-sharing system. The own revenues in accord with Romanian Local public finances Act [Act of local public finance, Art. 5 (1)] are: local taxes, contributions, quotas from income tax (in total amount of 82%) and others. Another source of financing are the transfers from the state budget or other budgets, but as a rule of local financial autonomy, it is indicate this amount to be smaller. The transfers from state budget have the form of sums from VAT and subventions.

If the ordinary resources are insufficient, a solution for local investments in infrastructure is *local indebtedness* using borrowings, as *extraordinary resources of local budgets*. There are two main possibilities that local government can use in borrowing: bonds and loans from commercial banks.

The Romanian local public finance Act stipulates that local councils, counties councils and the General Council of Bucharest County can contract internal and external loans, short, medium and long-term, for local public investments and for refinancing local public debt. An important prudential rule is that “annual debts representing the due installments deriving from contract loans…shall not exceed 30% of own revenues of the local budgets…” [Act of local finance, Art. 63 (4)].

However, prudence is recommended when employing local indebtedness, for Romania and other EU member states, because of the nominal convergence criteria which says that the ratio of government debt to GDP must not exceed the benchmark value of 60%. The practice of local indebtedness in the context of a big central government debt stock can generate the unfulfilment of the convergence criteria. For Romania and the other Central and Eastern European countries the situation is not a worrying one because they have a low level of total public debt, much less than 60% (Hungary being an exception).

If the public deficit ratio to Gross Domestic Product (GDP) exceeds the reference value of 3% (convergence criteria of The Treaty of Maastricht, also stipulated in the Stability and Growth Pact), no project will be financed from the Cohesion Funds, until the deficit problem will be solved. So, it is necessary to practice a prudent local indebtedness for not limiting the access to EU funds. In 2007, Romania was very close to the government deficit limit (2,7% of GDP).

The low level of funds available for local public administrations and real impossibility (and not legal) to raise local taxes for bigger revenues of local budgets, makes the money look insufficient for infrastructure investments, even for small investments. Local borrowing must be used prudently for not generating budgetary deficit over the limit, although it looks like a viable solution. In this context, it is necessary to find alternative sources of financing, such as European Union funds or public-private partnership.

3. EU funds for financing local infrastructure investments

The EU integration offers to the member states new opportunities to obtain financial resources for financing the development projects, inclusively local infrastructure projects. Starting with the moment of accession, the states benefit by non-reimbursable financial assistance through the funds allocated in accord with the European Union policies.

The fundamental policy of EU is the Economic and Social Cohesion Policy, whose implementation is realized with the help of three structural instruments, as structural funds (European Regional Development Fund – ERDF - and European Social Fund - ESF) and the Cohesion Fund - CF. The actions financed by these funds and the categories of eligible member states are presented in Table 1.

EU Fund	Supported actions	Eligibility
Cohesion Fund (CF)	- Transport infrastructure projects - railways, road traffic, inland waterways, civil air transport, etc. - Environment projects - energy efficiency, renewable energy and transport projects	EU Member States whose GNP per capita is below 90% of the EU-average
European Regional Development Fund	- Direct aid to investments in enterprises (focus on SMEs) to create sustainable jobs - Infrastructures related to research and innovation, telecommunications, environment, energy and transport	All 27 EU Member States

(ERDF)	- Support via financial instruments such as capital risk funds, local development funds, etc. for regional and local development and encouragement of cooperation between cities and regions - Technical assistance	
European Social Fund (ESF)	- Lifelong learning and adoption of workers and enterprises - Integration of unemployed, women and migrants in the labour market - Fighting discrimination in the labour market - Reforming education system and improving human capital	All 27 EU Member States

Table 1: Eligible Member States and supported actions from EU Funds

For the 2007–2013 period of time, the intervention objectives of the Economic and Social Cohesion Policy are:

- Convergence – for the regions where GDP/inhabitant is under 75% of the EU average (financed by the ERDF, the ESF and the Cohesion fund);
- Regional Competitiveness and Employment – for regions which are not eligible for the Convergence objective (financed by the ERDF and the ESF);
- European Territorial Cooperation – for regions, counties and transnational zones (financed by the ERDF).

