

THE LEGAL INDEBTEDNESS CAPACITY OF ROMANIAN LOCAL GOVERNMENTS – THEORETICAL AND EMPIRICAL EVIDENCES

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The factual, not only formal capacity of local governments to appeal to borrowed resources is, considering the current conditions, a prerequisite for ensuring economic and social development of local communities. In this paper we intend to position the main theoretical and empirical evidences on local governments' indebtedness capacity, mainly focusing on its sizing according to Romanian regulatory framework. With respect to previous research, the issue approached is one of great interest as it has not been, in the Romanian literature on local public finances, subject to a separate analysis of proportions.

The undertaken analysis comprises a quantitative dimension, based on processed data from the consolidated general budget of Romanian local governments for 2007-2009, in permanent conjunction with monitoring and analysis of the involved qualitative aspects. To ensure the relevance of the research results, the analysis undertaken refers to the legal framework in function throughout the considered period of time, without involving the legislative changes operated in mid-2010.

The main conclusions drawn from our analysis indicate that, considering the current Romanian socio-economic environment, under the impact of specific factors of different nature, the legal indebtedness capacity is far from being well valued, thus bringing its benefits to local communities development. This conclusion is valid from a global perspective as well as for different types of local communities. This appears to be inconsistent with the permanently claimed need to fund important local public investments, mainly in infrastructure, indicating, despite the high legal indebtedness capacity, the lack of factual access to borrowed resources.

We suggest, therefore, to introduce the concept of effective indebtedness capacity, the result of a particularized correlation for different local governments between legal indebtedness capacity and the manifestation of several factors with specific action and we intend to contribute, by future research, to its measurement.

Keywords: legal indebtedness capacity, effective indebtedness capacity, local governments, local public debt, local autonomy

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1. Introduction

Self-financing should be the key word when it comes to supporting expenditures of local governments which are autonomous (both administratively and financially). However, the whole modern world is confronted to the existence of vertical and horizontal fiscal imbalances, mainly caused by the heterogeneity of local fiscal potential which, combined with some equivalence of local public needs, determine local governments to permanently confront with the need to obtain more resources to cover all expenditures.

In these circumstances, central governments apply different solutions to restore equilibrium (operating subsidies, grants, subsidies, transfers, grants and quotas from shared taxes etc.), under

the generic title of intergovernmental transfers system (inter-administrative in the case of unitary states). However, local socio-economic development, especially in countries that pass or have recently gone through transition, demands for major investments, especially in infrastructure, the regions "left behind" being, from this point of view, the most obliged.

In accordance with the above mentioned situation, the need of local governments to finance higher expenses compared to the resources normally raised at their disposal, determines their options for the use of extraordinary resources, usually raised via local (public) loans. It should be noted, however, that recourse to loans is not a good solution in any circumstances (there are, for example, legal borrowing limits) and that the employment of such a solution basically represents a deferred payment through additional taxes, as the latter will represent the basis for raising public financial resources allocated for the repayment of loans and of additional costs generated by loans (interests, fees etc.).

2. The subject of the research, methodology and state of knowledge

The use of local public loans raises the issue of the indebtedness capacity of involved subjects, under two major aspects: what are the legal limits of indebtedness and how are they set, respectively, what is the effective capacity of local authorities to borrow. An analysis based only on the legal regulation of the limits would be unrealistic if it is not accompanied by a proper interpretation (analysis) of the effective indebtedness capacity of these communities.

Under these circumstances, the paper seeks to position the main theoretical and empirical evidences in the field based on a quantitative analysis (data from the consolidated general budget of local governments, 2007-2009), in permanent conjunction with monitoring and analysis of the involved qualitative aspects. For ensuring the relevance of the research results, the analysis undertaken refers to the legal framework in function throughout the considered period of time, without involving the legislative changes operated in mid-2010.

