FINANCIAL SIDE ANALYSIS OF LOCAL AUTONOMY IN ROMANIA

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Abstract:
Financial side of local autonomy expresses the capacity of local communities to have their own revenue and expenditure budget, distinct from that of the state in which revenues can cover expenses incurred to meet their requirements. The analysis of financial autonomy of administrative-territorial units in Romania is an interesting but complex approach given that some factors are actually difficult to predict and quantify.
The purpose of this paper is to clarify the meaning of financial side of local autonomy and analyze this in Romania based on indicators established in recent years for measuring the position of administrative-territorial units in relation to central government.

Key words: *local autonomy, local budget, public expenditure, government revenue*.

JEL classification: *H 72, H 83*

1) Introduction

Local autonomy implies the right of local government authorities to have cash resources, manage them and use them to perform the duties prescribed by law, to elaborate budget, to monitor the implementation of budget sometimes called financial autonomy (Voinea, 2011). In other words, financial autonomy is the ability of local authorities to have an own budget of income and expenses, distinct from the state's in which own revenues can cover expenses incurred to meet local collectivity requirements.

Local communities are human communities distinct from the state, with levels of public authority different from the ones the state has, which is an absolutely necessary condition for financial autonomy, administrative autonomy not being possible otherwise.

2) Content of the financial side of local autonomy

Distinct organization of local finances, based on their financial autonomy, allows relieving the central finances of a series of expenses, reducing the number and magnitude of cash flows between the two structural levels of public finances and also a clearer track of how funds are used. Separation of local finances from central ones, as met in other areas, is therefore determined by considerations of economy. Local finances better and more effectively meet the requirements of public utility in the territory. The question that remains to be studied and resolved is how far financial autonomy can extend, in other words, how big is the degree of centralization and decentralization in public finances field.

The degree of financial centralization varies according to the concentration degree of country's government, namely the extent to which local authorities are subordinate to central government. However, major issues of strategic, national interest, which affects all citizens, are funded centrally (defense, state's public order, state administration, external relations, environmental and citizen protection, art, health, education, science), just like macro-social policies of adjustment, stability and welfare are financed from central funds.(Văcărel, 2006)

Financial decentralization begins to operate beyond the limit from which the area of using public goods and services of national interest begins to shrink, and the comparative cost of decision-making at central level becomes too high. Thus, the costs with some utilities such as building roads, public protection, public lighting, municipal services, local transport, education, and so on, return to the local task. Of course, there are differences regarding the demand for public utilities and the possibilities of providing them from one territorial-administrative unit to another, especially because of open character of local communities and the fact that their relations with the environment are different.

In order to qualify for real financial autonomy, local collectivities need to:

- have sufficient own resources to meet their responsibilities;
- be able to freely determine their incomes and expenses;
- have a managerial informational system that would allow optimal and continuous correlation of incomes and expenses; (Munteanu, 2003)
- not being subject to an experienced control from the center regarding their financial decisions.

These conditions of different nature are reciprocally interrelated because on the one hand, the volume of own resources needed for material independency depends largely on legal capacity of local authorities to freely impose the introducing of new local taxes, to set quotas and tax base, and on the other hand, the power to decide, to grant exemptions from taxes or freely modify tax base, which on the other hand influences the level of charges that community can support.

The degree of local autonomy (and thus financial authonomy) of a local communities is closely related to the share of own incomes in total revenues of local budgets, but this criterion should not be generalized, as there are exceptions of European countries with highly developed local democracy, but with a centralized system of financing of local government.

The degree of manifestation of the financial side from the local autonomy is determined by the degree of separation of capacities on some public actions and services, the diversity and quality of public services, the development programs of territorial-administrative units, the improving of management of local budget expenditures.

On the other hand, central government cannot establish or impose any responsibilities to local government authorities in the process of decentralization of some public services or of the demand for new public services without providing adequate funds to carry out such duties.

The financial part of local autonomy does not mean total financial autonomy of local government authorities, but rights to use and manage financial resources belonging to villages, towns, cities and counties. Full financial autonomy of local government authorities would lead to separation tendencies within the state to manage financial resources for the benefit of residents of territorial-administrative unit.

