FINANCIAL DEPENDENCE AND BALANCE – NEW CHALLENGES OF THE PUBLIC SERVICE DECENTRALIZATION

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Abstract: *The paper intends to analyse a model of decentralization specific to Continental Europe, which shows that a transfer of responsibility to the local authorities has not always been appropriately followed by a transfer of resource, the consequence being the appearance of budgetary imbalances at the level of local communities. In this situation, the local communities are forced to identify the* ***funding source*** *and, therefore, they have used the most rapid instruments provided by the law and the financial institutions – the borrowed sources. As long as the borrowed funding sources have been used to the restoration of the public infrastructure and, therefore, to the public investments, the solutions identified by the public manager are not to be blamed, the problem being the use of borrowed sources in order to cover certain consumerism needs which illegitimately charges, in our opinion, the public cost, the obligation to finance the maturity rates including the interest falling back on the future generations.*
Key words: *public service decentralization, financial balance, public manager, funding policies*
JEL Code: M1, H3, H4,

Decisional and financial decentralization of public services

The financial management problems are diverse, from the income and expenditure budget, the management modern instruments, the basis for the decision capitalization, the local economic development or of the management of the public debt service are some examples that the **public manager** must study in order to be able to solve the perpetual "conflict" between the limited character of the resources and the population's diversified needs for public services.

The decentralization of the public services is also a problem preoccupying Continental Europe, the local and central authorities being interested – applying the principle of subsidiarity (of closeness to the citizens)**-** in transferring the decision concerning the services to that level of authority which satisfies the best and most promptly the public needs so that the services provided have as high as possible quality and utility level.

The decentralization model specific to Continental Europe shows that not always a transfer of responsibility to the local authorities has been appropriately followed by a transfer of resources, the consequence being the appearance of budgetary imbalances at the level of local communities which, forced to identify the **funding source**, have used the most rapid instruments provided by the law and the financial institutions – the borrowed sources.

As long as the borrowed funding sources have been used to restore the public infrastructure and therefore the public investments, the solutions identified by the public manager are not to be blamed, the problem being the use of borrowed sources to cover certain consumerism needs which illegitimately charge the public cost, the obligation to finance the maturity rates including the interest falling back on the future generations.

The consequences of the implementation of the decentralization model mentioned do not stop here. Worried by the impossibility of the local communities to face the funding needs, the central authorities have practically adopted two funding policies (in the relation with the local authorities):

a) **the first** corresponding to transfers, has the form of the sums broken down from some revenues of the state budget, having or not a special destination;
b) **the second** corresponding to the sums for balance; the purpose being to ensure the cover of the funding needs of those local authorities that do not have an appropriate financial capacity.

Intensely manifesting, both the decentralization of the public services and the financial decentralization and together with this the **financial dependence** on the resources of the state budget, the specialists have been interested in indentifying some indicators to measure this dependence and also to characterise the financial policies of the central authorities in the relation with the local authorities.

The Hutner coefficient-a measurement indicator of the financial imbalances

A first indicator studied was the Hutner coefficient which measures the horizontal imbalance too at the level of local authorities, established according to the relation:

Coef.H=1-Revenues not controlled by the local communities/Total expenses local communities

For the informed reader, the revenues not controlled by the local communities have the form of levies from the state budget, the values of the coefficient having different meanings:

a) **Coef H → 1** indicates a favourable situation, corresponding to a state of financial independence of the local communities;
b) **Coef H → 0** indicates an unfavourable situation, the majority of expenses being financed based on the levies from the state budget.

