

INTERGOVERNMENTAL FISCAL RELATIONS AND LOCAL FINANCIAL AUTONOMY IN ROMANIA

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Abstract: Since the fall of the communist regime, Romania had experienced a long period of structural reforms aimed to readjust the society and the economy to the requirements of democracy and market values. Public finances had played a major role in this assignment, but their tasks were impeded by the necessity of reforming the public finances itself. The transition from the central economy to the market economy had to be made simultaneously with the reform of the public finances. This had generated great difficulties in designing the new framework of the local finances which further, generated major difficulties for local governments. The paper tries to make a brief description of the decentralization of public finance in Romania, identifying the major evolutions and criticizing the actual system which is not yet compatible with the requirements of the EU.

JEL Classification: H72, H74

Key Words: decentralisation, local revenues, local expenditures, intergovernmental transfers

An efficient providing of public goods imposes that the responsibility of their management should fall in the hands of the public authority that it is the closest to the level where the public needs appear. As a practical matter, the central authorities cannot deal effectively with all public necessities. The existence of local communities determines various but common needs, for which the citizens have different preferences. An appropriate response to these preferences depends on the level of decentralization. As a process, decentralization is necessary and it is taking place more obvious in ex-communist countries, Romania included. These same countries have switched to democratic systems, meaning that they have to rethink and redesign public authorities' competences. The Romanian Constitution adopted in 1991 stated the following principles for organizing local public administration: local autonomy and decentralization of public services. Its revue in 2003 has added also the deconcentrate administration principle. These principles were extended by secondary legislation, such as Local Public Administration Law, no. 69/1991. However, even though the legal frame was existing, in reality the decentralization was non-existent. The competences transfer process has really began starting with 1993-1994.

Administrative decentralization has to be accompanied by financial decentralization. First steps in this regard were the adoption of local taxes law in 1994. Unfortunately, the act did not respond to the need of local financial resources according to the figures of local public expenditures. Only starting with 1998, these financial needs started to be met in practice. Another important step has been added in 2004 when the legal framework of decentralization has been adopted and thus, all previous incoherent measured have been repressed. The lack of a well-established financial decentralization strategy has generated the following problems for local administrations:

- legislative instability;
- the absence of a transparent system in establishing intergovernmental financial transfers;
- the impossibility of local administrative revenues prediction;
- the lack of precision in defining competences fro local administrative authorities;
- the augmentation of local administrative responsibilities without the transfer of needed/appropriate/covering resources.

The present study is going to focus on the following issues regarding financial decentralization in Romania:

- the correlation between local revenues and local responsibilities;

Figure No. 1 The transfers of responsibilities to the local governments during 1991 – 2005

Source: adaptation after www. ipp.ro

Starting from 1994, the prerogatives of local authorities have extended continuously, thus confirming the trend towards decentralization, which had to be supported by the revenues side of local governments' budgets. As we can see from the table below, many of the actions were financed by special destination transfers, being in contradiction with the local autonomy requirements, defined by Strasbourg European Chart.

The local government's expenditures have continuously increased during the 1991 – 2005 period, both in absolute and relative terms. The evolution is presented in table no.1.

| Year | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|------------|--------|--------|---------|---------|---------|----------|----------|----------|---------|---------|----------|----------|----------|----------|----------|
| GDP | 220.39 | 602.92 | 2003.57 | 4977.32 | 7213.55 | 10891.96 | 25292.57 | 37379.82 | 54573 | 80377.3 | 116768.7 | 151475.1 | 197564.8 | 246468.8 | 288047.8 |
| LBE | 5.84 | 19.94 | 69.60 | 173.51 | 326.53 | 495.52 | 1037.05 | 1338.15 | 2159.93 | 3321.67 | 7067.54 | 9268.84 | 12852.7 | 15540.7 | 18777 |
| LBE/GDP(%) | 2.65 | 3.31 | 3.47 | 3.49 | 4.53 | 4.55 | 4.10 | 3.58 | 3.96 | 4.13 | 6.05 | 6.12 | 6.51 | 6.31 | 6.52 |

**Table No. 1 The amount and the share of local budgets expenditures (LBE) in GDP
mil RON**

*Source: <http://www.insse.ro/cms/rw/pages/index.ro.do>;
http://discutii.mfinante.ro/static/10/Mfp/buget/executii/rom09_2007/rom01_septembrie.pdf*