In accord with their stage of economic development, the new EU member states from Central and Eastern Europe, inclusively Romania, can benefit by all three funds. For the period of time 2007 – 2013, Poland benefits by the biggest amount of funds (67284 mill. Euro, almost 19,37% of total funds), followed by the Czech Republic (7,68%) and Hungary (7,28%) (Figure 1)

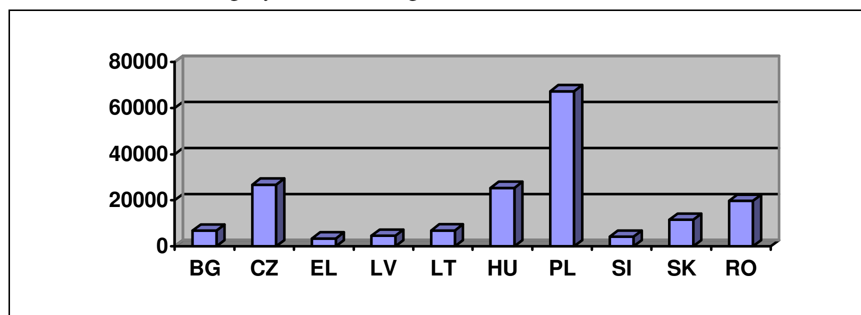

Figure 1: Cohesion policy 2007-2013: Indicative financial allocations for the new EU Member States (million Euro, current prices)

Source: European Commission

The total amount of Cohesion and Structural Funds allocated for Romania for 2007-2013 is 19668 million Euro, representing 5,66% of the total funds. 12661 million Euro are allocated through Structural Funds in the „Convergence" objective, 6552 million Euro are allocated through Cohesion Fund and 455 million Euro are allocated to the "European Territorial Cooperation" objective. The distribution of Structural Funds – Convergence objective- and of the Cohesion Fund for Operational Programs makes evident the priority of infrastructure projects in transport (23,8%) and environment (23,5%) (Figure 2)

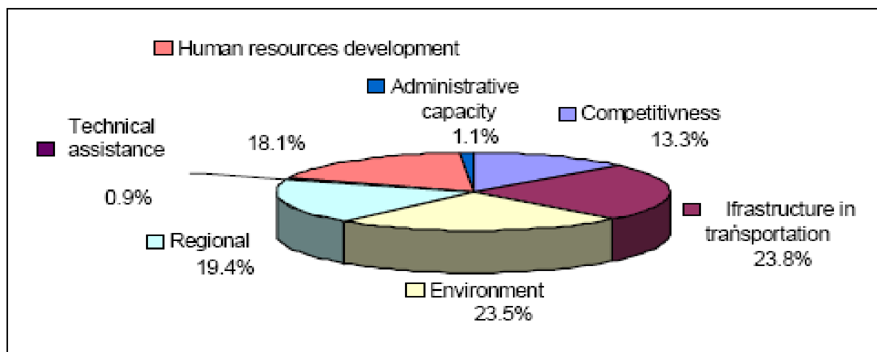

Figure 2: Estimative allocation on operational programs for Romania, 2007-2013

Source: The Romanian National Strategic Reference Framework (RNSRF) 2007-2013

Resources from Cohesion and Structural Funds represent an opportunity for the new member states, because they offer the possibility to make big investment projects, also in local infrastructure, withought using ordinary resources and without affecting the level of consolidate budgetary balance. The differences between borrowing and EU funds are as follows: the funds are not reimbursable and don't suppose interest rates.

Though, there are two aspects which must be taken into consideration. First, the rules of Cohesion and Structural Funds impose the necessity of co-financing by the member states. The maxim level of EU contribution is established by the Council Rules no.1083/2006, according to the EU financial perspectives for 2007- 2013.

Romania can benefit by a maximum communitarian financing rate at the level of OP of 85% for all three funds: ERDF, ESF and Cohesion Fund. The RNSRF allocation within the "Convergence" objective needs a national co-finance estimated at 5.07 billion Euro, proceeded from public sources (2/3 from the total of co-finance) and from private sources (1/3). The public co-financing will be assured from the state budget by the Romanian Government and from the local budgets of the public authorities which will apply structural instruments for financing.