In the figure below it is presented the evolution of the Hutner coefficient during 1998-2003, at the national level:

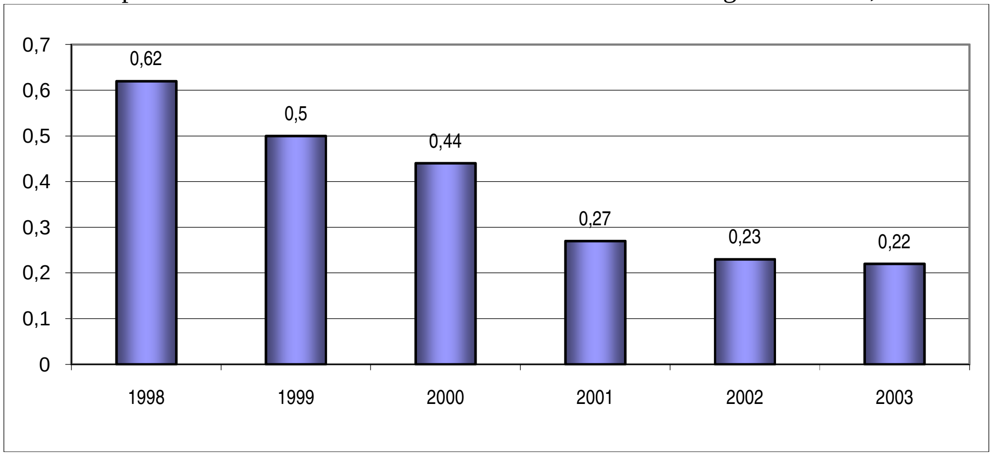

Figure 1– The evolution of the Hutner coefficient

It can be seen that, every year, the value of the Hutner coefficient indicates the existence of a more and more accentuated financial dependence on the central budget, a situation explained by the fact that, even though public services were decentralized, their funding has been made through conditioned transfers from the state budget so that in certain situations, the local communities had a decorative role in the management of services.

Global income tax – a measure of the vertical imbalance

In the same time, the indicator of the global income tax I_{IVG} , characteristic to the vertical imbalance (between the administrative-territorial units) in its calculus form as a ration between the global income tax transferred to an administrative-territorial unit and the income global tax levied at the level of an administrative-territorial unit I_{IVC} has also different meanings:

a) When $\mathbf{I_{IVG}}$ **is improper**, it indicates the fact that the local authority cannot cover from its revenues its own funding needs, the transfer of resources from the state (central) budget being necessary;
b) When $\mathbf{I_{IVG}}$ **is proper**, the local authority will have to benefit from transfers from the central budget, no matter the form it has (transfers or sums for balance).

From the financial manager's perspective it is important to study the **combined interpretation** of the two categories of indicators in order to characterise the financial policies of the central authorities in relation to the local authorities.

The following situations can be distinguished:

a) **Coef H → 1** and $\mathbf{I_{IVG} > 1}$**,** corresponds to a situation of a very good financial autonomy, the local community being in the situation to record resource surpluses which can be transferred to other local authorities, according to the balancing rules;
b) **Coef H → 1** and $\mathbf{I_{IVG} < 1}$**,** corresponds to the same situation of financial autonomy, the transfer of resources being already made because the local authority collected more than it had been transferred to it;
c) **Coef H → 0** and $\mathbf{I_{IVG} > 1}$**,** is a situation corresponding to a limited financial autonomy, the local authority being in need of transfers in order to cope with the funding needs of the public services;
d) **Coef H → 0** and $\mathbf{I_{IVG} < 1}$**,** a situation of limited financial autonomy, the local authority has the necessary resources transferred to cover the funding needs, so that the indicator of the global income tax is proper.

Knowing the particularities of the **funding policies** gives the possibility to the financial manger to study and capitalize certain financial strategies concerning the relation with the state budget, beyond the complexity of the transfers from the central budget, according to certain criteria such as:

- the transfer of a quota from the revenues levied based on a principle of derivation;
- the use of formulae;
- ad-hoc decisions;
- reimbursement of the costs of public services provided.

Types of financial transfers between the public authorities

Methods to determine the volume of transfers to the local public administration / Methods to allocate the transfers between the eligible local authorities	A proportion (quota) from the revenues of a state tax	Ad-hoc decision	Reimbursement of the expenses approved
Transfers established based on a principle of derivation	Type A transfer	Type E transfer	N.A.
Transfers established based on a formula	Type B transfer	Type F transfer	N.A.
Transfers established based on reimbursement of costs	Type C transfer	Type G transfer	Type K transfer
Transfers established based on an ad-hoc decision	Type D transfer	Type H transfer	N.A.

