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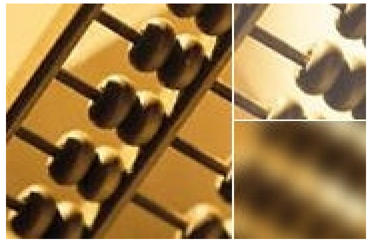
$$\alpha * \frac{1 - \dfrac{IVG/loc_i + TIL_i}{A*(IVG_j/loc_{med} + TIL_j/loc_{med})}}{\sum 1 - \dfrac{IVG/loc_i + TIL_i}{A*(IVG_j/loc_{med} + TIL_j/loc_{med})}} + \beta * \frac{S_i}{S_j} + \delta * \frac{T_i}{T_j} + \varepsilon * \frac{V_i}{V_j} + \mu * \frac{1}{N_r}$$

Local Budgets Equalization Policy in Romania



LOCAL BUDGETS EQUALIZATION POLICY IN ROMANIA

- The impact of the implementation of Emergency Government Ordinance No. 45/2003 -

FEBRUARY 2005

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The current study is part of a broader project concerning the Local Budgets Equalization Policy in Romania, developed with the support of the Open Society Institute (OSI) in Budapest and conducted between April 2004 and May 2005.

Throughout the research process, the project team from the Institute for Public Policy (IPP) has undertaken several consultations regarding the selection of the counties, the creation of the interview guidebook, the identification of the data to be collected at the level of each locality, together with representatives of the Association of County Council Economic Directors in Romania (our thanks to Mrs. Sirma Caraman and Mrs. Jenica Ioan), the Corps of Economic Directors within the Association of Municipalities in Romania (our thanks to Mrs. Mariana Boncea), the Corps of Economic Directors within the Association of Towns in Romania (our thanks to Mrs. Stela Stretean) as well as representatives of the Ministry of Public Finances and the Ministry of Public Administration and Internal Affairs. We would also like to thank senator Aurel Simionescu (secretary of the Committee on Public Administration and Territorial Management from the Senate of Romania) for his useful recommendations to our research. The analysis of the horizontal equalization of local budgets, by categories of revenues and expenditures, was done by Mrss. Mariana Boncea and Jenica Ioan. The long-lasting experience of the two ladies in local government matters enriched the current study with the perspective of specific issues facing local government institutions at various levels of financial capacity.

Within the project implemented by IPP, six documentation trips were organized, on which occasions we have enjoyed the full-fledged support of the economic directors from the Arad County Council (our thanks to Mr. Petru Has and Mr. Petru Socaciu), the Calarasi County Council (our thanks to Mr. Nicolae Popa), the Dambovita County Council (our thanks to Mr. Ion Radu), the Prahova County Council (our thanks to Mrs. Elena Chirita), the Tulcea County Council (again our thanks to Mrs. Sirma Caraman), the Suceava County Council (our thanks to Mrs. Doina Blaj). We would equally like to thank the presidents of County Councils/mayors, the economic directors and the accountants who have always responded quite willingly to the IPP requests. Our very special thanks to Professor Ken Davey from the Birmingham University, to Adrian Ionescu, LGI Director, Open Society Institute, Budapest and to Gabor Peteri, LGI Research Director, Open Society Institute, Budapest. Their suggestions have contributed a great deal to the creation of the present study.

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Summary

The study developed by the Institute for Public Policy (IPP) and called *The Local* Government *Budget Equalization Policy in Romania* was meant to substantiate certain recommendations to improve the current budget equalization system, starting from an objective examination of the way in which this system operates at present.

The field research was conducted between June 2004 and January 2005 and included both a quantitative and a qualitative component. The quantitative data came from two main sources: the Ministry of Public Finances for diverse information on local government budgets, and the National Statistics Institute for information about the population by age groups and surface area at locality level. The Institute team made field trips in localities of various dimensions in six case-study-counties: Arad, Calarasi, Dambovita, Prahova, Suceava and Tulcea. For each of these localities separate analyses concerning the 2003 and 2004 local budgets were made. The semi-standardized interviews produced detailed information about the way in which the Emergency Government Ordinance (E.G.O) No. 45/2003 on local public finances was applied, in view of the local government budget equalization process.

The criteria for the general assessment of the equalization process stipulated in the Ordinance took into account the autonomy, predictability and stability, transparency and objectivity, the adequate volume of the equalization resources, the fairness and efficiency of the allocation process, the non-distortion of the local fiscal burden, the encouragement of an efficient local financial management, the simplicity and ease of handling, the concentration and flexibility in relation to the economic growth.

