HIGHLIGHTS OF FINANCIAL DECENTRALIZATION IN ROMANIA

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ABSTRACT
The paper presents the evolution of financial decentralization in Romania, from its beginning, in 1994, with the first law on local taxes and duties, and until the present-day reform which outlines the premises of true decentralization in our country. The work analyzes the deficiencies of the first steps of financial decentralization, emphasizing the need to decentralize and/or transfer resources to the local level, in order to empower the administrative decentralization. In this section, the analysis focuses on the evolution of the broken-down split shares of the income tax. Finally, we analyze and comment the latest legislation on the matter, which seems to achieve the fine balance between the local budgets, as well as a necessary degree of transparency and objectivity.

Keywords **–** financial decentralization, local fiscal incomes, local government revenues

JEL Classification **–** E62, H71

Paper type –Case study

Introduction

The problem of administrative and financial decentralization remains an important one in the context of the current public policy in Romania. The process of decentralization of administrative activity is hallow and can become dangerous if not accompanied by financial decentralization to ensure the support of fulfilling the new responsibilities born on the local public administrations.

The substantiation of adequate policies to reach financial and administrative decentralization and to balance local budgets cannot be achieved without following the basic principles that theoretical research and long practical experience of developed countries have come to formulate. These concern, on the one hand, the allocation of responsibilities to local government and, on the other hand, the allocation of revenue sources to them.

The main steps of financial decentralization in Romania

In Romania, the first steps in financial decentralization were taken in 1994 with the adoption of the *Law on local taxes and duties* (Law no. 27/1994), moment which also marked the establishment of the own revenue of local community. After more than a decade and a half, it may be noted that due to legal developments, which allowed both the decentralization of income and the access to other financial instruments with the role of supplementing the existing funds, local communities have a greater financial autonomy.

Another important milestone was the emergence of the *Law of Local Public Finance* (Law no. 189/1998) which, besides uniformly addressing complex issues of local finances and increasing their financial autonomy, has the merit of presenting for the first time, in a coherent way, a solution to balance the local budgets, establishing certain balancing criteria and designating public authorities with tasks in these fields. Both the criteria and the role of President of the county council have been widely contested afterwards by the local authorities because they have allowed the political interference factor in allocating resources for local authorities. The reactions of former presidents of county councils are well known, in this matter, as they have made public statements that reveal their discretionary power in allocating funds, local rural communities being most affected in this regard.

However, through the application of this law, there has been progress in terms of financial capacity of local communities in Romania, which explains the evolution of their income in recent years. In 1999, the Government introduced, as a new source of financing local government, the split share of the income tax. Since 2000, in the decentralization process, a growing number of responsibilities have been transferred from the central to the local level. Naturally, it took a parallel transfer of financial resources. Therefore, part of the income tax, collected in each administrative-territorial unit has been left directly at their level, by means of breakdown of income tax rates, and the difference, which is summed into the state budget, as a manager of this source, is allocated from the income tax amounts broken down, both unconditional – for balancing, and conditioned – for special destinations. Therefore, starting this year, we can discuss a new budgetary "philosophy", because in the budget legislation there are new terms, such as special purpose revenue, shares of income tax amounts deducted from certain incomes of the state budget (VAT and income tax), amounts of income tax breakdown for balancing (Tobă, Giosan and Moraru, 2005, p. 64).

Also, during this period, a mechanism for negotiation and consultation between the central government and associative structures of the local public administration (The Association of Chief Financial Directors of County Councils of Romania, The Body of Chief Financial Directors of the Association of Municipalities and The Association of Towns in Romania) began to run. The purpose of these consultations and negotiations is to correlate how the transfer of responsibilities to the public services of communitarian interest is performed to their relating funding sources. Even if there were and still are some differences, it is noted that representatives of local public administrations undertake the responsibility of taking over all decentralized services, even if, at first, they are not able to provide these services at the quality standards offered.

Building on experience gained in the few years of applying the provisions of Law no. 189/1998, the associative structures of the local public administration, the local public administration, by the representatives of the relevant ministries, the domestic and foreign financers involved in monitoring the Romanian public administration reform agreed to make some major changes in the law on local public finance. These changes are reflected in Ordinance no. 45/2003 on local public finance (as approved and amended by Law no. 108/2004) and mainly concern the following issues (Tobă, Giosan and Moraru, 2005, p. 71):

- there was improvement in the number of terms and expressions that operate in local public finance, as defined by this legislation;
- it was attempted, after multiple negotiations with the representatives of all associative structures, representatives of ministries, the regulation by law of balancing criteria to eliminate, as much as possible, subjectivity in the conduct of the resource allocation process;
- a detailed legal framework was created for contracting and operating loans by the local public administration;
- penalties were established, quite shyly, however, for the officers authorizing budgeting not complying with discipline.

