

## AN ASSESSMENT OF THE FINANCING SYSTEM OF LOCAL COMMUNITIES IN ROMANIA

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**Abstract:** *The paper reflects the importance of the local budgets in the Romanian budget system and it shows the evolutions of the different types of revenues of local budgets in the period 1991-2005. It emphasizes the mechanisms of local budgets equalization during this period. An important part of the paper is dedicated to the differences between the structure and importance of local budgets order by development regions in order to reflect the different importance of the equalization grants for local budgets. It also suggests some improvements to be done in the mechanism of the equalization grants.*

The financing of local public services is ensured taking into account the revenues of the local budgets.

After 1989, the budget system of our country is organized in a new way, imposed by the market economy, giving up the unique state budget, derived from the unique national plan, an instrument of the excessive centralism. Thus, according to the Law 10/1991, we go to a budget system made of three components: state budget, local budgets and budget of the state social insurance.

Between 1991-1992, the structure of the revenues of the local budgets was formed of two main categories of revenues:

- own revenues, category to which current revenues and capital ones belonged;
- subsidies from the state budget.

During this period, we notice the reduction of the own revenues in the total revenues of the local budgets from 29,37% (out of which 29,06% - current revenues and 0,31% capital revenues) in 1991 to 15,85% (out of which 15,7% - current revenues and 0,15% - capital revenues), compensated by the growth of the state subsidies from the state budget from 70,63% in 1991 to 84,14% in 1992.

The list of public revenues is added since 1993 to the state budget law in order to establish the revenues corresponding to the components of the budget system, namely state budget and local budgets.

In the same year it was introduced the way of balancing the local budgets through the system of shared amounts. Also, the same mechanism was used for covering the expenses that was transferred to be financed by the local budgets, namely the material expenses for health and the expenses for social working.

By the Government Ordinance no. 15/2002 and by the state budget law no. 21/1993, some revenues were transferred from the state budget to the local budgets, such as: stamp duties from firms, tax on means of conveyance owned by firms, duties for examining drivers, user fees for releasing driving licenses and other revenues regarding driving on public roads, revenues from imputations and compensations, returning funds from the local budgetary financing of the previous years, revenues from houses built from state funds and sold.

Also in 1993, according to the annual budgetary laws, transfers from the state budget were given to the local budgets as it follows:

- to ensure social protection for the thermal energy supplied to the people with higher prices than the unique one approved of according to the legal disposals, as well as to ensure the functioning of the urban mass transit, according to the legal disposals and that can be covered by adding own revenues and deducted money from the salary taxes too;

- to finance capital expenses for objectives and new investment work or other funds (fully or with own sources) legally constituted to finance such investments and the allowances approved of with this purpose through the local budgets, investments as networks, central heating, water supplying, purifying machines for used water, pumping machines and garbage platforms, local, hydro technical installations, the town technical work interfacing the group of buildings, the mass transit networks, including trams, buses and trolley buses endowments.

The effect of these measures could be observed in 1993, when the percentage of own revenues increased to 21,41% from the total revenues, out of which 15,43% current revenues and 5,98% capital revenues (especially following the dwellings from the state fund). In 1994, there was a new reduction of the percentage of own revenues to 18,96% (16,04% - current revenues and 2,92% - capital revenues). From the data in table no.1 can be observed the rise of share amounts, along with subsidies from the state budget.

In 1994, the legal background was improved regarding the system of the revenues of the local budgets through the law no. 27/1994 concerning the local taxes and the law 34/1994 concerning the taxes on agricultural income. Through this laws, it was assign a system of taxes to the local budgets, such as: property taxes (land, buildings, vehicles) and other user fees (licenses, permits, etc.).

Thus, in 1995, once the law no. 27/1994 was passed, there was a growth in own revenues to 27,68%, followed by a new mitigation to 22,61% in 1996 and 18,95% in 1997. The capital revenues have again insignificant values (1,48% in 1995, 0,66% in 1997). In 1998 there was a new growth of own revenues to 24,74% from the total revenues, out of which 23,86% are current revenues and 0,88% - capital revenues, especially following an introduction of the special fund for supplying water and paving the roads in 1997.

Table no.1.

