

Study on the Local Financial Self-government in Romania

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Abstract. *Local authority financing is currently at the heart of the political debate. All the states are faced with the challenge of reconciling the need to control and reduce public spending with greater financial autonomy in local government; they are accordingly seeking ways of achieving an equitable distribution of financial resources among the different levels of government in a context of budgetary cutbacks at every level of public administration. If strengthening democracy means strengthening local self-government, this in turn means establishing systems of financing for local authorities which are at once efficient, fair and consistent with the state's economic imperatives. In other words, the principle of subsidiary, decentralization and local finances are all interdependent.*

In Romania this process started in 1990 and it is on the move even today. This paper is trying to find, by using economic instruments, what is the degree in which we succeed to create a real local financial self-government.

Keywords: self-government; local authorities; local communities; income; Romania.

JEL Codes: H72, H76.

REL Code: 13C.

1. Introduction

Local decentralisation is inseparably connected to financing the activity of the local communities, meaning the financial decentralisation or *the local financial self-government*, without the financial component, the administrative decentralisation would be difficult or even impossible to achieve. Justly, most researchers deem financial decentralisation as being the backbone of the administrative decentralisation system, the financial resources being those operationally making the connection between the needs of the local communities and the means necessary for satisfying them. Thus, the absence of financial resources would lead the local communities into the impossibility of satisfying the needs of its members, which would simultaneously determine the failure of administrative decentralisation. Financial decentralisation may also be the transmittance of some specific functions by the central government to the local public authorities, by line of administrative authority and tax incomes.

2. Theoretical bases

“The European Charter of the Local Self-government”, adopted in October 1995, specifies to article 9 regarding the financial resources that “Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers.”⁽¹⁾.

The general principles listed by the European Charter of Local Self-government are:

1. Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers.

2. Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the law.

3. Part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate.

4. The financial systems on which resources available to local authorities are based shall be of a sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks.

5. The protection of financially weaker local authorities calls for the institution of financial equalisation procedures or equivalent measures which

are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden they must support. Such procedures or measures shall not diminish the discretion local authorities may exercise within their own sphere of responsibility.

6. Local authorities shall be consulted, in an appropriate manner, on the way in which redistributed resources are to be allocated to them.

7. As far as possible, grants to local authorities shall not be earmarked for the financing of specific projects. The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction.

8. For the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law.

Even though certain basic principles are not set forth, a series of discrepancies occur between the local communities, thus determining the occurrence of several systems of expression. Thus, besides the territorial and demographic discrepancies, other factors also occur, such as the status of the local communities, the number of levels for local public administration, the division of competences, the regime of public finances.

The objectives of financial decentralisation are *to efficiently assigning the financial resources, equitably supplying the public goods in various geographical areas, providing the macroeconomic stability and promoting the economical improvement*. The financial independence is mainly achieved by the revenue budget and expenses of the local community, and the distinct organisation of the public finances is achieved based on the financial decentralisation allows:

- The exemption of central finances from a series of expenses;
- The decrease of the number of financial flows between the central authority and local authorities;
- The creation of a clearer image of the way of managing the national public finances.

As we were saying above, financial decentralisation may be achieved differently, depending on several factors, starting to be operational beyond the limit which the volume of public goods supplied at a central level is narrowing by a too high increase in the comparative cost for making decisions at a central level. An analogy may be done between the financial decentralisation and the concept of tax federalism, but their applicability is different depending on the organisational nature of the states (unitary states and federal states).

The analysis of the financial autonomy of the administrative-territorial units in Romania represents an interesting and inciting process, but a very complicated one, under the conditions where certain factors exist and are

difficult to quantify. A major impediment also consists in the existence of the statistic data at the regional level, which are either inexistent or they exist, but are incomplete.

The selected analysis method is of “analysis-diagnosis” type, based on financial indicators. The study of the local financial independence at a national level was focused on the statics and dynamics of own incomes (fiscal incomes and non-fiscal incomes of the local budgets), of the incomes and total expenses of all local public authorities, in lei for current prices, respectively constant prices, for the time interval 1991-2008, according to the data centralised from the control accounts of the local budgets.