We can easily see the increasing share local budget expenditures in GDP along the whole period, in spite of some short inconsistencies. The share of local expenditures in GDP has doubled from 1994 (3.49%) to 2004 (6.75%). The pattern is quite interesting: it increased during 1994 – 1996 as a result of the new prerogatives transferred to local governments, followed by a slight decrease during 1997 – 1999 as a result of structural adjustments of the public sector. The raising had started again in 2000, with a big leap forward in 2001 (from 4.13% to 6.05% due to the financing of personnel expenses in education sector. Another leap was in 2003 as a result of social assistance programs that were passed to the local governments. The same evolution is encountered when we considered indicators such: share of local budgets expenditures (LBE) in general consolidated budget expenditures (GCBE) and state budget expenditures (SBE).

| Year | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|--------------|-------|--------|--------|---------|---------|---------|---------|----------|----------|----------|----------|----------|----------|----------|----------|
| LBE | 5.84 | 19.94 | 69.60 | 173.51 | 326.53 | 495.52 | 1037.05 | 1338.15 | 2159.93 | 3321.67 | 7067.54 | 9268.84 | 12852.70 | 15540.70 | 18777.00 |
| SBE | 53.79 | 162.7 | 412.88 | 1093.03 | 1585.8 | 2373.2 | 5289.66 | 7761.66 | 10688.67 | 14916.8 | 18401.2 | 22682.4 | 28145.1 | 34073.5 | 38782.4 |
| CGBE | 83.96 | 249.77 | 677.08 | 1664.26 | 2506.09 | 3703.17 | 8563.68 | 13111.74 | 18918.62 | 28314.04 | 39031.68 | 48878.04 | 62727.1 | 77737.5 | 89897.8 |
| LBE/SBE (%) | 10.87 | 12.26 | 16.86 | 15.87 | 20.59 | 20.88 | 19.61 | 17.24 | 20.21 | 22.27 | 38.41 | 40.86 | 45.67 | 45.61 | 48.42 |
| LBE/GCBE (%) | 6.96 | 7.98 | 10.28 | 10.43 | 13.03 | 13.38 | 12.11 | 10.21 | 11.42 | 11.73 | 18.11 | 18.96 | 20.49 | 19.99 | 20.89 |

**Table No. 2 The amount and the share of local budgets expenditures (LBE) in general consolidated budget expenditures (GCBE) and state budget expenditures
mil. RON**

*Source: <http://www.insse.ro/cms/rw/pages/index.ro.do>;
http://discutii.mfinante.ro/static/10/Mfp/buget/executii/rom09_2007/rom01_septembrie.pdf*

The previous explanations are valid also in this case. At the beginning of the period (1991), the local budgets expenditures were 10.87%, but at the end (2005), they were almost half of the state budget expenditures (48.42%), thus reflecting the vast dimension of the decentralization process. The financing of these continuously increasing expenditures need local financial resources, which, in Romania, consist in two major sources: own revenues from local taxes and samplings and transfers from the state budget. The evolution of these indicators is reflected in the following tables.

| Year | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|

| | | | | | | | | | | | | | | | |
|-------------|--------|--------|---------|---------|---------|----------|----------|----------|----------|----------|-----------|-----------|-----------|-----------|-----------|
| SSB | 0.00 | 0.00 | 23.18 | 66.81 | 120.30 | 197.26 | 464.46 | 499.80 | 1039.89 | 1842.99 | 5092.45 | 7095.97 | 9374.30 | 11909.80 | 14667.10 |
| GDP | 220.39 | 602.92 | 2003.57 | 4977.32 | 7213.55 | 10891.96 | 25292.57 | 37379.82 | 54573.00 | 80377.30 | 116768.70 | 151475.10 | 197564.80 | 246468.80 | 288047.80 |
| PBS/GDP (%) | 0.00 | 0.00 | 1.16 | 1.34 | 1.67 | 1.81 | 1.84 | 1.34 | 1.91 | 2.29 | 4.36 | 4.68 | 4.74 | 4.83 | 5.09 |

**Table No. 3 The amount and the share of samplings from state budget (SSB) in GDP
mil. RON**

Source: <http://www.insse.ro/cms/rw/pages/index.ro.do;>

http://discutii.mfinante.ro/static/10/Mfp/buget/executii/rom09_2007/rom01_septembrie.pdf

The continuously increasing of the share of samplings from the state budget (SSB) in GDP used for balancing the local budgets, from 1.16% in 1993 to 5.09% in 2005 is quite remarkable. The financial decentralization was supported mainly by the samplings from the state budget which had represented the largest share in total local expenditures which in 2005 had reached 6.52% of GDP (see table no. 1). The evolution is quite spectacular in 2001 with a huge increase from 2.29% in previous year to 4.36% due to the special education expenditures and minimum reinsertion revenue which became financial tasks for the local governments.

