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## Article

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## Overviewing of Fiscal Decentralization in Romania

Rusu Cigu E.<sup>1</sup>, Petrisor M.B.<sup>2</sup>

**Abstract:** The research paper will focus on the fiscal decentralization in Romania, using the background offered by literature and the analysis of official statistics data for empirical evidences. We estimate the analysis to offer a viewpoint on the fiscal decentralization in Romania with positive aspects, but also deficiencies that require some solutions and policy options.

**Keywords:** local budget; fiscal decentralization; local sustainable development

### 1. Introduction

Fiscal decentralization is an issue and a major concern for both developed and developing countries. Of course, for developing countries fiscal decentralization represents a new form of society organization and at the same time looks as the only solution to all kinds of economic and political problems because the benefits are considered, in general, economic efficiency, cost efficiency in the provision of public goods, improved accountability, transparency, and increased mobility of funds, respectively as a way to encourage local economic growth (Oates, 1993). But, as all new processes, fiscal decentralization can create potential problems if it is applied through a “wrong public management”, in terms of administrative and financial.

The question how is possible that fiscal decentralization can be «good» or «wrong» has as answer the diversity of the Central and East European Countries, where the same rules of fiscal decentralization applied to these countries determined different results. The truly answer is not in fiscal decentralization itself, but in a multitude of factors of a social, cultural, economic, geographical, etc., some of them being «true inhibitors» which interacted and generated different results.

Romania applied fiscal decentralization as a process after December 1989, being a country with total lack of experience in market economy and democracy. The process of fiscal decentralization starting with the Constitution in 1991 and it is not completed yet.

### 2. The Subject of the Research, Methodology and State of Knowledge

The scope of this study is to emphasize fiscal decentralization as a process and its state in Romanian cities over the period of time 2005-2010. The approach of the research paper will be first on the

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background offered by literature regarding fiscal decentralization, and second will present some evidences of fiscal decentralization in the Romanian towns/cities, being combined the quantitative analysis based on processed data from the national data bases (e.g. Romanian National Institute of Statistics – RNIS, The Directorate for Fiscal Policies and Local Budgeting), with the analysis and monitoring of the involved qualitative issues. The last section provides our concluding remarks. In interpreting results and formulating public policy recommendations, the analysis has permanently related to the legal framework in work over the considered period of time.

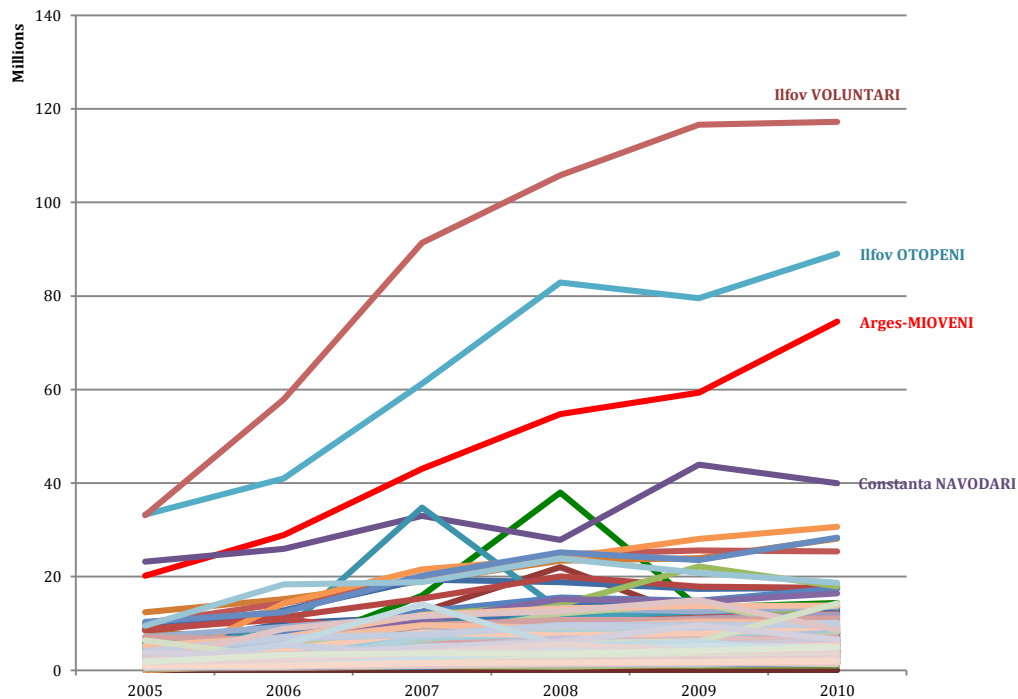
The theoretical debate on fiscal decentralization was subject of different schools of economic thought in time. One of the main theoretical approach of fiscal decentralization was developed by Tiebout (1956), Musgrave (1959), and Oates (1972), who considered that fiscal decentralization is characterized by efficiency in producing goods and delivering of public services and greater transparency in relation to the citizens. In recent years, fiscal decentralization is seen as a policy strategy with established rules. Arguments for the benefits of fiscal decentralization and certain empirical evidence led to a widespread decentralization trend particularly among developing countries and/or transition economies.