Local autonomy also means increased responsibility of local government authorities in the administration of local financial resources, in sizing expenditures in incomes' limits, in strengthening the control over the use of resources from local budgets and in careful management of debt.

3) Analysis on the financial side of local autonomy in Romania

Measuring local financial autonomy was the object of research on an international base due to the steps taken to quantify the relationship between decentralization and various macroeconomic variables. Thus, a series of qualitative and quantitative indicators have been established in recent years to measure the position of territorial-administrative units in relation to central government. However, some of these indicators are criticized due to the fact that they do not fully cover all parts of autonomy.

Until around 2000, most studies have used financial statistics of International Monetary Fund as starting point in measuring financial decentralization. Dominant formula compares the amount of expenditures/local incomes with the amount of total expenditures/incomes at national level or with gross domestic product (GDP). These relatively simple indicators are also used today, although some experts have identified their deficiencies.

Thus Ebel and Yilmaz in 2002[1], Meloche in 2004[2], World Bank in 2007[3] showed the disadvantages of these indicators, as following:

- when talking about incomes there is not a difference between different sources of local incomes. Nature and local autonomy degree may be differently perceived depending on the source of income. At the same time, it does not specify what percent of transfers are allocated to some general or specific objectives.
- for expenses, no distinguish was made between mandated expenses and optional ones. When talking about mandated expenses, even if they appear as expenses in local communities with a high degree of decentralization, local authorities are in this case just state agents who have limited decision-making powers. However, transfers from various levels of government appear in functional expenses.

These shortcomings of indicators generate an overestimation of decentralization degree and local financial autonomy.

The Organization for Economic Cooperation and Development (OECD), in 2001, has developed a new model for measuring income autonomy applied to Member States, but didn't also tried a model for expenses (Cigu, 2011).

The analysis of financial autonomy of territorial-administrative units in Romania represents an interesting but very complicated endeavor, given that there are some factors practically difficult to quantify. In order to study local financial autonomy, we are using a series of synthetic indicators regarding incomes and expenditures of local budgets.

a) *Self-financing capacity* of local authorities or *the degree of financial autonomy* (C_a) shows the weight that own incomes have in whole local budgets revenues.

C_a = (Own Incomes/Total Incomes) * 100

The amount of own revenues from local budgets triggers the possibility of making local public expenditures and at the same time reflects the degree of autonomy by the ratio that appears between own revenues, transfers of state's funds for balancing local budgets and loans. As higher the share of own incomes in total sources of local revenues is, the higher is the freedom of territorial-administrative unit to spend as they see, so that to assure the coverage of public needs, which translates into a broad financial autonomy.

Table no. 1 Local budget income in 2009

millions lei

Incomes	**Sums**	**Share %**
Total incomes	43526,1	100
Incomes from taxes, charges and rates deducted from	21886,4	50,28

[1] Ebel, R. D. and Yilmaz, S., *On the Measurement and Impact of Fiscal Decentralization*, Policy ResearchWorking Paper 2809, TheWorid Bank, Washington D. C., 2002

[2] Meloche, J.-Ph., Vaillancourt, F., şi Yilmaz. S., *Decentralization or Fiscal Autonomy? What Does Really Matter? Effects on Growth and Public Sector Size in European Transition Countries*, Policy ResearchWorking Paper 3254, TheWorld Bank,Washington D. C., 2004

[3] The World Bank. Data on Decentralization and Local Regional Economics. Electronic database and user guide, 2007, URL /www.worldbank.org/publicsector/decentraslization/data.htm

income tax		
Amounts deducted from VAT	17260,5	39,65
Subsidies	4379,2	10,06

Source: After Romanian Statistical Yearbook 2010, p. 609

In 2009, own incomes of local budgets in Romania, amounting 21886,4 millions lei, represents 50.28% of total revenues. As shown in the table below, the degree of financial autonomy is increasing relating to previous period.