### The evolution of the revenues of the local budgets between 1991 – 1998

million lei

Revenues	1991	1992	1993	1994	1995	1996	1997	1998
Total revenues	58626	199667	712549	1767150	3336458	4998504	10468498	13454174
Own revenues	17216	31639	152539	334999	923459	1130407	1984164	3328193
Current revenues	17036	31339	109957	283384	874147	1081678	1914827	3210224
Capital revenues	180	300	42582	51615	49312	48729	69337	117969
Shared amounts	0	0	231770	668109	1203024	1972609	4644559	4997959
Subsidies from the state budget	41410	168000	328340	762546	1199887	1848506	3790234	5054462
Donations	0	0	0	0	0	88	144	692

The source: The statistic Yearbook of Romania 2000.

The structure of the revenues for the local budgets between 1991 and 1998 is given in table no. 2.

**Table no. 2**

The structure of the revenues of the local budgets between 1991 – 1998

	1991	1992	1993	1994	1995	1996	1997	1998
Total revenues	100	100	100	100	100	100	100	100
Own revenues	29.37	15.85	21.41	18.96	27.68	22.61	18.95	24.74
Current revenues	29.06	15.70	15.43	16.04	26.20	21.64	18.29	23.86
Capital revenues	0.31	0.15	5.98	2.92	1.48	0.97	0.66	0.88
Other revenues	0	0,01	0	0,08	0,3	0,94	0,47	0,55
Samplings from the state budget, out of which:	70.63	84.14	78.61	80.96	72.02	76.45	80.57	74.72
a) Subsidies from the state budget	70.63	84.14	46.08	43.15	35.96	36.98	36.21	37.57
b) Shared amounts	0	0	32.53	37.81	36.06	39.46	44.37	37.15

- % -

The data emphasizes the strong dependence of the local budgets on the state budget, element that constituted a major impediment in stating the importance of the local public authorities as actors of the encouraged development of the locality and of the area.

The year 1999 represented a major turning point regarding the reform of the local financial system, the first law of the local public finances (the law no. 189/1998) conferring the local public administration an increased autonomy through the financial and patrimonial decentralizing. The law institutes the principles of the fiscal federalism, grounding a series of new elements for the local communities that implied the following:

- a) the obligation to cashing, determining and administrating the taxes by the local authorities;
- b) the possibility to take samples from some sources of the state budget as transfers to the local budgets;
- c) making loans by the local authorities, limited to 20% from own revenues.

As a result of passing law no. 189/1998, in the structure of the revenues of the local budgets appeared income tax shares, that is taxes which are partially given to different public budgets. According to the law no. 189/1998, taxes on the salary was paying in this manner: a share of 50% to the state budget, 40% to the budget of the administrative-territorial units where the activity takes place and 10% to the budget of the county. Financially speaking, these revenues are considered own revenues.

The same law introduced the equalization grants, although their budget classification, “shared amounts”, has existed for several years. The annual budget law establishes the equalization grants: the amounts are earmarked from some revenues of the state and the allocation criteria for each administrative unit are designed to support the poorer communities to compensate for the diminished fiscal capacity. The most important difference between “shared amounts” and equalization grants is that equalization grants follow a similar criterion with the “shared amounts”, except for the addition of an indicator for fiscal capacity. The equalization grants and the special destination transfers from the state budget are approved yearly, through the law of the state budget, for every county and for Bucharest. It established that out of the equalization grants, a share of 25% to be given to the own budget of the county. The difference was assigned to local budgets by the county council, through a decision taken after consulting the mayors and with special technical assistance from the general department of the public finances and of the state financial control, according to the approved assessment criteria.

The structure of the revenues of the local budgets in 1999 is as it follows:

- own revenues - 33,98% (out of which 32,47% current revenues and 1,51% capital revenues);

- samplings from the state budget, the percentage of which is of 64,39%, detailed as it follows:

- a) special destination revenues – 10,61%;
- b) income tax shares – 33,63%;
- c) equalization grants – 13,12%;
- d) subsidies from the state budget – 7,03%.

Taking into account the character of own income of the income tax shares, it is to be noticed the growth of the own revenues to 67,61% from the total of the local budgets. As a positive element, it has to be noticed the fact that the income tax shares reduces the level of the special destination transfers, which offers the local administrations more freedom of taking decisions.

