

FINANCIAL MANAGEMENT OF LOCAL GOVERNMENTS IN ROMANIA – PROBLEMS AND POSSIBLE SOLUTIONS

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Abstract:

The functionality of public institutions by providing efficient public services and, to a larger scale, the achievement of specific public administration goals are closely related with the decision-making process and how that process takes place within these entities. Thus, local financial management is a multifaceted subject shaped by political, administrative, legislative, economic, social factors that are consistently influencing its success. Starting from these premises, the article aims to highlight the main characteristics of the financial management of local authorities between 1990-2010 in Romania, implicitly revealing their impact using a quantitative analysis (i.e. income and expenditure of local budgets) and also, proposing viable solutions for eliminating them.

Key words: local financial management, financial liability, financial performances

JEL classification: H7, H77

1. Introduction¹

Providing different public goods at local level is not only a necessity, but also became a condition for the efficiency of the public interventions (Musgrave, 1989). According to such an approach, it must be acknowledged that clear separation between national needs and local needs and giving local authorities the right to freely manage the latter can make the supply of public goods at the level of the entire nation more efficient (Oates, 2007). Taking this into account and adding modern democratic values, such as the “right to self-government” of various administrative and territorial entities, local autonomy and decentralization of public services have become central elements of the reforms applied in the various administrative systems (Onofrei, 2007), especially in the South-Eastern European countries, which passed from the totalitarian political regime to the democratic one. On this basis, local financial management doesn't have to be just an “administrative local power”, that is possible to be accomplished in a “passive attitude”. Financial autonomy and decentralization can be the (if certain conditions are met) the real framework to be innovative, productive and efficient when public authorities facing different local requests or preferences. Thus, local financial management is a multifaceted subject shaped by political, administrative, legislative, economic, social factors that are consistently influencing its success.

2. The framework and the main characteristics of local financial management in Romania during the period 1991-2009

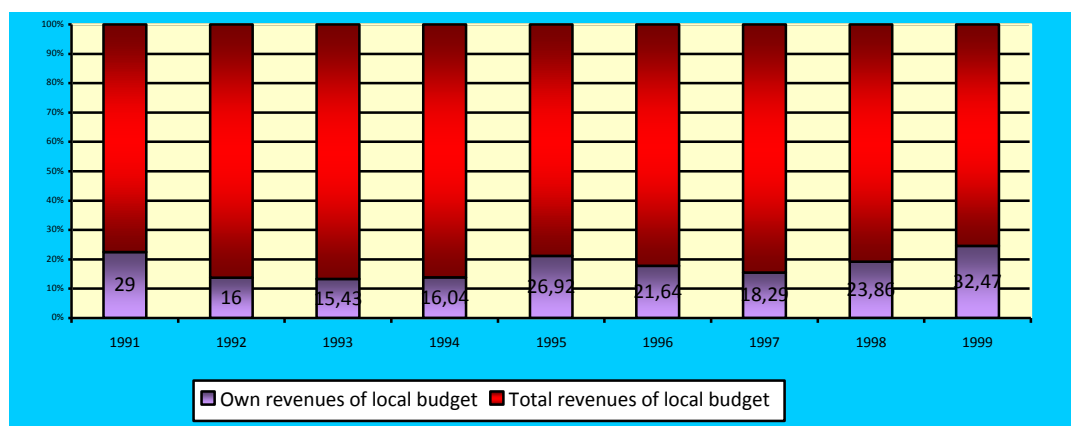
Romanian political-administrative system reform have had as the basic pillars the recognition and strengthening of local administrative-territorial autonomy, a process

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accompanied by administrative and financial decentralization, also. In this context, local budgets have moved towards their position as instruments of local financial autonomy, many legislative reforms being designed to increase the degree of local autonomy (Voinea, 2008).

In a first step, the Constitution adopted in 1991 included the basic principles for organizing local government as decentralization and local autonomy, imposing automatically the need to establish the stable, predictable resources for local governments, thus far the financial transfer equally competences transfers (Cigu, 2011). Although decentralization process has been addressed in statements and legislative power, the financial side has been addressed only in 1994, when Law no. 27 were set local taxes, the effects of the law starting since 1995, when own revenues increased from 16% to 26.92%. At least in principle, this law should have lead to a strengthening in the next few years the local budget revenues, but figures show that the majority of local budgetary resources are from the transfers, not their own revenues. Thus, in 1997 when was set up. The special fund of water supply and paving roads, transfers from the state budget increased from 76.45% to 80.71%. An important moment to strengthen the local financial management is one of 1998, when it adopted the Law of Public Finance no. 189/1998, being considered crucial year in the public finance reform because limited the sphere of "local public finances" and instituted some of the principles of fiscal federalism: the duty collection, establishment and administration of taxes by local authorities; possibility to transfers from state budget to local budgets; borrowings of local authorities within 20% of their revenues.