The transfers from the state budget had a contradictory evolution marked by increases, but also decreases, due to the many changes in the regulatory framework concerning the local finances. Their evolution is reflected in table no. 4.

| Year | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|--------|--------|---------|---------|---------|----------|----------|----------|----------|----------|-----------|-----------|-----------|-----------|-----------|
| GDP | 220.39 | 602.92 | 2003.57 | 4977.32 | 7213.55 | 10891.96 | 25292.57 | 37379.82 | 54573.00 | 80377.30 | 116768.70 | 151475.10 | 197564.80 | 246468.80 | 288047.80 |
| Transfers and special destination revenues (TSDR) | 4184 | 6808 | 7625 | 119.99 | 184.85 | 379.02 | 505.45 | 392.44 | 637.44 | 849.68 | 550.09 | 1054 | 920 | 1218.10 | |
| TSDR/GDP (%) | 1.88 | 2.79 | 1.66 | 1.53 | 1.66 | 1.70 | 1.50 | 1.35 | 0.72 | 0.79 | 0.73 | 0.36 | 0.53 | 0.37 | 0.42 |

**Table No. 4 The amount and the share of transfers from state budget in GDP
mil. RON**

Source: <http://www.insse.ro/cms/rw/pages/index.ro.do;>

http://discutii.mfinante.ro/static/10/Mfp/buget/executii/rom09_2007/rom01_septembrie.pdf

From the table above is easily distinguishable the year 1999, when the transfers dropped to 0.72% of GDP due not only to the general contraction of public expenditures, but also due to a new regulatory framework which increased spectacularly the own revenues of local governments. The Hunter coefficient also reflects this, reaching its peak in 1999.

| Year | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|-----------------------------|------|-------|-------|--------|--------|--------|---------|---------|---------|---------|---------|---------|----------|----------|----------|
| Local budget own revenues | 1,74 | 3,20 | 16,24 | 36,70 | 96,92 | 117,70 | 209,08 | 339,05 | 766,87 | 882,94 | 1191,55 | 1682,12 | 2855,60 | 3660,70 | 4111,48 |
| Total local budget revenues | 5,86 | 19,97 | 71,25 | 176,72 | 333,65 | 499,85 | 1046,85 | 1345,42 | 2224,37 | 3344,50 | 7119,57 | 9322,77 | 13078,10 | 15955,80 | 19489,90 |
| Hunter coefficient | 0,30 | 0,16 | 0,23 | 0,21 | 0,29 | 0,24 | 0,20 | 0,25 | 0,34 | 0,26 | 0,17 | 0,18 | 0,22 | 0,23 | 0,21 |

Table No. 5 The amount and the share of own revenues in total local budget revenues (Hunter coefficient) mil. RON

Source: <http://www.insse.ro/cms/rw/pages/index.ro.do>;

http://discutii.mfinante.ro/static/10/Mfp/buget/executii/rom09_2007/rom01_septembrie.pdf

The Hunter coefficient reflects the dependency of local governments from the state budget transfers and samplings. During 1994 – 1998 there has been a little variation from 0.21 to 0.25. In 1999, it has been reported a huge increase up to 0.34 as a result of the decentralization process enacted by the new Local Finance Bill of 1998. In 2001, when there has been a massive transfer of responsibilities to the local governments, which were financed from the state budget, the Hunter coefficient reached its minimum level (except the year 1992). In 2004, the coefficient reached the level of 0.23 due to the increasing of own revenues which had to cover larger amounts of expenditures.

The efficiency and the predictability of the intergovernmental transfers must be analyzed taking into account their mechanism of implementation. The actual system of intergovernmental transfers may be represented as in figure no. 2:

