

The Municipal Bonds – the Cause and the Effect of the Local Financial Decentralisation Growth. Romanian Case

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***Abstract.** This paper work analyses the connection between local financial decentralization and the potential of local public administration to sustain the local economic and social development by its own forces by taking part to the capital market. Next to the ordinary financial sources, which are the local taxes, the local collectivities resorted last years more and more to the loans, by issuing municipal bonds. As an effect and then as a cause of the local autonomy and financial independence growth, these kinds of financial instruments gave the chance to the local public administrations to answer all community needs in efficiency and efficacy terms.*

Key words: local autonomy; financial decentralization; local public revenues; municipal bonds; local public administration; Hunter's index.

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JEL Codes: H61, H74.

REL Codes: 11B, 13G.

The financial decentralization in Romania

The Romanian Constitution from 1991 recognizes the distinct existence of local collectivities as a part of the sovereign state, with particular interests and needs. These ones are organized as cities, municipalities and villages and are led by local public administrations⁽¹⁾ whose principal task is to answer the citizens' demands (both social and politic ones) by specific public services, in accordance with the principles stipulated in law⁽²⁾. Each of their actions is supervised by the central public administration authorities⁽³⁾.

Local financial resources⁽⁴⁾ have a special role in local development, because they represent the base for a prompt replay, in optimal conditions, to the community needs. Banking on these kind of resources, it may be initiated every kind of plan in the community' interest, but with the condition to consult first the citizens, who have the right to debate the public problems and to suggest solutions⁽⁵⁾.

Local administrative autonomy is conditioned by the financial autonomy, which assures the material support of first one's service (Văcărel et al., 2003) and offers the possibility to submit the local and national public services to the local specific demands and needs, in terms of efficiency and efficacy. This way, the specific problems which the members of the communities confront with may be better identified, especially the economic and social ones, and the appropriate solutions may be adopted.

Starting the financial decentralization expansion, the responsibilities of the local public administrations increased proportionally with the taxes/benefits ratio, the level of external effects and the scale economies for the public assets (Moșteanu, Iacob, 2007). To increase efficiency for local public expenses, these should be orientated to those programs with a few external effects and low scale economies, that meaning to consider only particular communities' objectives. This way, the social welfare reaches maximum, only if the public services are managed at the closer administration level to the citizen (Dascălu, 2006) and it's evident that "financial decentralization begins to work beyond the limit that suppose the area of using national public services and goods start to stint and the comparative cost of making decisions at the central level becomes very high" (Văcărel et al., 2003).

Financial decentralization refers to the right of the local public administration to collect its own revenues, in proportion to its needs, both from local taxes and complementary sources, like loans, only if the first category of incomes is not sufficient. In the same time, the financial decentralization supposes the freedom to select to which objectives to allocate the local finance (the ordinary ones, the borrowed ones and also the ones obtained by the public sources balancing process). The local autonomy gives the right to the authorities to decide the appropriate level of the local revenues but also the opportunity and necessity of the public expenditure from these sources.

Analyzing the financial decentralization level in Romania

The public revenues of the local administrations registered an exponential growth between 1991 and 2007⁽⁶⁾. After the oscillation of the proper revenues in the period 1991-2001, these ones established at 20% from all finance. Seeing the continuous and sustained growth of total incomes, we may conclude that even the percent of own revenues is almost the same every year, it augments period by period, as a sign of local autonomy and financial decentralization development. We had the same conclusion by reporting the local budget revenue to GDP, from 3% in 1991, to 6.8% in 2005, on the background of an exponential growth of GDP⁽⁷⁾. Also, public revenues per capita enhanced continuously⁽⁸⁾, even more starting the year 1998, when the local tax law improved. This moment marks the apparition of financial decentralization in Romania, being also cause and effect of the economic development of some regions.