Fig. no. 1: The share of own revenues in total revenues of local budgets in the period 1991-1999



Source: processing data of Statistical Yearbook of Romania 1990-1998

Own income fluctuate in the period 1993-1998 with a slight increase between 1993 and 1995 (from 15.43% in 1993 to 26.92% in 1995) and then decreased during 1996-1997. Transfers from the state have an annual average share of 75%, signifying an increased dependence of local communities from state budget transfers are earmarked to fund certain categories of local public expenditure.

Table 1: Romanian local budget revenues in 1991-1999

Revenues	1991		1993		1995		1997		1999	
	Amount (mil. Lei)	%	Amount (mil. Lei)	%	Amount (mil. Lei)	%	Amount (mil. Lei)	%	Amount (mil. Lei)	%
REVENUES - total	58626	100	712549	100	3336457	100	10468499	100	22243670	100
Own revenues	17036	29,0	109956	15,43	874146	26,92	1914827	18,29	7223449	32,47
Capital revenues	180	0,30	42582	5,97	49312	1,47	69337	0,66	334276	1,50
Other revenues	0		0	0	10088	0,30	49542	0,47	362679	1,63
Sampling from state budget	41411	71	560011	78,59	2402911	72,01	8343793	79,70	14323267	64,39

Source: processing data of www.mfinante.ro

Year 1999 reflect the effects of local public finance law, when there is an increase of own revenues of local budgets in total income from 23.86% in 1998 to 32.47% in 1999. For capital income and other income remains an insignificant share, and levies from the state budget for the trend in 1999 is down from 74.71% to 64.39%.

As we can see from the table, sources of income allocated to local authorities in Romania in the first phase were not likely to substantiate a realistic local autonomy, especially given that the transfer of administrative powers had a reasonable continuity. As shown in the figure below, during the entire period under discussion, local authorities in Romania have benefited from the transfer of various powers, which have attracted the need to be financed, striking fairly consistent in many cases the revenues of local budgets.

Fig. no. 2: Competences transfer from central level to local level in Romania in the period 1991 – 2008

				National Defense
			"Croissant and milk " program	"Croissant and milk " program
			Subsidizing Housing hitting	Subsidizing Housing hitting
			Religion	Religion
			Special education/ Guaranteed minimum income	Special education/ Guaranteed minimum income
		Assistance for persons with disabilities	Assistance for persons with disabilities	Assistance for persons with disabilities
		Agricultural Consultancy	Agricultural Consultancy	Agricultural Consultancy
		Veterinary Actions	Veterinary Actions	Veterinary Actions
		Airports	Airports	Airports
		Children protection	Children protection	Children protection
		Water supply and roads	Water supply and roads	Water supply and roads
		Special Funds	Special Funds	Special Funds
	Culture	Culture	Culture	Culture
	Education	Education	Education	Education
	Health	Health	Health	Health
Other economic actions	Other economic actions	Other economic actions	Other economic actions	Other economic actions
Other actions	Other actions	Other actions	Other actions	Other actions
Transport	Transport	Transport	Transport	Transport
Housing and planning	Housing and planning	Housing and planning	Housing and planning	Housing and planning
Social assistance	Social assistance	Social assistance	Social assistance	Social assistance
Public authorities	Public authorities	Public authorities	Public authorities	Public authorities
1991-1992	1995-1996	1999-2000	2003-2004	2007-2008

Source: authors

Table 2: Evolution and structure of local budget revenues in 2000-2008*(mil. RON)*

Indicators	2000		2002		2004		2006		2008	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
REVENUES - total	3345	100	9323	100	15955	100	27709	100	43629	100
Current revenues	801,74	23,97	1561,50	16,75	2747,20	17,22	26172,40	94,46	38641,30	88,57
Fiscal revenues	614,30	18,36	1184,20	12,70	2177,20	13,65	25236,80	91,08	37346,00	85,60
Nonfiscal revenues	187,44	5,60	377,30	4,05	570,00	3,57	935,60	3,38	1295,30	2,97
Capital revenues	59,51	1,78	59,20	0,64	328,80	2,06	518,80	1,87	639,30	1,47
Donation and sponsorship	0,00	0,00	0,00	0,00	19,30	0,12	0,00	0,00	0,00	0,00
Receipts from reimbursement granted loans	0,00	0,00	0,00	0,00	1,10	0,01	1,00	0,00	3,40	0,01
Revenues with special destination	352,30	10,53	432,70	4,64	0,00	0,00	0,00	0,00	0,00	0,00
Amount deducted from wage/income tax	1743,50	52,12	3907,00	41,91	6633,70	41,58	7550,30	27,25	14242,00	32,64
Shares and amounts from VAT	0,00	0,00	3185,10	34,16	5274,00	33,05	14539,00	52,47	18644,80	42,71
Grants	285,00	8,52	117,40	1,26	920,20	5,77	1016,40	3,67	4345,10	9,96