Table 1 – Classification of the administrative transfers, according to the method of revenue sharing

Source: Fiscal Decentralization, Roy Bahl, April 2000

Characteristic to these types of transfers are the following:

Type A transfer – anti-equalizer, it favours the rich local administrations with a high fiscal capacity.
Type B transfer – is based on the ensurance of the horizontal balance between the administrative-territorial units.
Type C transfer – conditioned transfer, it is based on the reimbursement of the costs of public services.
Type D transfer – is based on the allocation of sums based on ad-hoc decisions, being about discretionary criteria.
Type E transfer – unconditioned transfer with a general destination, the sums being allotted between the administrative-territorial units based on a principle of derivation.
Type F transfer – is also an unconditioned transfer based on an ad-hoc decision, but which is assigned between administrative-territorial units based on a formula.
Type G transfer – comes from the central level based on an ad-hoc decision and it is assigned between the active territorial units based on reimbursement of costs.
Type H transfer – is based only on ad-hoc decisions, being the most centralised, conditioned or unconditioned.
Type K transfer – is a transfer with a special destination, between the eligible local authorities the sums being assigned based on reimbursement of costs.
These types of transfers, usually, are used in a combined way, at the national level resulting the following funding scheme:

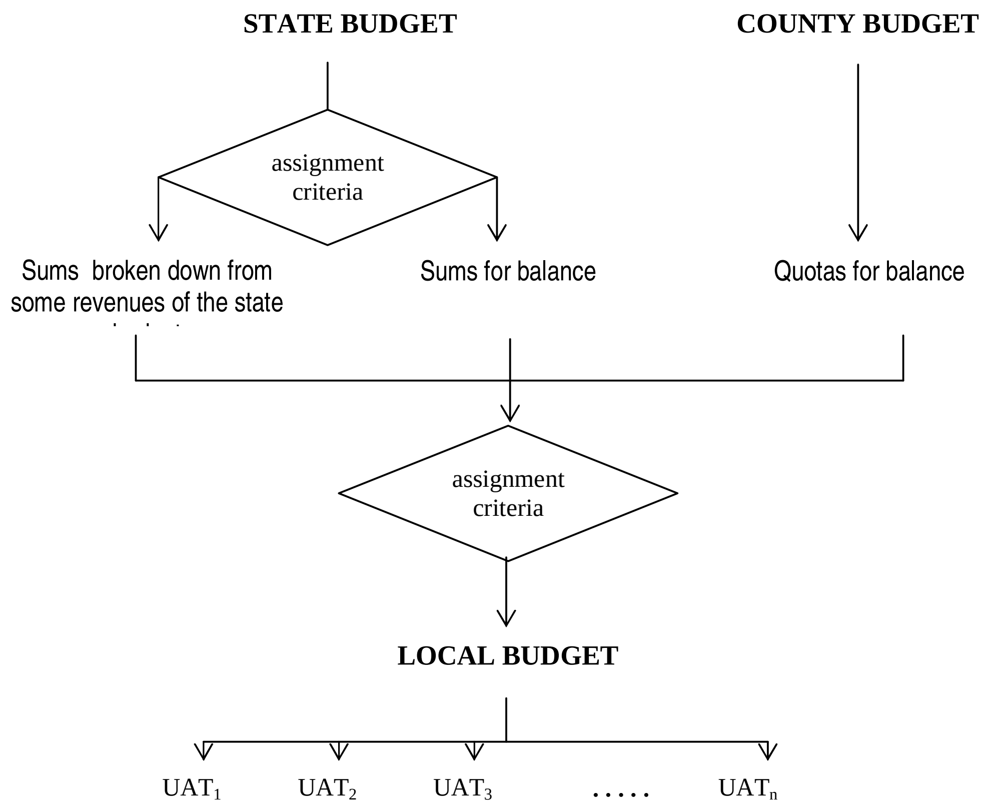

Figure 2– The flows of transfers and sums for balance assigned from the central budget to the administrative-territorial units

The financial flows represented above emphasise two particularities of the funding policies currently used in Romania in the relation between the central and local authorities:

a) **the first** is determined by the existence of conditioned transfers based on the reimbursement of the cost of public services provided (exp. Public Services in pre-university education);
b) **the second** is based on the quotas and sums for balance assigned according to certain criteria between the administrative-territorial units.