Some studies revealed that decentralization may have a negative impact on regional economic growth if the local government is not able to capture what the needs of local people and local characteristics of each region (World Bank, 1997; Martinez & McNab, 2001; Jumadi et al., 2013).

Prud'homme (1995) identify some of the problems that cause the failure of fiscal decentralization in promoting economic growth and local sustainable development, first of all the lack of the local apparatus less motivated and qualified to carry out the local responsibilities, and second the high level of corruption because local politicians and bureaucrats can be more vulnerable to the groups that have an interest.

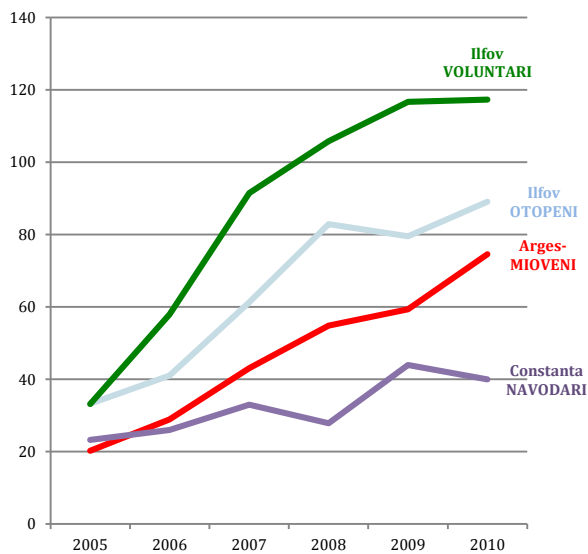
### **3. Stylized Facts**

In Romania there are 41 counties, 103 large cities/municipalities including capital city Bucharest, 217 towns, and 2861 communes. Our analysis includes the 217 towns of Romania. The evolution of local budgets of Romanian towns/cities presents diversity on a global picture over the period 2005 -2010.

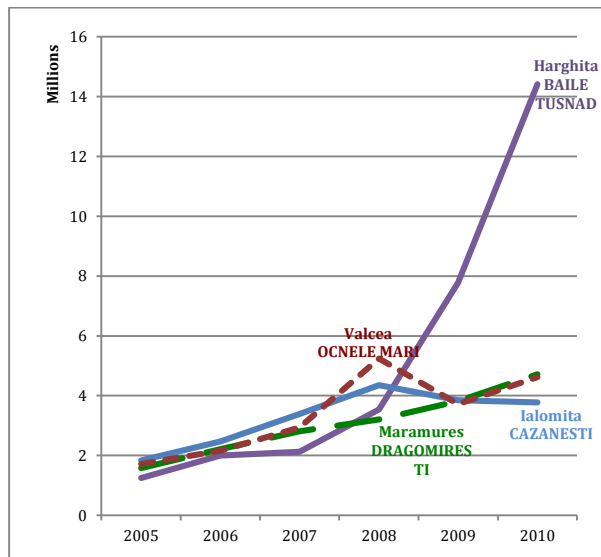


**Figure 1. Evolution of local budgets of Romanian cities between 2005-2010**

The chart above shows that the growth rates are low for most of the cities over the period 2005-2010. Another aspect is the low budget of the majority of Romanian cities under 20 million LEI, exception being Voluntari and Otopeni with over 80 million LEI, both belong to Ilfov County. In this context, Voluntari is the city with the largest budget in Romania with a sharp increase over the period analyzed. Otopeni is the second city according to the size of its own budget. Otopeni has a slight decline in 2008 and 2009, but in 2010 is an accelerated rate of increase in the local budget, the reason being that this town has two airports. Important fluctuations present Zarnesti (Brasov County) and Ovidiu (Constanta County) with a strong decline.