Source: processing data of Statistical Yearbook of Romania 2005 – 2009 and www.mfinante.ro

According to the table, we can notice a high proportion of shares and deducted from the state budget transfers in total local budget revenues. Since 2003, administrative-territorial units have benefited from stamp duty, legal and notary fees instituted by OUG no. 36/2002 on local taxes. Add to this the inclusion of allowances deducted from income tax under the category of local budgets' own revenues, which increased its own revenues in total revenues of local budgets. Grants have been characterized by fluctuations in 2000-2008, representing a minimum of 1.26% of total local revenue in 2002 and a maximum of 9.96% in 2008.

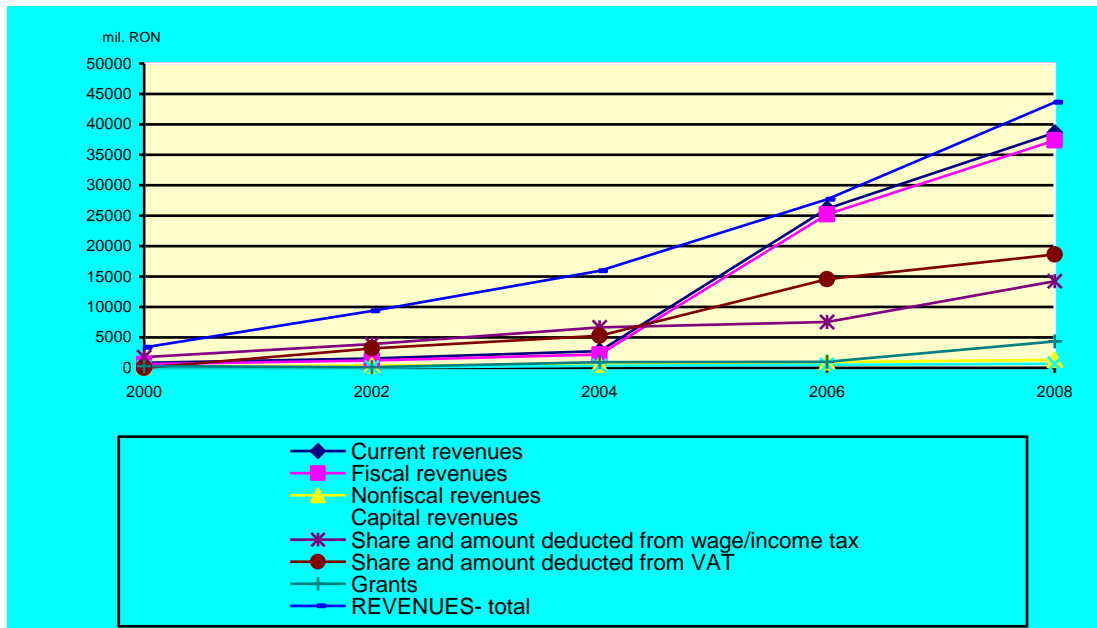
In 2005, due to the implementation of new tax reform as one rate of personal income tax of 16%, there are changes in local budget revenues. Reducing the tax rate and maintaining the same percentage rates of income tax deducted from the territorial-administrative units, they would registered smaller sums, which led the Government to increase the rates deducted from income tax in February 2005. Thus, municipalities have 47% of income tax, instead of 36%, county budgets will retain 13% of collected income tax from 10%; share which is balancing local budgets available to county councils increased from 17% to 22%². In 2006, local public finance law³, are kept the same rates of income tax deducted from the previous law covered. In 2010, the new legal framework⁴ establishes: 44% to local budgets of municipalities on whose territory income tax payers operate; 12% of the county's local budget; 21% in a separate account opened on the general direction of public finances in the county treasury, balancing the local budgets of municipalities and county budget.