Considering the lowest financial capacity of many local authorities to assure this co-financing, the Romanian Government decided to reduce as far as possible the local budget contribution. Thus, the principle which will be applied in the operational programs tell us that the personal co-financing which the local authority need to assure for a project will be in general 2% from the eligible value, a major exception being the projects which generates incomes. Consequently, the approved contribution of the local authorities is under 5% from the total of national co-finance.

Secondly, the new EU member states, and Romania in particular, don't have the capacity of absorption of these funds because of the inadequately institutional and legal framework, although the volume of cohesion and structural engagements is considerable.

In the first two years after the integration of the ten countries in the EU in 2004, the absorption rate has been under expectation (Poland, Hungary and Czech Republic). Only Latvia registered some performances. Also, Romania encountered the same problem in 2007. A study published by the National Bank of Romania in March 2008 pointed out that the level of European funds absorption by Romania in the first year as a EU member state (21,7%) was at the half of the level registered by other countries as Czech Republic, Poland (42,8%), Hungary (42,9%) and Slovakia. In this context, Romania became a net contributory to the European Union budget. Unless such a problem is properly addressed, it may result in de-commitments and the opportunities offered by EU funds would never materialize.

4. Financing local infrastructure projects through private participation (Public Private Partnership)

Public Private Partnership, as an alternative of financing the public investment projects, is applicable in the local infrastructure field, too. The mobilizing of available resources of both parts, public and private, presents a big advantage: it creates the possibility of local public administration to make big projects, which would be impossible without private partnership. Respecting the restrictions imposed by The Treaty of Maastricht and the Stability and Growth Pact on fiscal criteria, the Public Private Partnership is an

alternative to make big local investments in infrastructure without practicing supplementary pressure on local budget. On the contrary, the relief of local budget from the obligation to entirely finance the local investment projects creates the instrument to reduce budgetary deficit and to rise other categories of current expenditures.

An analyze of the employment of Public Private Partnership in the European Union countries demonstrates that this instrument of financing is relatively new. Only The Great Britain has been using the Public Private Partnership as an alternative of financing public investment, for over 15 years. This financing alternative is familiar in Great Britain and Portugal. In the other countries of EU, the amounts of Public Private Partnership contracts are low.

The same situation is present in the Central and Eastern European states of EU, including Romania. The legal framework of Public Private Partnership was developed only recently and so, its employment is still at the beginning. The legal framework of PPP in Romania started with Act no. 219/1998 on concession regimes and Government Ordinance no. 16/2002 on public-private partnership contracts. The harmonization with the European directive on public acquisitions and concessions determined the new legal framework in 2006, GUO no. 34/2006 (approved by Act n. 337/2006) on public acquisition contract, equipment and services concessions contracts.

Country	**Number of projects 1990-2006**					**Value of projects 1990-2006 (million USD)**				
	Total	**Energy**	**Telecom**	**Transport**	**Water and sewage**	**Total**	**Energy**	**Telecom**	**Transport**	**Water and sewage**
Bulgaria	22	13	5	3	1	7133	3566	2881	534	152
Czech Republic	67	27	14	6	20	21186	5165	15216	390	415
Hungary	58	26	17	6	9	24362	5903	13817	4437	206
Latvia	9	1	5	3	0	1985	177	1598	210	0
Lithuania	10	4	6	0	0	2384	409	1975	0	0
Poland	47	19	13	8	7	28261	2981	23365	1845	70
Romania	20	9	7	1	3	9563	2166	6258	23	1116
Slovak Republik	13	6	3	1	3	8107	4460	3592	42	14

Table 2: Private participation in infrastructure projects in the new EU Member States

Source: World Bank, Private Participation in Infrastructure Database

The incipient stage of development, from this point of view, registered in the new member states of EU from Central and Eastern Europe, can be presented using the number and the value of infrastructure projects financed by private participation (Table 2). Romania registered only 20 projects with a total value of 9563 million USD, after the Czech Republic, Hungary and Poland. The most important fields are telecommunications and energy. On the contrary, participation of private capital for financing transport projects is very small.

Being a European Union member state, Romania is expected to register a significant development of this financing mechanism in the next period of time, thus Public Private Partnership is an important option for future infrastructure local projects.

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