Table no. 3

### The structure of the revenues of the local budgets in 1999

<b>Revenues</b>	<b>1999</b>
Total revenues	22243670
Current revenues	7223449
Capital revenues	334276
Samplings from the state budget, out of which:	14323267
a) Special destination revenues	2360365
b) income tax shares	7480298
c) equalization grants	2918578
d) subsidies from the state budget	1564026
Money from the repayment of the given loans	30
Loans	362648

Following the introduction of the global income taxes, the change of the criteria of determining the income tax shares on administrative-territorial units takes place through the Law of the state budget for the year 2000.

Thus, the structure of the revenues of the local budgets is modified, introducing a income tax shares available for the county councils in order to balance the local budgets.

As a new source, the shared amounts from VAT was introduced in 2000 as well, in order to subsidize the thermal energy supplied to people.

In 2001 it was decided that the financing of the following actions should be done to the local budgets:

- ensuring the guaranteed minimum income, the financing source established being shared amounts from income tax;
- protecting children and disabled people, the financing source being shared amounts from VAT.

In 2002 it was added to all these share amounts from VAT to finance the agricultural consulting activity.

In 2003 the salaries of the non-clerical staff, as well as the disabled people's rights, were transferred for financing to the local budgets, establishing for the first – shared amounts from income tax, and for the second category – transfers given by ANPH.

The evolution of the local budgets between 2000 and 2003 is emphasized in table no. 3.

Table no. 3.

**Revenues of the local budgets between 2000-2003**

billion lei

<b>Revenues</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
Total revenues	33445.017	71195.736	93227.73	130780
Current revenues	8017.452	11158.679	15615.134	22859
Capital revenues	595.148	394.651	591.731	1590705
Samplings from the state budget, out of which :				
a) Special destination revenues	3522.664	3964.545	4327.365	3194
b) salary tax shares	1002.848	54.486	38.359	22
c) income tax shares	10621.34	18407.444	19945.891	24858.355
d) Subsidies from the state budget	2851.754	4532.284	1173.574	2597.484
e) shared amounts from TVA	-	21810.819	31850.888	34350.91
f) equalization grants	3323.179	4453.452	10773.524	15477.071
g) income shared amounts for thermal energy	1672.956	2659.447	3044.395	3579.435
h) sums provided by the county councils	1809.59	3538.81	5306.466	7085.933

The source: The Union of the County Councils from Romania, the stage of financial decentralizing in Romania, 2003

According to the data in table no. 4, the own revenues decrease from 25.75% in 2000 to 16.23% in 2001, subsequently noticing a small growth of this percentage (17.38% in 2002 and 18.7% in 2003). If we take into consideration the income tax shares as well, the own revenues represented 60,51% in 2000, followed by a tendency of constant reduction between 2001 and 2003, as it follows: 42.16% in 2001, 38.82% in 2002 and 37.72% in 2003. The reduction of the own revenues (including the income tax shares) is due to the transfer of the previously mentioned responsibilities, together with some other special destination financing sources, which led to the drastic reduction of the financial autonomy of the local authorities.

Regarding the evolution of the shared amounts from TVA during this period, their percentage had an anfractuuous evolution, nevertheless being situated around 30% during all these years (2001-2003) – between 25.84% in 2003 and 34.16% in 2002.

The evolution of the local budgets between 2004 and 2005 is influenced by the Emergency Order no. 45/2003, but also by the law changes regarding income taxes for 2005.

Table no. 5

**Revenues of the local budgets between 2004-2005**

million lei (RON)

<b>Revenues</b>	<b>2004</b>	<b>2005</b>
Total revenues	15955.8	19480.9
Current revenues	27472	3149.5
Capital revenues	3288	397.5
Equalization grants	2293.93	2137.5
Income tax shares	4320.88	3010.2
Shared amounts from TVA	5273.99	9516.5
Salary tax shares	21	2.9
Subsidies, out of which:	9202	1218.1
a) Subsidies from the state budget	8341	1102.1
Donations	193	23.5

Repayment of the given loans	11	2
Loans	-	23.2
Working capital fund to cover temporary slacks	294	-

The source: The statistic Yearbook of Romania 2004, 2005 and 2006, the annual general account for the state budget for 2004 and 2005

According to the data in table no. 5, we notice a growth of the own revenues from 3076 million lei (RON) in 2004 to 3547 million lei (RON) in 2005. Nevertheless, an important problem the localities had to deal with in 2005 was the one generated by introducing the unique quota tax of 16%. Thus, along with the transfer of some actions such as those concerning education, health, social protection and the subsidy payment for electrical energy that needed to be financed between 2000-2004, the local budgets had to deal with the diminishing of the income tax cashing. It is to be noticed that, even if the income tax shares that remain at the local budgets was modified, its reduction was significant in 2005, compared to 2004, that is from 4320.88 million lei (RON) to 3010.2 million lei (RON).