For the time period 1999-2007, the biggest local revenues were registered by villages and municipalities⁽⁹⁾. For the villages, most of the finance (over 70% in the period we focused on) represents transfers from other public budgets. That suggests a high level of financial dependence and also the concern of the public authorities to sustain rural development because of the inferior financial capacity of the population (given

by the smallest medium income per capita as against the municipalities and cities) and the low tax collection level. For the municipalities, the situation is explained by the better economical and financial situation of the tax payers (because of the bigger tax basis) but also superior tax pursue and collection. This fact becomes relevant when we are comparing the high percentage (over 50%) of proper public local revenues in total local ones, that meaning a good financial decentralization level which offers independence in allocating the funds and flexibility seeing the financial sources for the local investment projects.

Globally, there is used a specifically index to measure the level of local financial decentralization, the Hunter's index.

$$H = 1 - \frac{R_{nc}}{R_t}$$

where:

H – Hunter's index;

R_{nc} – revenues not controlled by local public administration;

R_t – total revenues of the local public administration.

As the index result is higher, to 1, as the financial autonomy level is higher⁽¹⁰⁾.

Practically, this index shows how much from the local public expenditure is based on revenues the destination absolutely free (Boloş, 2006).

The way this formula is presented in financial literature reflects only the percentage of the incomes which are

controlled by the local public administrations, in whole public local incomes. This is happening because, theoretically, an equilibrated budget suppose incomes equal with expenditure. This is not always possible. From example, in Romanian case, the last years, the local budgets registered excedent. That means an opportunity cost of extra liquidities. So, the Hunter's index reflects, in fact, the volume of local expenditure banked on own revenues or transfered from other budgets, amounts of money which may be consumed in the way local administration decides on.

Analyzing the local incomes and expenditures for the whole districts, towns, municipalities and villages of Romania, we may observe that the local public budgets are all dependent of the state public budget, because the computed indexes are very small. We may notice also the big dependence of the poorest districts which confirms our expectance (the poor districts have a population with small incomes, so taxation basis is as inexistent)⁽¹¹⁾.

We have to remark that the Hunters index is oscilating year by year, whith a growing tendency, and the best results are at the municipal level.

Even the results of analyzing local budget incomes are optimistically, it's imposible not to conclude unfavourable seeing this oscilation. The causes generating this situation may be: problems in collecting own incomes because of the violation of the tax law or the absence of

the supervising, especially in the rural areas (and the need of big equilibration amounts), a low financial capacity of the population of the community, which is relied with the level of local development, the level of medium incomes, of the tax policy (we still are the country which applies the lowest taxes in whole European Union!!!).

Even the last years the legislation improved, the main problems are still economical and it needs o long period of time the local financial situation to register progress.

Municipal bonds issue – an alternative source for financial local investment projects

The local public administrations authorities have a legal right to complete their financial sources with other kind of incomes because the ordinary ones, from taxes, may be some times insufficient. One of these extraordinary revenues is the internal or external loans, used to sustain local public investments or to refinance the local public debt⁽¹²⁾. The law of public debt⁽¹³⁾ imposes some restrictions (for example, the maximum level of the amount borrowed along with the interest and the commissions has to limit to 20% of current revenues of the local public administration) to prevent the insolvency. These loans may take forms as bank credits or bonds issues.

If until 1995 the local collectivities did not borrow money, after this year, the amount of loans registered a high percentage from entire local financial sources, with a top period in 1996, 1999

and 2004⁽¹⁴⁾. Starting the year of 2001, on the development of the capital market context, the local authorities identified a new source of financing in bonds. First issue was realized from Predeal city, having like objective the arrangement of a ski track⁽¹⁵⁾. Till nowadays there were listed 42 municipal bonds at Bucharest Stock Exchange. From all these, 16 did not reached their maturity yet. Many municipalities appealed to more than one bond issue (as Bacău, Alba-Iulia, Lugoj, Timișoara, Oradea, Deva, Predeal, Sebeș), as a sign of their success and opportunity. The objectives of the municipal bonds issues are looking to modernize some principal roads in towns, cleaning water systems, way of access to touristic areas, extensions of water nets, sewerage, natural gas nets, modernizing districts etc.