3. Method and results

In order to study the local financing, a series of synthetic indicators have been created: the local authorities’ capacity of self-financing, the degree of local authorities’ financial dependence, the general degree of covering the expenses onto the own incomes and index of financial position of a local authority.

a. The local authorities’ capacity of self-financing or the degrees of financial independence indicate the weight which own incomes have within the total of the incomes of local budgets. The mathematical relation is:

$$Ca_{loc.} = \frac{Vp_{loc.}}{Vt_{loc.}} \times 100 \quad (1)$$

where:

$Ca_{loc.}$ shows the local authorities’ capacity of self-financing;

$Vp_{loc.}$ signifies the local authorities own incomes;

$Vt_{loc.}$ shows the total incomes of local jurisdictions.

b. The degree of local authorities’ financial dependence signifies the weight which all of the following have in the volume of total incomes of the local budgets: the quota and amounts deducted from the income tax, the amounts deducted from the value added tax, as well as the budgetary transfers received by the local authorities from the state budget or other budget. The calculation method is:

$$Gd_{loc.} = \frac{CST_{loc.}}{Vt_{loc.}} \times 100 \text{ or } Gd_{loc.} = 100 - Ca_{loc.} \quad (2)$$

where:

$Gd_{loc.}$ represents the degree of local authorities' financial dependence in relation to the central authority;

$CST_{loc.}$ signifies the quotas and amounts deducted from the income tax, the amounts deducted from the value added tax, as well as the budgetary transfers received by the local authorities from the state budget or other budgets;

$Vt_{loc.}$ shows the total incomes of local jurisdictions.

c. The degree of covering the local expenses based on the own incomes indicate the extent where the total expenses of the local budgets are financed based on the own incomes.

The calculation algorithm is:

$$Gvp/c_{loc.} = \frac{Vp_{loc.}}{Cht_{loc.}} \times 100 \quad (3)$$

where:

$Gvp/c_{loc.}$ represents the degree of covering the local expenses based on the own incomes;

$Vp_{loc.}$ signifies the local authorities own incomes;

$Cht_{loc.}$ shows the total expenses of local jurisdictions.

1. As it results from Table 1, after the calculations made, *the own incomes* of all administrative-territorial units of Romania have an oscillating evolution generally caused by the frequent legislative amendments. In real terms, these indicates a significant increase in the middle of the range, in between 1991 – 1994, of 47.1% in 1994 compared to 1992, due to the fiscal and budgetary policies in the direction of financial decentralisation, so that it would drop by 8.1% in 1994 compared to 1993.

Table 1

**The evolution of own incomes, local revenues and expenses
in Romanian, in between 1991 -2008 – sample assembly**

Indicator	UM	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Venituri proprii (prețuri curente)	milLei	17	32	153	335	923	1.130	1.984	3.327	7.557	12.135	15.518	20.533	27.284	30.759	31.495	26.172	17.441	20.599
Venituri proprii (prețuri constante)	milLei		11	47	140	682	778	802	2.144	5.113	8.410	11.294	16.626	22.889	26.747	28.070	23.621	15.475	18.069
Deflator (anual)	%		300	327,4	239,1	135,3	145,3	247,3	155,2	147,8	144,3	137,4	123,5	119,2	115,0	112,2	110,8	112,7	114,0
Venituri totale (prețuri curente)	milLei	59	200	713	1.787	3.336	4.999	10.469	13.454	21.253	33.357	71.043	93.022	128.143	158.989	194.287	276.934	368.031	456.977
Venituri totale (prețuri constante)	milLei		67	218	739	2.466	3.440	4.233	8.669	14.379	23.116	51.705	75.322	107.503	138.251	173.161	249.940	326.538	400.857
Cheltuieli totale (prețuri curente)	milLei	58	199	696	1.735	3.265	4.955	10.371	13.382	20.869	33.141	70.523	92.487	128.284	155.139	187.527	253.608	339.314	493.956
Cheltuieli totale (prețuri constante)	milLei		66	213	726	2.413	3.410	4.193	8.622	14.120	22.966	51.327	74.888	107.621	134.904	167.136	228.888	301.077	433.295
Variația veniturilor proprii (față de anul anterior)	%		-38,69	47,13	-8,15	103,69	-15,73	-29,02	8,03	53,70	11,28	-6,93	7,14	11,47	-1,97	2,39	-16,90	-40,87	3,60
Variația veniturilor totale (față de anul anterior)	%		13,53	9,00	3,72	39,55	3,11	-15,31	-17,19	6,88	8,77	55,00	6,02	15,57	7,89	8,91	28,64	17,92	8,92
Variația cheltuielilor totale (față de anul anterior)	%		13,72	6,61	4,27	39,09	4,44	-15,37	-16,86	5,52	10,05	54,88	6,19	16,36	5,16	7,73	22,06	18,72	27,70
Capacitatea de autofinanțare a autorităților locale	%	29,37	15,86	21,41	18,96	27,67	22,61	18,95	24,73	35,56	36,38	21,84	22,07	21,29	19,35	16,21	9,45	4,74	4,51
Gradul de dependență financiară a autorităților locale	%	70,63	84,14	78,59	81,04	72,33	77,39	81,05	75,27	64,44	63,62	78,16	77,93	78,71	80,65	83,79	90,55	95,26	95,49
Gradul de acoperire a cheltuielilor locale pe seama veniturilor proprii	%	29,46	15,88	21,92	19,31	28,27	22,81	19,13	24,86	36,21	36,62	22,00	22,20	21,27	19,83	16,79	10,32	5,14	4,17