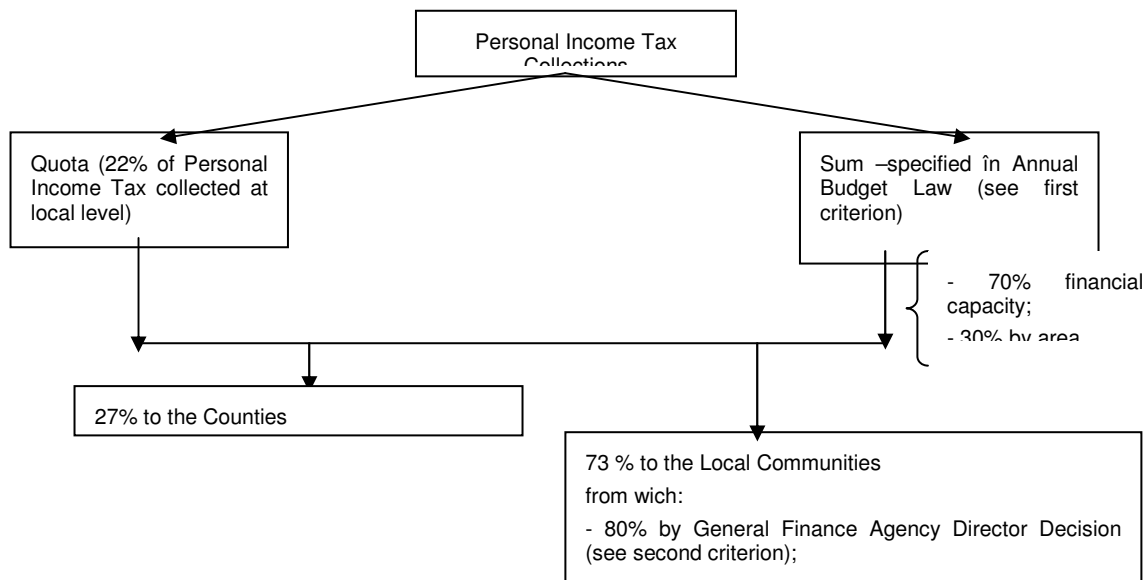


Figure no. 2. The present structure of the intergovernmental transfers in Romania

The annual sum is determined as follows:

a) financial capacity based on personal income tax collected per person, 70% in amount, using the following formula (first criterion):

$$Sr.j = \frac{\frac{Ivm.tj}{Ivm.j} \times \frac{Nr.loc.j}{Nr.loc.tj}}{\sum_{j=1}^n \left[\frac{Ivm.tj}{Ivm.j} \times \frac{Nr.loc.j}{Nr.loc.tj} \right]} \times Sr.tj,$$

where:

Sr.j - recouped amounts assigned to the counties ;

Sr.tj - recouped amounts to be assigned to all counties;

Ivm.j – average personal income tax collected in previous year in each county;

Ivm.tj – average personal income tax collected in previous year in all counties;

Nr.loc.j – number of residents of each county;

Nr.loc.tj. - number of residents of all counties;

b) county area, 30% in amount.

Twenty seven percents of the annual legal approved sum and twenty two percents of personal income tax to be collected at central budget are allocated to county budget. The remaining percents are allocated to municipalities budgets as follows:

- 80% of the sum are going to be allocated in two stages by the head of General Public Finance Department (at county level), according to the following criterion: number of residences, inside city area, financial capacity of the municipality;

- 20% of the sum are going to be allocated by county council regulations only to co-financed infrastructure projects.

At the General Public Finance Department level, the legal procedure is the following:

a) calculation of two indicators: „average municipality revenue based on personal income tax per resident” and „average county revenue based on personal income tax per resident”, using the following formula (second criterion):

$$I_{vm.l} = Iv.l / Nr.loc.l$$

$$I_{vm.j} = Iv.j / Nr.loc.j$$

where:

Ivm.l – average personal income tax per resident, collected during the previous year,

Iv.l – personal income tax collected at municipality level during the previous year;

Nr.loc.l – number of municipality residents;

Ivm.j – average personal income tax per resident, collected at county level during the previous year;

Iv.j – personal income tax collected at county level during the previous year;

Nr.loc.j – number of residents in each county.

During the first stage of the process, the sums are allocated only to the municipalities that are registering a smaller average of personal income tax than the county average one, based on residents number (75%) and inside city area (25%). These sums are limited in such a way that their average should be smaller or equal to average county personal income tax for the previous year. The average itself is calculated using the following formula:

$$M_{loc.e1} = [Iv.l + Sr.e1]/Nr.loc.l$$

where:

Mloc.e1 – first stage allocation average per resident;

Iv.l – personal income tax collected at municipality level during the previous year;

Sr.e1 – first stage allocation sums per municipalities;

Nr.loc.l – number of residents.