The issue proposed for debate did not represent the subject of a major and distinctive research in Romanian literature, partially being captured in the broader context of treating local public finances issues. Thus, I. Văcărel (Văcărel et al. 2006: 591-602) notes that the possibility of local indebtedness incurrence is closely related to the manifestation of local autonomy. Gh. Voinea (Voinea 2008: 103) deals with the content of legal indebtedness limits, concluding that they must be cautiously set.

3. Qualitative dimensions of the legal indebtedness capacity of Romanian local governments

The Romanian legal framework on local governments borrowing mainly consists in Law no. 273/2006 on local public finances, which enables local governments to approve the contracting or guaranteeing of loans for local public investments and local government debt refinancing, subject to certain conditions. Thus, according to the legal provisions in force between 2007 and 2009, the total amount of annual debt payments representing the principal on contracted and/or guaranteed loans, interests and other related charges, including those on the loan which was intended to be contracted and/or guaranteed (but excluding, in line with the objective of improving the absorption of European funds, the loans contracted or guaranteed by local governments to ensure pre-financing or co-financing for projects benefiting from European financial assistance), should not exceed 30% of local budgets' own revenues.

Considering this legal requirement, we can measure the legal capacity (potential) of indebtedness as the difference between the limit of 30% for the share of local public debt service in local governments' own revenues and the actual level of this indicator in the reference year.

Since 2010, in line with Government Emergency Ordinance no. 63/2010, the condition required to allow for new local government borrowing has been reconsidered by referring to the last three

years average indicators and excluding local revenues from the sale of goods. The compliance with the limit is, thus, assessed according to the following formula:

$$C_c + C_n \leq 30\% * \frac{\sum_{i=1}^3 [V_p(t-i) - V_c(t-i)]}{3} \quad (1)$$

where: C_c/C_n - principal + interests + other fees for old/new loans

V_p – local governments' own incomes

V_c - revenues from the sale of goods

t- year of reference

We appreciate that the most sensitive issue regarding the dimensions of the legal indebtedness capacity is represented by their validation into practice, so that the local (financial) autonomy expresses, as it would be natural, not just as management of legal tasks as in the devolution system, but as a support and incentive for originality, innovation, creativity and development in line with local preferences, as direct expression of a local "entrepreneurial" administration, indispensable in our times. As it results from our analysis, for Romania, under the impact of specific factors of different nature, taking advantage of the legal indebtedness capacity is far from bringing its benefits to local communities' development.

4. Quantitative dimensions of the legal indebtedness capacity of Romanian local governments – comparative perspectives

Globally considered, the indebtedness capacity of Romanian local governments reflects the general state of the economic and social environment, being directly connected with. Although repeated local public finance reforms sought to satisfy the permanent request of local communities representatives and also the recommendations of international community representatives to increase the level of local governments' own revenues (by reference to the expenditures assigned to them), the situation has not registered substantial progress. In fact, allowing for additional revenue sources for local governments as well as the transfer in various forms (mainly grants and quotas from shared taxes) of increasing amounts of resources in nominal size from the state budget to local budgets has permanently been overtaken by increasing local expenditures, as a result of transferring more and more responsibilities from central governments to local governments.

On such basis, combined with the lack of adequate predictability of local revenues and, recently, with deteriorating overall economic situation, most revenues have been directed towards current expenditures and not capital ones. In this context, the lower orientation towards investments was reflected in some conservation of the indebtedness capacity of local governments, which decreased over the period of analysis, but not so much as it would have been expected within a local environment where the need for infrastructure and capital repairs is obvious.

Considering the indebtedness capacity, determined as the difference between the legal limit of the local public debt service share in local governments' own revenue, of 30%, and its effective level, corresponding data for all Romanian local governments are summarized in table no.1.

Table1. Overall share of local public debt service in local governments' own revenues

Indicators/Year	2007	2008	2009
Own revenues of local governments (million lei)	17317,4	20587,7	21117,6
Local public debt service (million lei)	769,2	1290,6	1732,3
Local public debt service/Own revenues (%)	4,44	6,27	8,20

Source: author's own calculations, data from the Ministry of Public Finances

The data in table no. 1 show that, during the period of our analysis, overall local governments have exploited only 27,33% of their legal indebtedness capacity, which is fundamentally inconsistent with the permanently claimed need for additional financial resources and the

relatively low level of urban and rural development in Romania, especially when considering the infrastructure.