The revenues and expenditures of the municipalities which issued municipal bonds reveal a decentralization level higher than the average level. We have to notice Predeal, Bacău, Alba Iulia, Timișoara, Oradea, Cluj-Napoca, and Năvodari, which decentralisation level passes over 60% for all the period of research. From these ones, the municipality of Predeal got the top level, with a 90% decentralisation.

The bonds of Predeal municipality got the best rating BB+ from Bucharest Equity Research Group (BERG), a financial consultancy firm which initiated first rating service in Romanian financial market. The good marks which Predeal obtained bank on the fact that the proper revenues are

highest than the ones received from the state budget and the city tries to get the financial independence⁽¹⁶⁾. On the other side we find Zalău bonds that got a 2C rating which shows the vulnerability in managing revenues and puts question mark on its capacity of assuming financial independence.

The marks are based on the information published by local authorities. The relevant indexes of the financial component of the rating were obtained by analyzing the local budgets' execution accounts, the financial data of local employers registered from the Romanian Ministry of Economy and Finance and the debts of the tax payer to the local budget. The economical component of the rating includes social–demographic data (like salaries, the population's aging, education and unemployment), their evolution and the structure of the economic activities and of the unpropitious or mono industrial area risk. Also, the economic component gives importance to the stability and the political structure of local public administration and its capacity to increase the proper income percentage in entire revenues.

For the other municipalities we remarked in our study, the rating was as follows: Bacău B+, Cluj-Napoca B+, Târgu Mureș B+, Alba Iulia B. This rating completes our conclusions seeing the level of local decentralization. Many from these cities issued more than one time bonds and they assumed a higher maturity of the loan (until the year 2025 or even 2026). This fact suppose a risk increasing, both for

investors (who will have to wait more to receive back the loan and maybe will register opportunity costs) and for municipalities, because the market medium rate of interest keeps growing up as a result of the Romanian National Bank's actions to stop the increment of inflation rate. The growth of the market rate of interest's level generates a supplementary financial effort to pay the variable coupon, lied to the rate of interest evolution⁽¹⁷⁾. To be able to take this risk, it supposes to be solvent and that is reach information about the local capacity and potential in finance area.

After we analysed step by step every municipal bond issue from Romania, our conclusion was that as the maturity is longer, as the extra remuneration up to the medium rate of interest decreases. That is a sign that local administrations try to prevent assuming debts bigger than their potential, because in the future may happen everything.

We computed the level of decentralisation for the cities which issued municipal bonds using Hunter's index. Generally, we discovered values up to the average level⁽¹⁸⁾ (excepting Campulung, Zalău, Medgidia, Bistrița). That ones which registered a high level for this index (closer to one), so they are more independent financially, realized by now more than one issue on market. We have examples as Predeal (90%), Bacău (over 60%), Alba Iulia (between 50% and 60%), Timișoara (60%), Targu Mureș (60%), Lugoj (about 50%), Sebeș (over 55%). Their financial independence sustains and

explains them as actors on the Romanian capital market.

We have to underline the importance of a municipal bond market in this moment for the Romanian capital market, in a moment of a high volatility at Bucharest Stock Exchange, reached in the context of international financial crisis. The Stock Indexes loosed by now over 50%⁽¹⁹⁾, this year, and this is a sign of a real crack-up for mutual funds. These registered loss over 55 billion lei⁽²⁰⁾ and the investors see very clearly they have to change investment policy. They should choose the assets with fix incomes, as bonds, deposits or alternative assets as gold, stones, properties as buildings or lands.

Conclusions

Starting with the increasing transparency of the allocation and the use of budgetary state sources at the local level, set by the Local Public Finance Law from 2006, but the changes in tax law brought by the Taxation Code, the level of the public local administrations' independence sensitively increased. These means bigger possibilities to collect local revenues and to use it both with equilibration revenues received from other budgets the way they want to, according the real and particular needs. The increment of decentralization sustained the local development. Local revenues, the equilibration revenues and the possibility to earn new sources from the capital market which to be managed

by themselves gives endorsement to the local investments, which may be seen as a platform of a sustainable economical and financial growth. As the decentralization level increased, as the local investments initiatives took place. So, because of the finance needs, the local authorities asked for it using the capital market. Their demand is guaranteed by their solvency. The rate of interest is attractive and variable, following the same tendency as the rate of interest of banks but in lower risk conditions (the municipalities' loans have only bankruptcy risk, and that in cases there are not guarantees from the state, and the market risk, much of it being canceled because of the sensitivity of the coupons at the market level of the rate of interest).