Table no. 2 Dynamics of local budgets incomes structure (%)

Incomes	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Own incomes	46,8	45,93	43,86	47,48	47,30	50,28
Amounts deducted from VAT	47,43	47,31	52,47	39,53	42,73	39,65
Subsidies	5,77	6,76	3,66	12,98	9,95	10,06

Source: After Romanian Statistical Yearbook 2003-2010

b) The degree of financial dependence of local authorities (G_d) means the weight that rates and amounts deducted from income tax, amounts deducted from value added tax, and budgetary transfers received by local authorities from state budget or other budgets (CST) have in total revenues of local budgets volume (Vt).

$$Gd = \frac{CST}{Vt} x100$$

Table no. 3 Dynamics of financial dependence of local budgets (%)

Incomes	**2006**	**2007**	**2008**	**2009**
Own incomes (rates deducted from income tax, exclusively)	16,61	17,31	14,66	15,83
Rates deducted from income tax	27,24	30,16	32,64	34,44
Amounts deducted from VAT	52,47	39,53	42,73	39,65
Subsidies	3,66	12,98	9,95	10,06

Source: After Romanian Statistical Yearbook 2003-2010

The degree of financial dependence of local authorities in Romania moves in the opposite direction of self-financing capacity and is quite high. If we consider that income tax is charged to state budget and then distributed according to the criteria prescribed by law[4] to local budgets, the degree of financial dependence of local authorities is very large, revolving around the level of 85%.

c) The weight of sums and rates deducted from some incomes for balancing local budgets in state budget

This indicator reflects the extent to which central public government is involving in sustaining the activity of local government and in order to express local autonomy, it should be as small as possible.

Table no. 4 Weight evolution of sums and rates deducted from certain incomes to balance local budgets in total revenues of state budget in the period between 2002-2009

Year	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Incomes of state budget (millions lei)	17920,6	25244,7	32195,4	36599,5	40698,1	48984,6	61151,0	56434,8
Sums and rates deducted from certain revenues to balance local budgets (millions lei)	7096,0	9374,3	11909,8	14667,1	14539,0	14552,5	18644,8	17260,5
Weight of sums and rates deducted from	39,5	37,1	36,9	40,0	35,7	29,7	30,4	30,5

[4] Law no. 273/2006 regarding local public finances, art. 32, modified by O.U.G. no. 63/2010

certain revenues to balance local budgets in state's budget (%)								

Source: After Romanian Statistical Yearbook 2003-2010

Weight of sums and rates deducted from certain incomes for balancing local budgets in state's budget has fluctuated over the period analyzed, yet following a declining trend (Fig. no. 1.1.). Thus, in 2002 this indicator recorded the value of 39.5%, then dropped the next two years, and in 2005 reached the peak for this period (40%). In the last part of the period, the indicator drops to 30%, which demonstrates us that progress was made in the decentralization process.

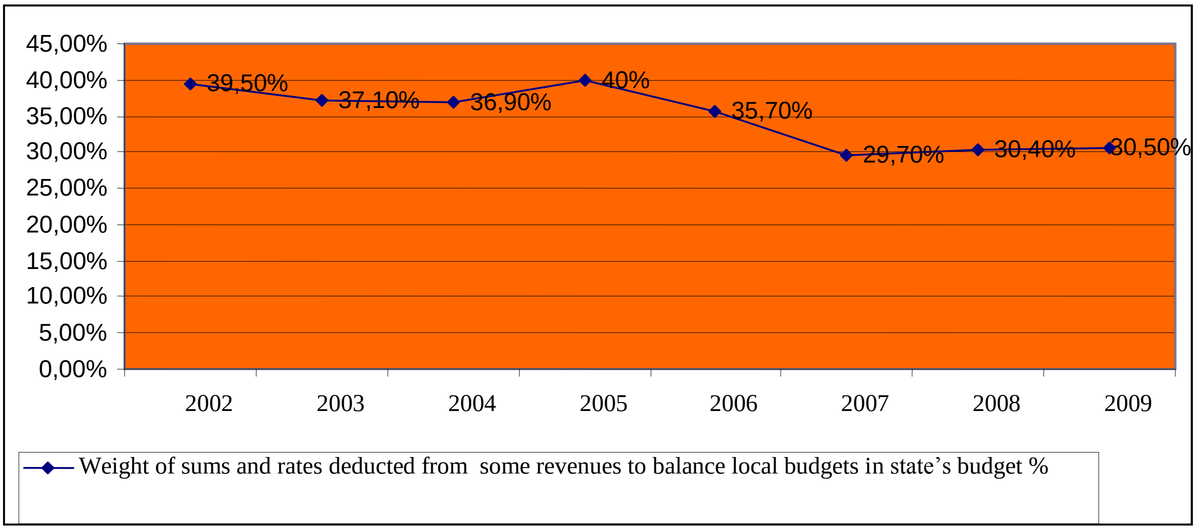

Fig. no. 1 Weight evolution of sums and rates deducted from certain revenues for balancing local budgets in total revenues of state budget during 2002-2009