As a result of all these evolutions, we notice that the own revenues (without taking into account the income tax shares) in the total of the revenues of the local budgets, in 2004 and 2005, slowly decreased (from 19.28% to 18.21%), but if we take into consideration the income tax shares as well, this reduction was fairly significant, from 46.37% to 33.67%.

Introducing the mechanism of the income tax shares did not produce important results as a consequence to the fact that they could be modified through the law of the state budget.

Through the Emergency Ordinance of the Government no. 45/2003, it was also determined that from the income tax collected at the level of each administrative-territorial unit, a share of 36% should be allocated monthly during the 5 working days after the end of the month to the local budgets of the community where the tax payers carry on their activity, 10% to the budget of the county and 17% to a distinct account, opened by the county council in order to balance the local budgets.

Subsequently, taking into account the need of maintaining the level of the revenues of the local budgets, the Emergency Ordinance of the Government no. 9/2005 approved of and modified by the Law no. 114/2005, established that a share of 47% of the income tax so collected should be allocated monthly during the 5 working days after the end of the month to the local budgets where the tax payers carry on their activity, 13% to the own budget of the county and 22% to a distinct account, opened by the county council in order to balance the local budgets of the villages, towns, cities and county.

The evolution of the shares for the apportioned tax is given in table no. 6.

Table no.6.

#### The evolution of the shares for the apportioned tax

Significance	1998	1999	2000	2001	2002	2003	2004	2005	2006
The state budget	50%	50%	40%	38,7%	37,5%	37%	37%	18%	18%
Local budgets	40%	35%	35%	36,5%	36,5%	36%	36%	47%	47%
The own local budget of the county	10%	15%	10%	10%	10%	10%	10%	13%	13%
Balance Shares	-	-	15%	15%	16%	17%	17%	22%	22%

The source: [www.mfinante.ro](http://www.mfinante.ro)

We can remark from the data in table no. 6 the growth of the income tax shares to the administrative-territorial units, simultaneously with the growth of the shares that balance the local budgets.

At the regional level, the revenues of the local budgets are given in table no. 7.

Table no. 7

**The revenues of the local budgets on Development Regions**

million lei (1998-2004), lei RON (2005)

Revenues total	1998	1999	2000	2001	2002	2003	2004	2005
TOTAL	13454174	22243670	33445017	71195736	93227730	130780741	159558487	19480864263
NORTH-EAST	1843194	2900247	4326750	10417605	13921778	19701224	23374985	2839920885
SOUTH-EAST	1615379	2849274	4343602	8966180	12031634	17045292	19892867	2504028697
SOUTH	1601335	2557503	4093360	9002314	11880841	16849205	20409714	2430090730
SOUTH-WEST	1088870	1760615	2863123	6585410	8455613	11571395	14249737	1715612084
WEST	1242403	1943295	2892202	6278320	8220276	11948339	15054141	1891096473
NORTH-WEST	1525814	2561449	3817445	8807951	10969691	15335458	18759510	2374586034
CENTRE	1506795	2373834	3432156	7679873	10329291	14555620	18292774	2236965161
BUCURESTI – ILFOV	3030384	5297453	7676380	13458082	17418605	23774208	29524758	3488564199

The source: The National statistics Institute, series Tempo

By comparing the revenues of the local budgets every year to the regional PIB, we can get a mirror of the importance of these budgets in that certain Development Regions.

Table no. 8 refers to the importance of the local budgets for the 8 Romanian Development Regions in period 1998 – 2004.