In the three years of implementing the provisions of this ordinance (2004-2006), certain amendments were necessary with respect to its provisions, intended to increase accountability of local actors involved in managing public money, to enshrine the principle of separation of duties of the factors of decision, respectively, execution, or to counteract the collateral effects (loss of income) that the modification (on January 1st, 2005) of the system of taxation of natural persons' income propagates on the budgets of the local collectivities. Also, there were noted limitations of the balancing system of the local budgets and the possibility to further improve these extremely important procedures.

The efforts in this direction put in by stakeholders have resulted in a *new version* of the *Law on local public finance* (Law no. 273/2006), whose provisions are applicable from January 1, 2007 (with some exceptions). It adds new elements to the old regulations, especially regarding:

- expanding budgetary principles and rules with a number of other recognized principles of international practice in local public finance (the principle of solidarity, the principle of local financial autonomy, the principle of proportionality, the principle of consultation);
- defining the concepts of financial crisis and insolvency of the administrative-territorial units and procedures to follow when facing such situations;
- introducing some institutional arrangements on the basis of which the Committee for local public finance is established, as body with consultative role in the process of elaborating certain regulations of financial character with respect to the local budgets and their balancing;

- last, but not least, it brings major changes in the system of balancing local budgets, starting with the criteria used and ending with the allocation of responsibilities in this process.

The analysis of local budget revenues

The analysis of the current system of administrative territorial units' revenues in our country reveals that it is an outcome of the combination between the method of entrusting certain incomes and the method of sharing other incomes (see Table no. 1).

Table no. 1. The structure of local budget revenues in 2007-2009 (% of the total)

Income revenues	2007	2008 [1)]	2009 [1) 2)]
REVENUES (I + II + III + IV + V)	100.00	100.00	100.00
OWN REVENUES	*47.39*	*47.22*	*50.53*
I. Current revenues	**85.44**	**88.56**	**87.54**
Fiscal revenues	***81.90***	***85.60***	***84.64***
Tax on income, profit and capital earnings	31.67	32.94	34.72
Tax on income, profit and capital earnings from legal persons	0.08	0.04	0.05
Tax on profit	0.08	0.04	0.05
Tax on income, profit and capital earnings from natural persons	31.51	32.85	34.63
Tax on income	1.35	0.20	
Shares and amounts broken down from tax on income	30.16	32.65	34.63
Other taxes on income, profit and capital earnings	0.07	0.05	0.04
Taxes and duties on ownership	8.00	7.25	7.93
Tax on buildings	5.41	5.25	5.82
Tax on lands	2.01	1.70	1.72
Judicial stamp duties, stamp duties for notary	0.45	0.16	0.28

activity and other stamp duties			
Other taxes and duties on ownership	0.13	0.14	0.11
Taxes and duties on goods and services	41.90	45.09	41.72
Amounts broken down from VAT	39.54	42.74	39.45
Other general taxes and duties on goods and services	0.10	0.10	0.08
Duties on specific services	0.04	0.04	0.04
Duties on using goods	2.22	2.21	2.15
Other fiscal taxes and duties	0.33	0.31	0.26
Non-fiscal revenues	***3.54***	***2.97***	***2.90***
Income from ownership	1.79	1.27	1.28
Sales of goods and services	1.75	1.70	1.63
II. Capital revenues, of which:	**1.67**	**1.47**	**0.78**
Income from privatization	0.02	0.02	0.002
III. Financial operations	**0.0005**	**0.008**	**0.36**
Cashing from refund of granted loans	0.0005	0.008	0.36
IV. Subsidies from other levels of general government	**12.88**	**9.96**	**9.91**
Subsidies from state budget	12.67	9.68	9.75
Subsidies from other administrations	-	-	0.16
V. Amounts received from E.U.	-	-	**1.41**

[1)] Provisional data

[2)] The dates refer to the achievements of the period 1.I.-30.XI.2009

- : not available

Source: Monthly Statistical Bulletin no. 12/2007 for 2007, Monthly Statistical Bulletin no. 12/2008 for 2008 and Monthly Statistical Bulletin no. 11/2009 for 2009

There are, on the one hand, the so-called *own revenues*, consisting of taxes, duties, contributions and other payments, other income and shares of income tax, which in recent years, represent almost half of their total revenue, aspect denoting the increased financial autonomy of local public authorities.

Preponderant in total revenues are current revenues, which are maintained throughout the period analyzed at a relatively constant level, which oscillates around 86% of the total revenues. Of the current revenues, over 95% are of fiscal nature, being acquired mainly by levies from the state budget (over 85% of tax revenues are shares and amounts broken down from tax on income and amounts broken down from VAT) and direct taxes aimed at different forms of wealth (land, buildings, vehicles). To note, however, that these local taxes have national regulation and the powers of local authorities is limited to the possibility of overcoming national variation by a margin by 20%, only in the sense of increasing it (the prior maneuvering margin was of plus or minus 50%) .