However, the average value of the indebtedness capacity must be subject to cautious interpretations, since it hides different realities from one region to another, from one type of area or administrative division to another. For the Romanian development regions, indebtedness capacity data are reflected in table no. 2.

Table2. Local public debt and the share of its service in local governments' own revenues, by development regions

Development region/Year	2007		2008		2009		
	SDL/VP* (%)	Rank	SDL/VP (%)	Rank	SDL/VP (%)	Rank	Local public debt (millions lei)
Nord-Vest	3,38	5	5,30	4	11,16	6	945,0
Nord-Est	14,34	8	15,56	8	11,82	7	1432,7
Sud-Vest Oltenia	1,70	1	3,23	1	4,62	1	415,9
Sud-Est	4,33	6	5,77	6	9,79	5	701,4
Sud-Muntenia	2,80	3	4,11	2	6,02	2	1004,7
Vest	7,22	7	9,71	7	8,36	4	758,4
Centru	2,58	2	5,73	5	11,47	7	1055,9
București Ilfov	3,01	4	4,73	3	6,13	3	4409,5

*SDL/VP - local public debt service/local governments' own revenues

Source: author's own calculations, data from the Ministry of Public Finances

Data in table no. 2 show that the North-East region, ranking last in terms of development, appreciated through GDP per inhabitant had, between 2007 and 2009, the lowest indebtedness capacity, the situation being consistent with the need to support investment projects in this region. On the other hand we can see that, although the North-East region ranks last in terms of the indebtedness capacity, from the perspective of the overall public debt it occupies the penultimate position. In opposition, the București Ilfov region ranks first in terms of overall local public debt, definitely detaching from the other regions, but ranks among the top three positions in terms of indebtedness capacity. Basically, the Bucuresti-Ilfov region simultaneously records a high local public debt and high indebtedness capacity. South-West Oltenia region also has a special position, occupying, in terms of overall public debt, the last position and ranking first in terms of the indebtedness capacity.

Considering the difference between urban and rural areas, we can note that rural communities have a greater indebtedness capacity, as a result of lower borrowing, as shown in table no. 3. Although the registered situation is normal, the spread of the indebtedness capacity is not as broad as the spread of overall local public debt between rural and urban communities.

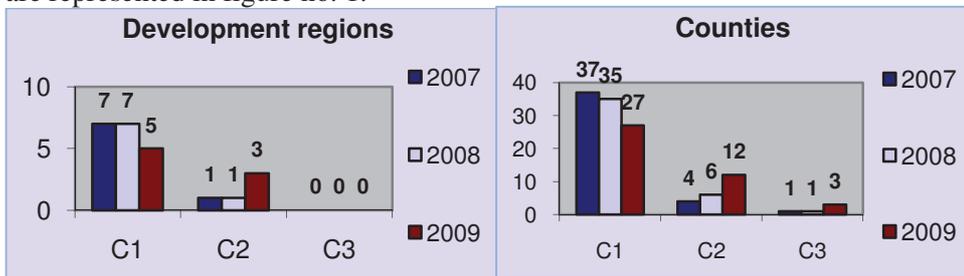
Table 3. The share of local public debt service in local governments' own revenues by urban and rural areas and administrative divisions

Communities-Type of administrative division/Years		2007	2008	2009
Communities	Urban (%)	4,25	6,99	9,24
	Rural (%)	5,30	3,05	3,49
Administrative divisions	Communes (%)	5,30	3,05	3,49
	Cities, other towns and sectors of București (%)	4,51	7,96	10,21
	Counties, București (%)	3,68	4,98	7,27

Source: author's own calculations, data from the Ministry of Public Finances

Considering the administrative divisions, the situation is similar. The data in table no. 3 show that towns have the lowest indebtedness capacity, followed by counties and communes. For the particular case of Romania, this is also due to the lack of consistent practice of partnerships between different counties, which could provide a more consistent support for local borrowing.