The in-depth analyses conducted at local and national level provide a more detailed view of this overall assessment. The evolution of financial decentralization in Romania shows that the weight of local government expenditure in the GDP has practically doubled in 2004 as against 1994. At the same time though, the values of the Hunter coefficient highlight for the 1999 - 2004 interval an increased dependence of local governments on transfers from the central budget.

As regards the horizontal balance, there are major discrepancies among the general-purpose revenues, mainly before the equalization process, between the municipalities (especially the county-seats) and the rural communities. This is also reflected in the

provision of public services, whose volume and diversity vary a lot between the rural and urban areas. The equalization transfers go mainly to the commune local councils (due to the lower own revenues of the latter, determined by their economic underdevelopment) and to the county councils due to the gap between the responsibilities transferred onto these and their general financial resources.

The structure of expenditures related to various types of local governments underscore the differences among localities of different sizes. The county and the municipal councils hold high weights in the expenditures which reflect the costs of public services and the modernization of their infrastructure (investments). The local councils in small towns and in rural areas hold very high weights in the expenditures generated by the operation of local governments and in the staffing expenditures. As regards the transparency and objectivity of the current budget equalization system, there are problems related to the consultation work and the provision of technical assistance stipulated in the Ordinance, the uniform measurement of the criteria mentioned in the legislation, and last but not least, the firm application of the appropriation criteria provided by the E.G.O. No. 45/2003 as well as the control and sanction mechanisms to be applied in case of non-observance.

To increase the transparency of the entire system, IPP recommends the direct allocation by the Ministry of Public Finances to the local councils, or, as a transitional stage, through the General Public Finance Directorate at county level. Based on the simulated models, the IPP recommendation to improve the current system takes into account the principle of concentrating the allocated sums by establishing an exclusion criterion especially for the equalization process from county to local level. The appropriation formula that has considerably improved the model is the one which relates the fiscal capacity to the mean value of the personal income tax per capita. One has to highlight that the introduction in the formula used to determine the fiscal capacity of the revenues derived from local taxes and fees has improved the results.

Last but not least, the Institute wishes to underscore the importance of non-distorting the own financial effort (burden), hence of stimulating the increase of the own resources. The equalization sums received by one locality must be influenced, through diminution, by the non-collection of local fees and taxes, or by the decrease of the standard or mean levels of local fees and taxes. The responsibilities of local governments must become clearer, both with respect to the separation between the two levels of local government and especially to their definition as exclusive, shared and delegated responsibilities.

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Introduction

The issue of fiscal decentralization is one of major importance in the current context of public policies in Romania. Initiated by the application of Law No. 189/1998 on local public finances and carried further throughout the past year by the new legislative provisions included in the E.G.O. no. 45/2003 (endorsed by Law No. 108/2004) on local public finances, the drafting of certain measures in the field of fiscal decentralization in Romania involves the development of coherent and adequate policies for all the tiers of local government.

At the same time, the political background against which the IPP study was conducted was an election year, in which decentralization was one of the basic topics mentioned both before the general elections of November 2004[1] and by the current Government, within the governing program for the period 2005-2008[2] . The creation of certain policies in this area without a well-founded impact analysis, both in theory and in practice, will not be able to meet the fundamental objectives of central government, nor will it meet those of local government.

If we add to this picture the reported cases of “biased” allocation of equalization sums by the County Council, of much too disproportionate transfers from central level to certain counties, or cases of political migration of mayors closely connected to the way in which equalization sums are allocated, we find more and more clear the need for an independent assessment, as a substantial contribution to the formulation of public policy recommendations.

To this effect, with regard to the specific issue of budget equalization, the study conducted by the Institute for Public Policy (IPP) is meant to be a landmark in the process of identifying problems and making recommendations concerning both the transparency of the equalization sums allocation manner and increasing the overall efficiency in the creation of budget equalization mechanisms so that they meet the needs of local development.

The main purpose of this study is to substantiate several recommendations for the improvement of the current budget equalization system, based on an objective analysis of the operation of the present system.

The goal of the study

To substantiate the recommendations for the improvement of the budget equalization system.

In its approach of the topic of fiscal decentralization, the IPP study has placed its assessment in a context by conducting in-depth case-studies in various counties, by visiting localities of different sizes and fiscal capacities. The empirical data thus collected have then been made objective by their being set against a range of theoretical principles underlying the process of fiscal decentralization. Thus, the principles which make up the foundation of the allocation of responsibilities and categories of revenues to the local government have driven both the national-level analyses and the local-level ones (of the visited localities), with respect to the discrepancies between the responsibilities transferred from central to local level and the fiscal capability to fulfill them.