² O.U.G. nr. 9 din 24/02/2005, publ. în M. Of., partea I, nr. 174 din 28/02/2005, art. 28

³ Legea finanțelor publice locale nr. 273 din 2006, publ. în M. Of. nr. 618 din 18/07/2006, art. 32 (1);

⁴ O.U.G. nr. 63 din 30/06/2010, publ. în M. Of. nr. 450 din 2 iulie 2010, art. 32 alin 2

Fig. no. 3: Evolution of the main categories of local budgets revenues in 2000-2008

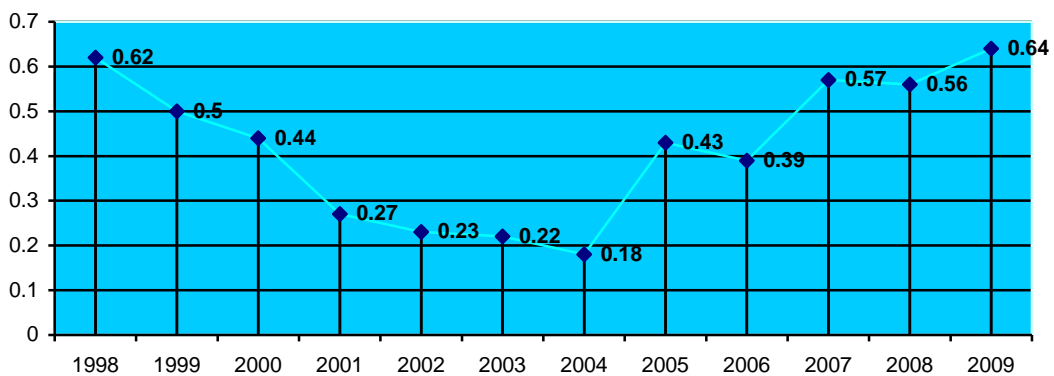


Source: processing data of Statistical Yearbook of Romania and www.finante.ro

The figure shows that the local budgets revenues registered a trend generally upward, especially fiscal revenues which resulted in a growth of current revenues and overall in local budget revenues.

In terms of local autonomy, application of balancing local budgets raises the question of the degree of financial dependence of local authorities. Hunter's coefficient, which reflects the degree of financial dependence of local authorities to central government level for the period 1998-2009, shows the following values:

Fig. no. 4: Evolution of Hunter Coefficient values in Romania during 1998-2009



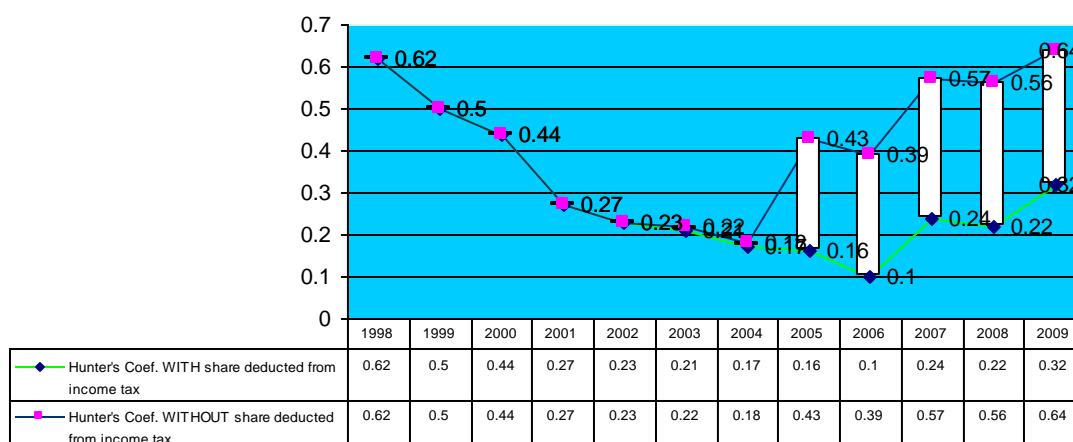
Source: processing data of Statistical Yearbook of Romania 2000 – 2009 and www.finante.ro, Regulation on state budget 2009

During the period 1998-2009, local governments have been a factor ranged between 0.62 and 0.44 between 1988 and 2000, after which it drops sharply after the takeover by local budgets finance costs university teaching staff and decreased slightly over the period 2003 - 2004 as a result of the transition assistance and social protection expenditure from local authorities. Since 2005, there is a turnaround situation, Hunter coefficient was 0.43 in 2005 and 0.57 in 2007, 0.56 in 2008 and 0.64 in 2009.

According to local public finance law, share deducted from income tax have been considered as local budgets' own revenues since 2003, but in practice they have been collected to the state budget and then redistributed to the administrative-territorial units. Thus, if the hypothesis shares deducted from income tax are included in the

category of amounts collected from the state, Hunter's coefficient values are much lower.