In completion of their revenues, the administrative-territorial units benefit of *shared revenues*, which maintain a high degree of dependence to the state budget.

The determination of the volume of resources that will be distributed to local authorities is carried out, in Romania, in two ways:

- as a proportion (share) of income achieved by means of a state tax (case of the income tax, which in the recent years was gradually made available to the local collectivities and which currently remains at a rate of 82% to the local budgets, as shown in Table no. 2);
- as amount deducted from certain incomes of the state budget, with or without special purpose (case of the amounts broken-down from the value added tax or income tax).

Table no. 2. Evolution of shares from income tax (%)

Year	Income tax share for local collectivities	of which:		
		Income tax share for municipalities, cities, communes	Income tax share for counties	Income tax share for counties for the purpose of balancing the local budgets
1999	50	35	15	-
2000	60	35	10	15
2001	61.5	36.5	10	15
2002	62.5	36.5	10	16
2003	63	36	10	17
2004	63	36	10	17
20	82	47	13	22

05				
20 06	82	47	13	22
20 07	82	47	13	22
20 08	82	47	13	22
20 09	82	47	13	22
20 10	82	47	13	22

For the City of Bucharest a distinct shares system is practiced, the tax share left available to the municipal budget being higher than the one afferent to the sectors of the City of Bucharest (in the period 2005-2007, the shares were 23.5%, 47.5% and, respectively, 11%).

Source: legislation specific to local public finance and annual budgetary laws.

The magnitude that the samplings to the local budgets have in the overall state budget revenues, the concrete forms of levy and amounts transferred to the destination are shown in Table no. 3.

Table no. 3. Samplings from state budget by local budgets in the period 2006-2009 (% of total)

	200 6	200 7	200 8	200 9 [1]	201 0 [2]
Samplings from state budget – total, of which:	100 .0	100 .0	100 .0	100 .0	100 .0
Shares and amounts broken down from tax on income	34. 2	43. 3	43. 3	44. 7	46. 3
Amounts broken down from VAT	65. 8	56. 7	56. 7	55. 3	53. 7

[1] provisional data

[2] projected data

Source: own calculations based on annual budgetary laws

The transfers made on account of shares broken down from the income tax do not have a conditional character, the respective amounts being capable of being assimilated to the own incomes of the local budgets, especially if we consider the permanent nature the law currently gives to these incomes. On the other hand, with respect to the amounts broken down from

VAT, the trend of emphasis on the degree of conditioning with respect to the manner of using these resources can be observed in recent years. Thus, the amounts broken down from VAT are destined to financing the expenditure of state pre-university educational units, for sustaining the child protection system, and agricultural consulting crèches units (at local and county level), for subsidies of thermal energy delivered to the population; for county and communal roads, for the retechnologization, modernization and development of the centralized system for thermal energy production and distribution, for sustaining disabled people protection system, culture, cults and balancing local budgets, for social allowances and allowances for heating dwellings with wood, coal and petroleum fuels, for financing community services of persons registration.

Balancing the local budgets

Regarding the current balance system established by Law no. 273/2006, it is built on two levels: from national to county level and from county to local level.

The balancing from the national level to the county level targets the amounts broken down from certain income of the state budget, in order to balance the local budgets and is achieved on the basis of two criteria: inversely proportional with the financial capacity, solely determined on the basis of average tax per capita (with a weighting coefficient of 70%) and directly proportional to the counties' areas (with a weight of 30%).

The balancing from the county level to the local level concerns first broken down amounts from the state budget to balance the local budgets, but also the share of 22% of the income tax made available to the county councils, in order to balance the subordinated local budgets, and their distribution manner has been radically reformed. Thus, after 27% of the money is allocated to the own county budget, the difference is allocated to local budgets of communes, towns and municipalities as follows:

a) 80% of the amount shall be divided into two stages, by decision of the director of the county general direction of public finances, decision which is communicated to the prefect, the County Council and local councils in the county.

In the first step, the amount is allocated only to the administrative-territorial units whose average income tax per capita collected during the previous year is below the average tax collected at the county level in the same period, based on two criteria:

- share of population in administrative-territorial units involved in this stage in their total population (in a proportion of 75%);
- share of the area inside the city limits of the administrative-territorial units that participate in this stage, in the total area inside their city limits (in a proportion of 25%).

To be noted that the amounts allocated in the first stage are limited, so that the resulting average per capita (including income tax collected during the previous year and the amount allocated in this phase) is less than or equal to the average income tax per capita, collected on entire county in the previous year.