Globalizing the results of our analysis, we propose a grouping of Romanian communities on three categories: local communities with public debt service share in local governments' own revenues below 10% (C1) are regarded as having a high indebtedness capacity, those for which this indicator takes values between 10 to 20% (C2) have average capacity and those with more than 20% (C3) reduced indebtedness capacity. The results for development regions and counties are represented in figure no. 1.



Source: author's own calculations, data from the Ministry of Public Finances

Figure 1. Number of development regions/counties by indebtedness capacity

From the above grouping it may be noted that most counties had, over the period of our analysis, high indebtedness capacity, but their number is declining, especially in the last year of analysis (from 37 in 2007 to 27 in 2009). Presently, only three out of 42 counties have reduced indebtedness capacity, which represents approximately 7% of the total. Similarly, the analysis by development regions shows that none of them has reduced indebtedness capacity, as a result of the offsetting effects that occur at intra-regional level, and few have medium capacity (highly approaching to the lower limit of the interval, of 10%) although, in this case also, we find that their number is increasing (from 1 in 2007 and 2008 to 3 in 2009).

Compared with the findings of our analysis, there are, nevertheless, enough reasons, in the current socio-economic context deeply marked by the international crisis, for the disparities to become more acute, the negative effects being primarily noticeable for the small local communities with low fiscal potential.

5. Conclusions

The analysis conducted clearly highlights the fact that Romanian local governments have a high legal indebtedness capacity, though it would be expected that the specific development needs determine them to use borrowed resources to a greater extent. This situation can be explained by the amount of local debt, by the unstable economic and legal context, but also by their excessive caution and socio-economic circumstances. In this respect, the restrictions imposed on local

borrowing in the context of the current Romanian economic crisis (the 30% limit being determined with reference to local governments' own revenues, excluding capital ones) might prove counterproductive in the short term, although they have economic and financial rationality. We might confront with the unfavorable situation where local governments will no longer have wide access to borrowing, and central government will not, at its turn, be able to guarantee their loans, sometimes indispensable to finance new investment objectives. We also insist on the idea that the main role, in this context, goes to local financial decision makers, which should have a proactive approach towards identifying new sources of revenue or more efficiently exploiting those already existing, which should provide them with more consistent own resources.

Judging cautiously, it must be noticed that the analysis carried out on local governments indebtedness capacity only highlights their formal, conventional indebtedness potential which is, in most cases, fundamentally different from the effective indebtedness capacity. The latter is actually the result of a particularized correlation for different local governments between legal indebtedness capacity and the manifestation of several factors with specific action. Among them stand local administrative capacity, financial market conditions, political, economic or social internal and international circumstances etc. In this regard, it is relevant the case of the city of Botosani which failed, in 2010, to issue bonds on the financial market, the subscriptions being below the minimum required limit. We propose in this context, to accept the need for a clear distinction between the legal and effective indebtedness capacity, accompanied by a permanent focus of public decision making processes on the latter. Only this way the correspondence with the real situation, essential for the appropriate development of local governments, could be achieved.

In these circumstances, setting a single limit, valid for all local governments, as happens in the Romanian system, appears in many cases counterproductive in relation to the reasons and rationality of the indebtedness. An example of good practice that could be considered a general benchmark for a future regulatory framework, could be that of Portugal, which practices legal borrowing limits annually personalized for each local government, thus valuing their real potential. No doubt, such an approach raises some difficulties when we consider more than 3000 administrative units and not 300 as in the case of Portugal, but we think that there are adequate decision-making structures at the central authority for public finances level, that could design and implement a such a strategy, especially considering that the informational systems facilitate these processes.

From this perspective, we believe it to be interesting, useful and necessary to develop through future scientific studies an independent concept of effective indebtedness capacity, based on justified and measurable indicators which could capture the different practical situations in which local governments could find themselves at different moments in time, research direction that we intend to follow.

Notes

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