The significance of the topic is also highlighted by the complex issues involved by a detailed analysis, which implies the consideration of all the aspects pertaining to the current status of the local government financing system in Romania. To carry out a comprehensive and objective analysis of the issue of budget equalization, the present study intends to provide answers to the following questions:

- ✐ Have there been improvements with regard to the allocation of equalization funds according to the current system, stipulated by the E.G.O. No. 45/2003, compared to the one in place before the enforcement of the Ordinance? If so, what kind of improvements?
- ✐ What differences are there between the fiscal capacities and the responsibilities incumbent on the various types of local government? What was the trend of the horizontal unbalance, whose diminution was the main objective of the budget equalization system?
- ✐ How transparent is the current budget equalization process?
- ✐ How can the current budget equalization model be perfected?

The goals of the equalization grant substantiation policy must also take into account the fundamental principles of the allocation of responsibilities and revenue sources to the local government, so that they are achieved effectively, according to the type of grant allocated. By examining the benefits and the shortfalls of the distribution of certain matching conditional (specific-purpose) grants, lump sum-type conditional grants or unconditional (general-purpose) grants, as well as the general principles which must underlie the system of inter-governmental financial/fiscal transfers, the first section of the study, Principles of fiscal decentralization, sets the fundamental lines of the analysis. The budget equalization system set forth in the E.G.O. No. 45/2003, aiming at the reduction of the intra-county and inter-county imbalances, is then assessed in section two (Criteria for the evaluation of the budget equalization system) according to the criteria derived from the description of the theoretical framework in section one.

Together with the analysis conducted and with the policies meant to downsize the vertical imbalance, hence an increased local government fiscal autonomy and volume of resources available to them, the impact on the discrepancies among counties or between urban and rural areas must be equally assessed. A system of inter-governmental transfers that disregards the specific capacity of various types of local government to fulfill the responsibilities (to provide public services) bestowed upon them, can ultimately result in a dramatic failure for the future of any decentralization policy. The IPP study examines in the section on The stage of fiscal decentralization in Romania the progress of the main indicators relative on the one hand - to the ratio between the responsibilities bestowed onto the local government and its fiscal capacity (the analysis of the vertical balance) and on the other to the gap among the own fiscal capacities of the various types of local government (the analysis of the horizontal balance).

The national level data is then subject to an in-depth analysis related to the localities visited within the case-study counties (the section on The analysis of the case-study locality budgets), separately, for county-seat municipal authorities, town local governments, rural local governments of communes with a high, an average and a low fiscal capacity indicator. The variation of the level of fiscal autonomy, of the degree of local government-related expenses covered from local revenues, of the weight of local own revenues in the total budget by type of local government in different counties (horizontal analysis) and in the same county (vertical analysis) shows the visible inequities among the fiscal capacities of different local governments, even if their range of responsibilities is more or less the same.

In parallel with the implementation of the E.G.O. no. 45/2003, the allocation of the formula-based equalization grants was also introduced, but there was no specific mention of any sanction or control mechanism for those who breach it. Under such circumstances, the transparency and objectivity of the entire allocation system, particularly with regard to the relation between the county council and the local councils, become a crucial problem, examined in section 5 on The transparency of the budget equalization process at local level.

The fiscal capacity, the population size, the surface area and other criteria specific to a county are the indicators included in the allocation formula provided by the E.G.O. no. 45/2003. The section on The criteria for the allocation of the equalization grants and the simulation models demonstrates whether these indicators are sufficient or not for the identification of the local level needs, the variables which can be added to the existing model, given the available databases, as well as the improvements that can be brought to the current system, if we consider the fundamental goals of the equalization policy. If we take into account all the items of criticism and the solutions for improvement expressed in the previous sections, the last section summarizes the main conclusions and recommendations. One has to mention at this point that special attention must be also attached to the principle of stimulation (in addition to the principle of equalization) so that local governments get the necessary support in the development of their own activities and are at the same time encouraged to keep growing, to take the lead in accessing yet other financial instruments which might generate yet further local revenues.

For the equalization policy to reach its goal and become a useful tool for the local government, the measures proposed by the IPP must be correlated to other important issues, to accomplish a genuine local government decentralization in Romania, such as: a clear separation of the responsibilities incumbent upon county councils, municipalities, towns or communes, or those aimed at the decentralization of public services.

Notes :

[1] Acc. to the *Updated Government Strategy for speeding up the process of reform in local government between 2004-2006*, available at http://www.mai.gov.ro/Documente/Strategii/Strategie%20 to %20monitor%206_05_2004%20MO.pdf (date of access: 15 august 2004).