So we may conclude about the tendency of financial decentralization of the local public administration, fact sustained by their frequent appeal to the capital market, which comes to consolidate the local autonomy. The growth of decentralization level made possible the maturity of the loan to increase in terms of financial security. The investors are encouraged by the extra rate of interest given over the average rate of interest on market. The apparition of the municipal bonds on Romanian capital market offered a new instrument which may be used to diminish the portfolio risk, a viable alternative to the bank deposits, in lower

risk conditions and much attractive as remuneration rate. The municipal bonds do play a double role, as well in Romanian capital market development as in the financial local autonomy growth.

The municipal bonds issuing means an extra step to the local financial independence and their success, mostly on the principal market, gave a lot of impulse to the local authorities. The facts these kinds of loans are exclusively reimbursed from local resources increased the attention of the local public administration seeing the way the revenues are collected, their amount and how reasonably are the expenses. It's true that some municipalities had some troubles and could not manage the payments and they sold some of their assets. These kind of events are signaling about how important is to be efficient in estimating and in making the local expenditures. It is also necessary to equilibrate, as volume and temporally, the revenues with the expenses. So, the municipal bonds issuing represents also a cause of the local decentralization, not only an effect, as first. They are sustained from a sufficient local decentralization level and force, by the financial responsibilities which suppose, to additional effort. This way, the local authorities are more prudent and extremely responsible with the resources they are managing, and all these have a very good impact on the financial decentralization growth.

Notes

- ⁽¹⁾ The Romanian Constitution from 1991, the article no. 120.
- ⁽²⁾ The Law no. 273/2006 of local public finance, stipulates principles as follows: the local autonomy, the decentralization of public services, the eligibility of local public authorities, the legality and the citizens consultancy in solving local problems, all of that above the power of the national, unitary and indivisible state of Romania.
- ⁽³⁾ The Romanian Constitution from 1991, the article no. 122.
- ⁽⁴⁾ The Local Autonomy Book stipulates that the local public authorities, in the national economy politics context, have the right to possess proper financial sources, sufficiently and proportionally with their competences established by the law, which to dispose free to exert their attributions.
- ⁽⁵⁾ The Law no. 215/2001 of local public administration.
- ⁽⁶⁾ The data we used have been obtained by processing the local budgets execution accounts, from the public informations offerd by the Romanian Ministry of Economy and Finance on its official website, www.mfinante.ro.
- ⁽⁷⁾ Idem 6.
- ⁽⁸⁾ Idem 6.
- ⁽⁹⁾ Idem 6.
- ⁽¹⁰⁾ The Institute for Public Politics, *Bugetele locale- intre teorie și practica*, Bucharest, 2001.
- ⁽¹¹⁾ The data we used have been obtained by processing the local budgets execution accounts, from the public informations offerd by the Romanian Ministry of Economy and Finance on its official website, www.mfinante.ro.
- ⁽¹²⁾ See Mosteanu Tatina, *Buget si trezorerie publica*, Universitara Publishing House, Bucharest, 2004.
- ⁽¹³⁾ The law of public debt no. 313, *Monitorul Oficial* no. 577/2004.
- ⁽¹⁴⁾ Idem 6.
- ⁽¹⁵⁾ Informations from www.kmarket.ro.
- ⁽¹⁶⁾ *Bursa Review*, 12.05.2003.
- ⁽¹⁷⁾ The formula used for computation, the generally one, is: $(ROBID+ROBOR)/2 + X\%$.
- ⁽¹⁸⁾ Idem 6.
- ⁽¹⁹⁾ www.primet.ro.
- ⁽²⁰⁾ www.standard.ro.

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