Source: data processed by the Statistic Journal of Romania 1992-2008.

In 1995, as consequence of the measures taken in order to amend the legal frame concerning the local taxation, materialised by the stipulations of Law no. 27 of 17th May 1994 regarding the taxes and local charges and of Law no. 35 of 30th May 1994 concerning the agricultural income tax, an “explosion” of the own incomes occurs, by an increase of 103.7% compared to 1994. Unfortunately, the tendency is not maintained during the following two budgetary years, the financial own resources of the local budgets dropping by 15.7% in 1996 compared to 1995 and by 29% in 1997 compared to 1996, due a locally weak fiscal efficiency.

For 1998 – 2002, the dynamics of the own incomes is an ascending one, with a maximum increase of 53.7% in 1999 compared to 1998 and of 11.2% in 2000 compared to 1999, caused by the extension of the local self-government as consequence of Law no. 189 coming into force on 22nd October 1998, regarding the local public finances.

As of 2003, the own incomes indicate a sinuous evolution, with increases and decreases, in real terms, due, on one hand, to Law no. 571 coming into force in December 2003 regarding the fiscal code, and, on the other hand, due to amending the organic regularisation regarding the local public finances, by

the Emergency Ordinance no. 45 of 5th June 2003 concerning the local public finances. The first regularisation brings about significant sifts at the level of fiscal base of taxes and local rates.

Towards the end of the analysed interval, the drop most emphasised is found in 2007, compared to 2006, by 40.8% caused especially to action of Law no. 273 of 29th June 2006 regarding the local public finances.

2. As it may be noticed from the same Table 1, the *total revenues and expenses of all Romanian local authorities* indicate an ascending tendency during the period taken into consideration, an exception being years 1997 and 1998, with drops of approximately 15-17% each year, compared to the previous one.

Starting with 2000, introducing the global system of taxation the natural persons' incomes, as well as applying the quotas and amounts deducted from this income tax, has provided an increase of the total local incomes by 8.8% compared to the previous year. The growth by incomes recorded locally in 2001, when the total financial resources have risen by 55% compared to 2000 results entirely from the amounts deducted from the state budget from the value added tax.

Moreover, what is very important is that after 2003 we notice a major discrepancy between public incomes and expenses. The increase or even the drop of the incomes was accompanied by a sustained augmentation of the local total expenses, caused by the ample process of financial decentralisation, by relieving the state budget of a series of categories of expenses, but without appropriately providing the needed local financial resources.

3. As it results from Table 1, *the Romanian local authorities' capacity of self-financing* is sufficiently low in the interval 1991-1994, with values within the range 15.9 and 29.4%, which indicates a strong centralised feature of the national public budget. This was due to the additions of local financial resources based on the amounts deducted from the wage tax, but especially based on the subventions assigned by the central authority.

The regulations regarding the local taxes, which were adopted in 1994, had effect in 1995, a year when the degree of local financial independence increased suddenly from 19% in 1994 to 27.7%. The low tax output registered in 1996 through 1998 has naturally caused a drop in the capacity of self-financing, which reached 19% in 1997, the addition of the local incomes being predominantly done by means of the subventions assigned from the state budget.