The sums not distributed in the first stage are allocated in the second stage, to all administrative-territorial units in the county, depending on their financial capacity, determined by the average income tax per capita in the year preceding the year of computation;

b) 20% of the amount is allocated, by the county council decision, to support local development programs, for infrastructure projects that require local financing, based on written request from the administrative-territorial units in the county.

It is noteworthy that starting from January 1, 2008, the amounts set by county and each administrative-territorial after running the two balancing stages, are diminished with the non-collection degree. This is a sub-unit coefficient determined by comparing the amounts of local taxes, rents and royalties received in the previous financial year to the amounts receivable from the same sources, as set through the approved budgets for the respective year. Amounts withheld by diminishing are added to the share of 20% that is allocated by decision of the County Council to support local development programs.

Finally, for a better foundation of local budgets, since 2009 an operating section is developed (including current expenditure needed to carry out duties and powers prescribed by law), together with a development section (including capital expenditure), which are approved as annexes of each budget. In the process of balancing the local budgets the possibility of covering the operating section from own income will be explored and, only where appropriate, amounts will be proposed in order to balance this section, such as to ensure the minimum standards of cost and quality for providing public services to the general public. Thereafter, in the limit of the amounts possible to be provided for by the state budget, the amounts to be established in the development section of the local budgets will be set.

Conclusions

The analysis of the balancing system established starting with January 1st, 2007 allows the formulation of several conclusions and the emphasizing of some of its features:

a) in its entirety, through the allocation criteria used, the balancing system combines the approach by balancing the financial resources per capita (by using the criteria of financial capacity) with the approach of balancing the needs of expenditure (using the criteria of area and population, as indicators that approximate these needs). In conclusion, the current system is a mixed one, which allocates the balancing resources proportionally to the indicators reflecting the magnitude of the expenditure needs and inversely proportional with the indicators reflecting the size of a part of their own resources;

b) with reference to the first stage of the balancing process (from national to county level), it may be noted that the current allocation formula, in terms of eligibility, all county administrations are eligible to receive balancing grants, regardless of their own sources or needs. It was considered, thus, that the horizontal imbalances in the case of counties are not so important as to necessitate the use of a criterion for the exclusion from balancing process;

c) at the second level of balancing (from the county level to the local one), the situation is different. Here, it is noticed firstly that the most substantial amounts (80%), usually destined to cover the current needs, is assigned based on criteria, systematized in various calculation formulas, while the amounts meant for development (20%) are distributed by ad hoc decision of the County Council.

In the first stage of balancing, we resort to a criterion for exclusion, eliminating from the balancing process the localities where the average income tax per capita exceeds the average registered in the county. Using then for distribution two criteria expressing needs (population number and built-area) is attempted the focusing of the balancing resources towards the poorest localities, with the greatest needs of expenditure.

This was even more necessary because in each county there are very high discrepancies between the urban and the rural environment. The intra-county differences are much greater than the inter-county ones, which justifies the use of an exclusion criterion. Moreover, in the specialty literature, there are opinions that the problem would become simpler if the balancing would be performed from the national level directly to the local level, using a unitary exclusion criterion for the whole country (Tobă, Giosan and Moraru, 2005, p. 171).

Also, the problem of improving the criteria used by this balancing model remains open. The measure of eliminating from the balancing system a criterion left to the choice of the county council in relation to the area specific is questionable. We believe that the allocation of amounts broken down with special destination can be improved by taking into account other criteria, as well, such as the share of population aged up to 18 years (in case of transfers targeting the educational system), of the population over 65 years (in case of transfers targeting at social welfare), etc. (Boloș, 2006, p. 96).

d) we must highlight the intention of implementing a balancing model that stimulates the development of the own income base and mobilizes the local administration apparatus to improve the collection degree of own revenues by introducing the principle of reducing the amounts allocated through the balancing system, correlated to the non-collection degree;

e) the current balancing criteria do not provide for the possibility of assigning certain balancing amounts to cover the costs involved in the administration of institutions of the type that do not have beneficiaries solely from within the respective administrative-territorial units (hospitals for neuropsychological patients, homes for the elderly, etc.), or for the maintenance of objectives built within projects that required co-financing;

f) we also appreciate the fact that the current balancing system has gained in objectivity and transparency. A clearer indication of how to calculate the indicators included in the balancing model and, above all, the financial capacity, limits the possibility of its manipulation in various computing variants. The involvement of the General Directions of Public Finance in the balancing process limits the maneuvering and interference margin of the political factor, leaving available to the county councils only 20% of the balancing amount. In addition, the law requires the obligation, both for county councils and for the directors of the county general directions of public finance, to communicate to the interested parties the decisions adopted regarding the balancing process and to publish them on their websites. Failure to comply with legal provisions regarding balancing brings forth the absolute nullity of decisions adopted, established by the administrative contentious court, at the notification by any interested person.

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