Fig. no. 5: Comparative evolution of the Hunter's coefficient value with and without inclusion share deducted from income tax in total transfers from the state budget during 1998-2009



Source: processing data of Statistical Yearbook of Romania 2000 – 2009 and www.mfinante.ro

According to the figure, including allowances deducted from the income tax generates values much lower coefficient, which indicates an increase in financial dependence. Thus, during the 1998-2009 reporting period, we can see changes in the coefficient between 0.62 and 0.10. In 2009, the Hunter's coefficient is 0.32, which compared to previous years, highlights the fact that this year the balance transfers were made in smaller amounts. It is noted that the establishment by law of shares deducted from the income tax as own revenues, making the financial independence of local budgets to increase.

3. Current concerns and priorities related to the quality of local financial management

In the local government reform process in Romania, to increase the financial side of local autonomy, a priority is dealing with problems of preparation, substantiating, approval and implementation of local budgets. This goal requires first considering the local budget as a management tool, which allows for increased power of decision authorizing officer to manage resources and expenditures, regardless of source of funding. We believe that improving management of the local budget process requires a human resource management, which aim is competent officials to establish trust, cooperation and responsibility. It is recommended that those involved in the local budget process to have specialist training, courses, demonstrate competence and skill. In this direction, in order to attract young professionals well trained in public administration in Romania has sought to create a new specific public functions with special status, called public manager⁵, that take advantage of a special promotion system and a motivating salary level.

Local budget implementation generally requires to be improved in two main directions:

- Optimization of local public administration authorities in the preparation phase of the local budget, as an overstatement of income leads to a weak foundation of the budget and hence the low budget execution. This explains that in the beginning of the year, on the following own resources oversized or unrealistic expectations of possible allocations from the central government, are made

⁵ OUG nr. 56 din 25/06/2004, publ. în M. Of., Partea I nr. 590 din 01/07/2004

expenditures on the base of the potential resources and not certain resources, which produce failures in the commitment of expenditure and payments due to lack of funding sources;

- Strengthening expenditure control and creating conditions for increased efficiency in the use of public funds to finance public spending. So that, a system should be flexible and transparent for distribution and allocation of financial resources by destination, monitoring and evaluation of the functioning of administrative and local public services and performance measurement and quality service delivery.

Within these main areas, the improvement of implementation of local budgets could be achieved by promoting effective financial activities through the following: establishment of a dashboard (bimonthly) to allow decision-makers (mayors, county council presidents, business executives, heads services, etc..) to monitor receipts and payments; to take prompt decisions and to foresee future events; organizing a coherent and effective program for tracking the receipt of revenues; ensuring a tight and strict control of spending to avoid undue costs and inefficient local authorities ensuring that financial resources are used fairly and lawfully; develop a specific set of financial indicators to be mayor month analyze and interpret; correct sizing of staff required within the local City Council and County Council, civil servants must perform their job duties in strict compliance with legislation and to develop the cult of legality.

Another important aspect to be considered is the fact that improving the relationship between local authorities and taxpayers is essential in the context of local autonomy as a key objective of local authorities would be to identify public services that citizens expect to align the supply of public services to the requirements of the "market" (Cigu, 2011). The modern economy requires that public authorities to adapt quickly to changes taking place in the market space. Connected to a dynamic environment, public institutions are obliged to receive its signals and respond as quickly and efficiently possible which means developing a marketing policy in line with market requirements. Such a policy is expressed by formulating a set of strategic objectives, appropriate strategies and tactics of a set of (concrete) in relation of interdependence (Onofrei, 2007). Unfortunately, the reality in Romania shows that this component of local public management is not taken into account by local authorities having negative consequences especially in the supply of local public services.

4. Conclusions

In conclusion, we consider for improving the effective and efficient management of local budgets must be taken certain measures to the level of the local authorities to:

- Developing and updating public policies in all areas of activity of local government to improve budget programming activity;
- Involvement with responsibility of all staff, inventory and assessment of taxable supply, ongoing monitoring by the executive management of revenue collection during implementation;
- Realistic, fair evaluation and substantiation of public expenditure and their continuous monitoring, in terms of regularity and legality of their commitment and performance and the effectiveness and efficiency of using public funds for their financing;
- Improve the efficiency of internal audit control structures and by empowering them to perform their duties prescribed by law. Always encouraging and monitoring their activities;
- Strengthening the responsibility at the level of local government executives on how inventory tracking, management and use of all goods and property items;

- Implementing all measures necessary to understand legal framework by staff involved in recruitment, settlement, ordering and payment of expenditures;
- Empowerment of local councilors on analysis of budget execution, budget resources and public assets and private management at the local government.

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