d) *The degree of coverage of local expenditures on account of own revenues (Gvp/c)* shows the extent to which total expenditures of local budgets *(Cht)* are funded at the expense of their own income *(Vp)*

$$Gvp/c = \frac{Vp}{Cht} x100$$

This indicator should be as high as it gets for the territorial-administrative unit to demonstrate financial autonomy

Table no. 5 Dynamic of local expenditure coverage with own revenues of local budgets (%)

	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Own incomes of local budgets (millions lei)	2109,4	2968,8	3127	3596	12153,2	17475,2	20639,2	21886,4
Total Local public expenditures (millions lei)	9268,8	12852,7	15540,7	18777,0	25392,8	33982,3	42210,2	42074,5
Coverage of local expenditures with own incomes of local budgets	22,75	23,09	20,12	19,15	47,86	51,42	48,89	52,01

Source: After Romanian Statistical Yearbook 2003-2010

Coverage of local spending on the account of own income shows a very similar dynamic with the one of self-financing capacity (Table no.1.7.), determined by the fact that total incomes raised locally differ by less by the volume of local public expenditures. The table shows a low coverage of local public expenditures with own incomes for 2002-2005 of maximum 23.09% in 2003. Coverage of local public expenditures doubles during 2006-2009, reaching a value of 52.01% at the end of it.

This trend means that the process of decentralization and strengthening of financial autonomy is in progress and with visible results.

d) *Hunter coefficient* shows the part of expenditures from local budgets that are funded from sources controlled by central government, according to following relation:

$$coef.H = 1 - \frac{CST}{Cht}$$

The closest the value of this coefficient is to 1, the degree of financial autonomy is higher. Hunter coefficient during 2006-2009 has an increasing trend from 0.42 in 2006 to 0.57 in 2009, which proves that Romania has taken important steps regarding financial decentralization and simultaneously increasing of local autonomy.

Table no. 6 Dynamics of Hunter coefficient, 2006-2009

Year	**2006**	**2007**	**2008**	**2009**
Total Local public expenditures (millions lei)	25392,8	33982,3	42210.2	42074,5
Amounts deducted from VAT	14539	14552,5	18644,8	17260,5
Hunter coefficient	0,42	0,57	0,56	0,58

Source: After Romanian Statistical Yearbook 2003-2010

According to public finance law, rates deducted from income tax are included in own revenues of local budgets, but in practice they are collected to state budget and then redistributed to territorial-administrative units. The same ascendant trend is followed by Hunter coefficient, calculated in the hypothesis of including rates deducted from income tax into the category of amounts transferred from the state budget.

Table no. 7 Dynamics of Hunter Coefficient (with inclusion into state budget's transfers of rates deducted from income tax) during 2006-2009

Year	**2006**	**2007**	**2008**	**2009**
Total Local Government expenditure (million lei)	25392,8	33982,3	42210.2	42074,5
Transfers towards local budgets from the state budget (million lei)	22089,3	25653,1	32876,3	32242
Hunter coefficient	0,14	0,25	0,22	0,24

Source: After Romanian Statistical Yearbook 2003-2010

In this case, table data shows that this indicator has a very low value of only 0.14 in 2006, increasing to 0.24 in 2009. This shows the important share of rates deducted from income tax in the structure of local budgets incomes in Romania.

4) Conclusions

The research carried out shows that although the principle of autonomy and decentralization of public services is invoked, territorial-administrative units are still dependent on transfers of fund from the state. Financial indicators analyzed indicate the existence of local financial autonomy, but funds are insufficient for local government authorities to have wide power to decide on the constitution and spending of local public funds. However, financial autonomy and decentralization process records every year more favorable and more visible results.

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