The sudden change of the indicator in between 1999 – 2000, when it exceeds the threshold of 35% as consequence of Law no. 189 coming into force on 22nd October 1998, regarding the local public finances, is not also

maintained in the upcoming period. For example, in 2002, the degree of independence reaches 22%, especially due to the increases that occurred at the level of the fiscal transfers.

Moreover, the auto-financing capacity indicates an obviously decreasing tendency towards the end of the range, going from 22% in 2002 to only 4.5% in 2008. In this case also the main factor is represented by the deduction realised only at the level of the local public expenses, not on the component of incomes.

4. *The degree of the Romanian local authorities' financial dependence* evolves inversely to the self-financing capacity and is high enough, especially within the range 1991 – 1994, when it reaches the level of 84.1% in 1992 and extremely high, of over 90%, starting with 2006 (Table 1).

5. *The degree of covering the local expenses based on the own incomes in Romania* indicates a dynamics that is very similar to the self-financing capacity (refer to Table 2 and Figure 1), determined, on one hand, by the endless legislative changes, and, on the other hand, by the fact that total incomes mobilised locally differ slightly from the volume of local expenses.

Low values of the indicator are registered, especially for the range 1991-1994, between 15.9 and 19.3%, which indicates the fact that public expenses were financed preponderantly based on the amounts deducted from the wage tax, but especially based on the subventions assigned by the central authority. After 1994, due to notable legislative changes on the way of decentralisation from 1994 and 1998, a tendency of increase in the degree of financing the expenses by means of own incomes is found out, the lowest value being 19.1%, registered in 1997.

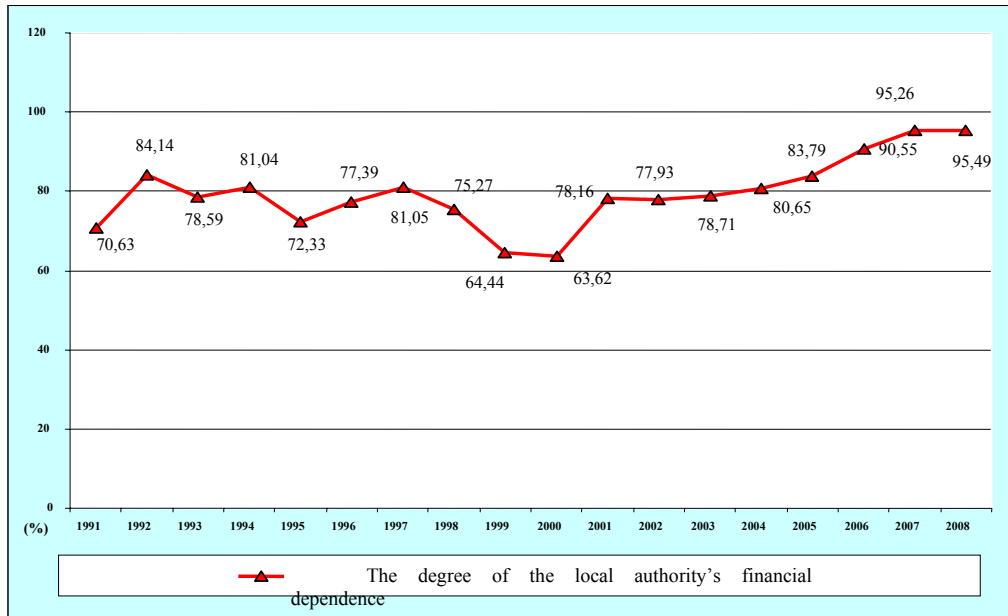


Figure 1. *The degree of covering the local expenses based on the own incomes in Romania between 1991-2008*

4. Conclusions

In consonant with passing at the local level of a series of public services, without providing the needed resources based on the own incomes, the degree of financing the expenses by means of own incomes reaches only 4.1% in 2008.

The essential remark is the one according to which the decentralisation process has followed a slow but sure trend up to 2002. Starting with 2003, the central authority has transferred locally a series of public services, but without accompanying this procedure by the necessary own local financial resources. Consequently, it is found that the local entities are “under a significant financial control” of the central authority’s.

Note

⁽¹⁾ See *European Charter of local Self-Government*, European Treaty No.122, Strasbourg, 15th October 1995, art. 9, par.1.

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