**Figure 3. Local budgets of the richest cities in the country between 2005-2010 (millions Lei)**

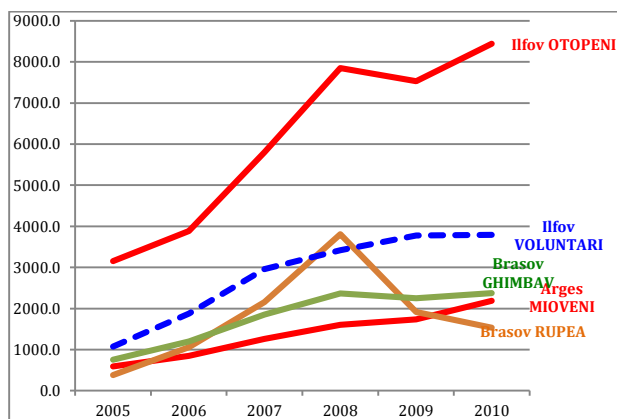


**Figure 4. Local budgets of the poorest cities in the country between 2005-2010 (millions Lei)**

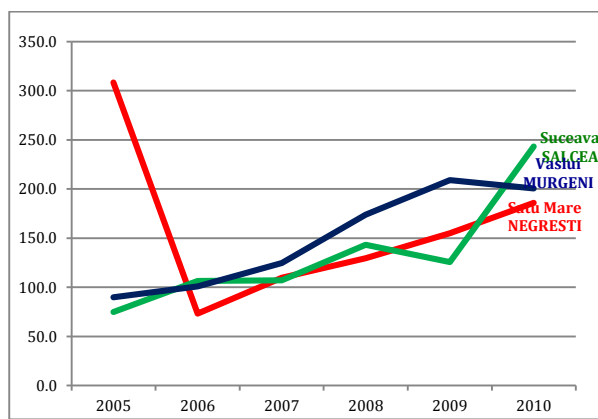
Among cities with large local budgets are also Mioveni (in Arges County) and Navodari (in Constanta County). Mioveni is an important industrial center both at national and international level, because of Group Renault Company with Renault and Dacia brands, generating 3% of Romania GDP.

The poorest cities in the country have local budgets almost 100 times smaller than the richest. Baile Tusnad (Harghita County) is marked by a significant increase in local budgets after 2008, because this area has a strong tourist potential. Ocnele Mari in Valcea County registered a maximum of the local budget in 2008. The Dragomiresti town (Maramures County) has seen a steady upward trend.

The comparison of local budgets as a whole gives us information about the economic flows in the analyzed towns, but does not provide us with information about the efficiency of these flows or information about their usefulness. For this reason, it is essential that these local budgets be correlated with the population to obtain an indicator that is proportional to the purchasing power of the residents of the analyzed city and represents the average contribution of a citizen to the local budget.



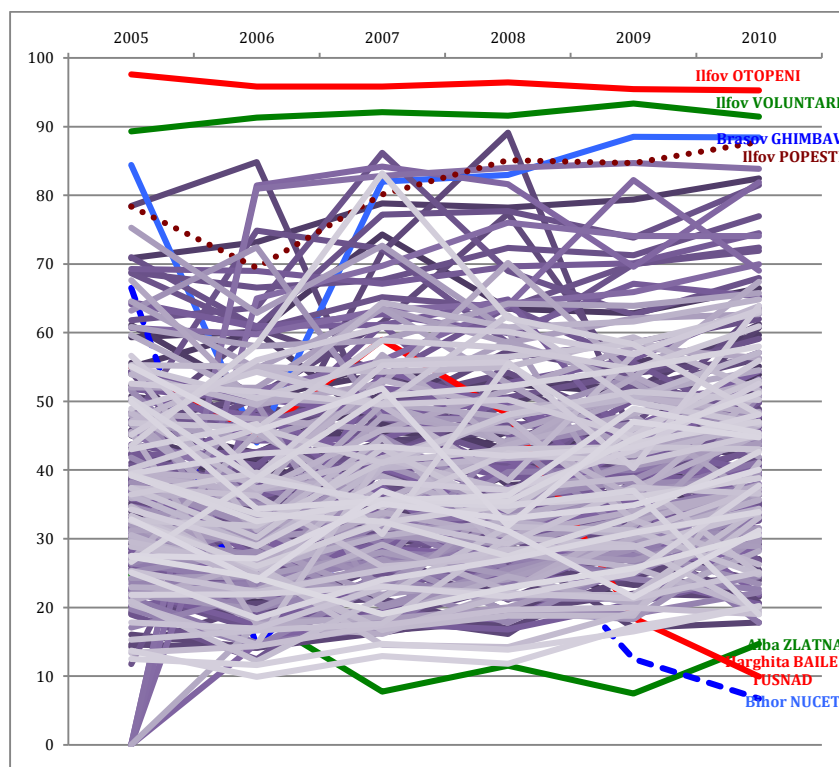
**Figure 5. Own revenues per capita of the richest cities in the country between 2005 and 2010**