From the perspective of the financial management it is interesting to study the criteria applying to assign balance sums between the state budget and the county budgets and then between the county budgets and the local budgets.
The first category of criteria is based[637] on the **financial capacity** made on average per inhabitant for each county in a percentage of 70% and the surface of the county in a percentage of 30%.
The balance funds allotted to each county are established according to the formula:

$$FdEj = C_1 \times \frac{1 - \frac{IVG/\ loc\ j}{IVG/\ loc\ med}}{\sum_{i=1}^{n}\left(1 - \frac{IVG/\ loc\ j}{IVG/\ loc\ med}\right)} + C_2 \times \frac{Sj}{Sn}$$

where:

FdEj – balance funds at the level of each "j" county
C1 – the criterion afferent to the financial capacity in a percentage of 70%
IVG / loc j – global income tax per inhabitant at the level of each "j" county
ITL / loc med – average global income tax at the level of counties
C2 – criterion afferent to the surface of the county in a percentage of 30%
Sj – surface of the "j" county

[637] *Art. 29, paragraphs (1), (2), (3) of GEO 45/2003 – concerning local public finances, published in the Romanian Official Gazette no 403 of 19 June 2003*

Sn – surface of the territory obtained by summing up the surfaces of each "j" county

The financial flows described above, which are generated between the state budget and the state budget and the county budgets in relation to the balance sums "admit" for financing all the counties, being about a "socialised" balance without taking into consideration the principle of concentration, which implies the acceptance for balance only of those counties which are under a certain limit established nationally.

In turn, the financial flows generated between the county budget and the local budgets based on the quotas and sums for balance are assigned according to the four criteria regulated by law[638]:

- financial capacity 30%
- the surface of the administrative-territorial unit 30%
- the population of the administrative-territorial unit 25%
- other criteria established by Decisions of the County Council 15%

Applying these criteria, the fund for balance which will be assigned between the county budget and the budget of every administrative-territorial unit are based on the formula:

$$FdEu = C_1 \text{ x } \frac{\frac{IVG(j)\ :P(j)}{IVG(u)\ :P(u)} \text{ x } \frac{P(u)}{P(j)}}{\sum_{j,\,u=1}^{n}\left[\frac{IVG(j)\ :P(j)}{IVG(u)\ :P(u)} \text{ x } \frac{P(u)}{P(j)}\right]} + C_2 \text{ x } \frac{Su}{Sj} + C_3 \text{ x } \frac{Pu}{Pj} + C_4 \text{ x } Ac_J$$

Where:

C1, C2, C3, C4 – are the percentage wise quotas corresponding to criteria: financial capacity, surface of territory, population and other criteria established by law

Su, Sj – the surface of the administrative-territorial unit and of the county

Pu, Pj – the population of the administrative-territorial unit and of the county

Acj – other criteria established by the County Council

IVG(u), IVG(j) – global income tax at the level of the administrative-territorial unit and of the county.

Conclusions

The complexity of the calculus may discourage the financial manager when trying to understand the balance mechanism, yet it is important from the perspective of completing the funding sources of the local budget with sums resulted from balance. In practice, there have been frequent situations when not knowing the assignment criteria and their non-compliance have led to assignments according to discretionary criteria of the sums and quotas for balance by the county councils.

These balance criteria between the county budget and the local budgets do not comply with the principle of concentration in order to eliminate from balancing those administrative-territorial units which exceed a certain average level of IVG and do not take into consideration the structuring of the population on age groups, for example until 18 years old and over 65 years old, in order to ensure the financing of social expenses (education or social assistance and protection).

In the end, knowing these mechanisms – either it is about the measurement of financial dependence or independence or the budgetary balance – is necessary in order to consolidate the so much desired and requested by the local authorities financial autonomy.

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[638] *Art. 29, paragraphs (1), (2), (3) of GEO 45/2003 – concerning local public finances, published in the Romanian Official Gazette no 403 of 19 June 2003*