During the second stage, the unallocated amount is going to be recouped to all municipalities according to their financial capacity using the following formula:

$$Sr.e2 = \frac{\frac{Ivm.j}{Ivm.l} \times \frac{Nr.loc.l}{Nr.loc.j}}{\sum_{l=1}^n \left[\frac{Ivm.j}{Ivm.l} \times \frac{Nr.loc.l}{Nr.loc.j} \right]} \times Sr.j.e2,$$

where:

Sr.e2 – second stage allocated sums to each municipality;

Sr.j.e2 - second stage allocated sums to all municipality;

Ivm.l – average personal income tax per resident, collected during the previous year;

Ivm.j – average personal income tax per resident, collected at county level during the previous year;

Nr.loc.l – number of residents in each municipality;

Nr.loc.j – number of residents in each county.

The amounts will be corrected using the revenue collection degree for previous year, excluding litigious revenues.

As a conclusion, we consider that the actual transfer system has improved in comparison with the previous one but it is not flawless considering that:

- the sum to be recouped to local municipalities is annually established and thus it can be modified affecting the predictability of local revenue;
- the allocation at the county level is subject to a discretionary administrative decision;
- there is no municipalities' exclusion criterion at the second stage of allocation;
- the residents criterion is a global one, without taking into account the structure of public goods consumers (pupils, retired population, students etc.);
- there is no criterion to considering the institutions that offer public goods to residents from other municipalities (retirement homes, institutions for mentally challenged persons).

When the revenues from local taxes and those from transfers from the state budget are not sufficient in order to cover the local expenditures, local governments may contract loans. The local authorities may warrant these loans with their own revenues, except the case when the total amount of the local public debt (present and future) exceeds 30 % of total own revenues. In order to cover the risks generated by the loans contracted, local governments may constitute a risk fund, outside of the local budget. The revenues of this fund came from commissions and interests from the beneficiaries of the loans warranted by the local authorities, interests paid by the state treasury and penalties for the overdue payments made by the beneficiaries of the loans to the local budgets representing capital, interests and commissions. In the case of consuming the risk fund, the amounts used to cover the loans granted by the local governments are to be recovered from the debtors.

| | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---------------------------|--------|--------|---------|---------|---------|----------|----------|----------|----------|----------|-----------|-----------|-----------|-----------|-----------|
| GDP | 220,39 | 602,92 | 2003,57 | 4977,32 | 7213,55 | 10891,96 | 25292,57 | 37379,82 | 54573,00 | 80377,30 | 116768,70 | 151475,10 | 197564,80 | 246468,80 | 288047,80 |
| Total local revenues(TLR) | 5,86 | 19,97 | 71,25 | 176,72 | 333,65 | 499,85 | 1046,85 | 1345,42 | 2224,37 | 3344,50 | 7119,57 | 9322,77 | 13078,10 | 15955,80 | 19480,90 |
| Loans | 0,00 | 0,00 | 0,00 | 0,00 | 0,00 | 4,69 | 4,94 | 7,29 | 36,26 | 2,80 | 21,76 | 55,13 | 23,92 | 0,00 | 23,20 |
| Loans/GDP (%) | 0,00 | 0,00 | 0,00 | 0,00 | 0,00 | 0,04 | 0,02 | 0,02 | 0,07 | 0,00 | 0,02 | 0,04 | 0,01 | 0,00 | 0,01 |
| Loans/TLR (%) | 0,00 | 0,00 | 0,00 | 0,00 | 0,00 | 0,94 | 0,47 | 0,54 | 1,63 | 0,08 | 0,31 | 0,59 | 0,18 | 0,00 | 0,12 |

Table No. 5 The amount and the share of loans in total local budget revenues and in GDP mil. RON

Source: <http://www.insse.ro/cms/rw/pages/index.ro.do>;

http://discutii.mfinante.ro/static/10/Mfp/buget/executii/rom09_2007/rom01_septembrie.pdf

The loans contracted by local governments were insignificant during the whole interval. The biggest share was in 1999 as a result of a new Local Finance Bill which had extended the local authorities prerogatives in contracting loans. Thus, many big projects of urban development were unable to be fulfilled, generating much discontent among citizens. This solution of local budgets balancing implies greater responsibility from the local authorities and generates more focus in getting more future revenues to the local budgets, in order to repay the loans.

In conclusion, in spite of the fact that Romania had made important steps towards decentralization, the actual local budgetary system needs continuous improving, mainly in the field of providing the predictability of the local governments revenues, that will allow the initiation and the implementation of long and medium terms programs and projects. The high dependency from the state budget, the discretionary decisions in allocating the transfers and the increase of the prerogatives only when it comes to local expenditures are the major factors that impede a real decentralization process in our country.

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