**Figure 6. Own revenues per capita of the poorest cities in the country between 2005 and 2010**

The highest own revenues per capita are recorded in Otopeni (Ilfov County), which is visible from the rest of the cities. We observe that the city of Voluntari (Ilfov County) with the largest local budget does not have the highest own revenues per capita. From the perspective of low own revenues per capita, we observe that Negresti (Satu Mare County) recorded severe fluctuations, with a strong decline in 2006.

One of the most relevant indicators of fiscal decentralization is the degree of financial autonomy, calculated as a ratio between own revenues and total local budget revenues.



**Figure 7. The degree of local autonomy of the Romanian cities in 2005-2010**

Cities in Romania present diversity in term of degree of local autonomy, most of them have a low degree of local autonomy (under 40%). The degree of local financial autonomy is very high (over 90%) in the cities of Otopeni and Voluntari (both in Ilfov County and near the capital city Bucharest). The Nucet city in Bihor County shows significant fluctuations from a high financial local autonomy over 60% in 2005 to the lowest degree of autonomy under 10% in 2010. A possible explanation would be that the city of Nucet is a mining town with deposits of uranium, molybdenum, bismuth, iron, silver, and copper. After 2002, Romania lost the right to mark gold bullion products, which led to a significant decline in industry in this area.

These major fluctuations in the degree of local autonomy can be attributed to the lack of decisional stability at the local level correlated with major legislative fluctuations.

Most of the Romanian cities have as main revenue to the local budget "Sums deducted from VAT for state pre-university education institutions, nurseries, county and local agricultural consultancy centers and for supporting the child protection system". These revenues have a precise destination according to their name, which means that local authorities cannot dispose of them for other purposes, so that the actual local budget for managing the city is extremely small.

Some cities have the main local revenue "Quotas deducted from income tax". From the income tax received to the state budget, a share of 41.75% is distributed monthly to the local budgets of communes, cities and municipalities on whose territory the taxpayers carry out their activity, within 5 working days from the end of the month in which the tax was collected. A share of 11.25% is registered in the local budget of the county and a share of 18.5% in a separate account opened by the general directorates of the county public finances to the county treasury for balancing the local budgets of communes, cities, municipalities and the county (Article 32 of the Local Public Finance Act).

Of course, at the level of highly developed cities with a high degree of local autonomy, the size of this revenue is not a surprise, but we notice that there are also some cities with a low degree of autonomy where the share is important, such as Turceni, Aninoasa, Petrila, and Uricani. Turceni is a city whose economy gravitates around the Turceni Energetic Complex that provides about 10% of Romania's annual electricity consumption. Together with the other two energy complexes in Oltenia (CE Rovinari and CE Craiova), it covers about one third of Romania's electricity production. Aninoasa, Petrila, Uricani are cities based almost exclusively on the mining industry and they receive many subsidies.

#### **4. Conclusion**

The main conclusion of the study is that from the analysis of local city budgets we could not identify a Romanian city with outstanding results in increasing the degree of local autonomy. Cities with a high degree of local autonomy are favored by a particular geographic position or benefit from certain investments considered to be of national interest. Therefore, it is questionable whether figures are the result of performing local authorities or the result of external factors.

Decentralization is still in the process of transformation. Important steps have been made but still feels a lack of predictability due to the instability of governments in Romania. This frequent change in the direction of the government also creates chaos for local authorities, which from a financial perspective are highly dependent on the state budget. Thus, we find it impossible to implement large-scale projects at the local level, precisely because of these frequent changes. We have come to the point where we talk about local scale projects only very rarely, and then due to favorable circumstances or quick project implementation or other situations.

Our results for town areas determine us to say that Romania made great steps in decentralization process, but the process is still in progress because there is a relatively low degree of local financial autonomy.

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