Table no. 8

**The percentage of the local budgetary revenues in the regional PIB**

	1998	1999	2000	2001	2002	2003	2004
TOTAL	3.60	4.08	4.16	6.10	6.15	6.62	6.47
NORTH-EAST	3.66	4.23	4.49	7.26	7.48	8.00	7.93
SOUTH-EAST	3.30	4.31	4.68	6.81	7.03	7.66	6.76
SOUTH	3.22	3.64	4.17	6.29	6.33	6.80	6.42
SOUTH-WEST	3.02	3.35	3.82	6.28	6.50	6.45	6.48
WEST	3.61	3.38	3.84	5.59	5.59	5.98	5.95
NORTH-WEST	3.37	3.85	4.02	6.44	6.09	6.36	6.19
CENTRE	3.23	3.45	3.37	5.33	5.40	5.87	6.08
BUCURESTI – ILFOV	4.90	5.59	4.55	5.37	5.45	6.11	6.17

It has to be noticed the great importance of the local budgets in the Ilfov-Bucharest Development Region, between 1998 – 2000, while between 2001 – 2004, the areas where the revenues of the local budgets from the regional PIB is higher than the average percentage in the country are the North-East Area and the South-East Development Regions.

An analysis of the dependence of the local budgets at the level of development areas on the state budget and of the differences in size of this dependence would suppose the analysis of the

samplings from the state budgets (less the deducted shares from the salary/income taxes) in the total of the revenues of the local budgets at a regional level.

Table no. 9

**The percentage of own revenues and of the income tax shares  
in the total revenues of the local budgets**

Development Regions	1999	2000	2001	2002	2003
1. North-East	63,51%	55,51%	34,86%	32,12%	27,96%
2. South-East	76,29%	64,37%	45,78%	44,96%	40,25%
3. South	77,48%	61,12%	40,86%	37,75%	33,07%
4. South-West	78,66%	60,99%	40,40%	36,21%	32,27%
5. West	79,38%	64,38%	43,57%	40,30%	38,60%
6. North-West	76,89%	64,34%	41,37%	35,90%	35,26%
7. Centre	76,82%	65,88%	42,34%	38,97%	38,23%
8. Bucharest	87,78%	88,12%	75,66%	67,61%	65,11%

Taking into account data regarding the implementation of the state budget, the conclusion is that Bucharest, South-East, West and Centre Development Regions have a lower dependence degree to the central budget, the higher dependence being in the case of the North-East Development Region, followed by the South and South-East Regions. This variety of data emphasized another weakness of this system: it doesn't consider the inequality to the national level, but to the county level. This suggests that has to be made an improvement in the equalization transfers system, in order to consider the disparities between country's localities.

Law no. 273/2006 changed the equalization transfers system, but maintained the principle of disparity within county. The main improvement of the system in our opinion is that the re-allocation of the responsibility over local transfers was given to the general directorates for public finance, which is likely to lead to more objectivity and transparency. Yet system remains unnecessary complex and inequitable (because it essentially equalizes, by stages, inside Counties, instead equalizing all Local Councils across the nation simultaneously), but improve the efficiency of equalization transfers by excluding from the distribution those local governments which are above the average of per capita tax capacity.

To improve transparency and compliance in the implementation of the transfer system may be designed deterrence mechanisms for county governments in the form of a system of fines, such as a share of taxes or even transfers to be received in the next period. This means to maintain actual system of equalization transfers, which is based of a mix of rules and discretion that determines the pool of funds for equalization. It has to increase the flexibility and predictability of local budgets incomes and expenditures by making the size of the equalization pool predictable.

Local budget formulation, execution, monitoring and evaluation phases was affected as a result of unpredictable and poorly coordinated intergovernmental fiscal relations. As Gomez, Martinez-Vasquez and Sepulveda noticed, this is also a multi-tiered process too fragmented, which detracts from the transparency of the system and is likely to negatively affect its stability. A solution of a better coordination of intergovernmental fiscal relations could be those suggested by the mentioned authors – introduction of a bifurcated scheme of the equalization transfers. Under the bifurcated scheme the equalization transfers are distributed from the center (by the ministry of finance) to the counties and, separately, from the center to all other local governments. As a result, the apportionment process will be simplified because all computations could easily be made at once, and for all localities, using a basic software package.

Another suggested improvements in the equalization transfers system are: bringing the profit tax as one of the sources for the equalization pool; simultaneously consideration of both the

expenditure side of local budgets (expenditure needs) and the revenue side (fiscal capacity); redefining the derivation basis of shared taxes from the place of work to the residence of the taxpayer.

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