[2] See Chap. 11 the Reform of Local Government, in the Government Program 2005-2008, source: www.guv.ro (date of access: 7 January 2005).

Metodology

The documentation work for the development of the present study has started as early as April 2004. The field research, given physical form by the present report, took place between June 2004 and January 2005 and consisted in both a qualitative and a quantitative component.

The quantitative data refers to the execution of the local budgets for 2003 and the first six months of 2004, together with other data covering 1994-2004 and regarding the evolution of the GDP, the consolidated general budget, the state (central) budget, the local budgets, the transfers from the central budget to the local budgets, the grants deducted from the personal income tax for the equalization of local budgets, as well as detailed information about the localities from the case-study counties (Arad, Calarasi, Dambovita, Prahova, Suceava si Tulcea). The case-study counties have been selected so that to be different, based on two criteria: the personal income tax per capita (inhabitant) and the population density. Several localities have been visited within each county, including the county seat municipality, one town and three communes (selected on the basis of their fiscal capacity, measured by means of the per capita personal income tax). In all of the six counties in question, copies of the County Council Decisions were requested, together with annexes and substantiation reports, regarding the distribution of the grants deducted from the personal income tax and of the sums deducted from the 17% share for the equalization of the local budgets, per local government units, as well as the approval of the criteria for the distribution of the sums accounting for 15% of the sum total of the amounts deducted from the PIT and of the sums deducted from the 17% share for the equalization of the local budgets, per local government units, for 2004.[1]

To develop the simulated quantitative models in order to improve the current budget equalization system, the IPP team made use of county-level and locality-level data issued by the National Statistics Institute about the surface area, the total population, the population under 18 and the population of 65 and over.

The analysis of the stage of fiscal decentralization in Romania as well as the county-level maps were developed on the basis of the data provided by the Ministry of Public Finances.

The qualitative data were collected through the interviews conducted both with the economic directors and the accountants from each institution in question (the County Council included) and with the County Council Presidents/mayors and the directors of the General Public Finance Directorates (GPFD) in each county.

The semi-standardized interview guidebook asked the interviewees to provide a comparison between the allocation of the equalization grants as defined in the Ordinance and the system used before the enforcement of the E.G.O. no. 45/2003. They were also asked to comment on how the current system could be improved (which other criteria should be taken into account, and to what extent), how did the Advisory (Consultative) Committee operate, what would the distribution of the equalization grants look like if the entire process were to be managed by the General Public Finance Directorates at county-level, a.s.o. In the case of the county councils and the GPFDs, additional questions were asked about the specific criteria considered in the allocation of the 15%, the hurdles in the application of the Ordinance provisions, and the technical assistance role played by the GPFDs.

To have a more in-depth view on the topic of observing the criteria for the distribution of the equalization grants at national and county level, IPP has submitted public information requests to the Government of Romania, based on Law no. 544/2001 on the free access to information of public interest, with specific reference to the substantiation of the allocation of these sums from the Budgetary Reserve Fund available to the Romanian Government.

In order to formulate certain recommendations best fit to meet the local needs and to equally observe the practices already in place on an international level, the IPP team has organized a meeting in Bucharest on the 4th of October, 2004. The participants were international experts and representatives of the Ministry of Public Finances, the Ministry of Public Administration and Internal Affairs, the Parliament of Romania, the Association of County Council Economic Directors from Romania, the Corps of Economic Directors with the Association of Municipalities in Romania, the Association of Towns in Romania, the Association of Communes in Romania, NGOs and the media.[2] Part of these conclusions and recommendations are included in the present study.

Notes :

[1] To monitor the allocation of the equalization grants for 2005, IPP has submitted public information requests based on Law no. 544/2001 on the free access to information of public interest to two other county councils (Olt and Vaslui) and has accessed the respective decisions (resolutions) from the web pages of four other county councils (Constanta, Giurgiu, Harghita and Timis)

[2] The summary of the ideas and suggestions formulated at this debate can be accessed at the following address: www.ipp.ro.

1. The principles of fiscal decentralization

The substantiation of an adequate policy of local budget equalization in Romania imposes the need to observe certain fundamental principles applicable to both fiscal and administrative decentralization. The non-observance of such principles is translated, especially at the level of the municipality, town and commune mayors who were interviewed during the case-studies, in the following terms: insufficient funds transferred in comparison with the responsibilities assigned to them; similar levels of responsibilities, and hence of needs, for a locality of 2,000 inhabitants and one of 10,000 inhabitants, or for localities of different ranks a commune as opposed to a municipality. Next come the theoretical principles which underlie the assignment /allocation of responsibilities/revenues to the local government in order to implement effectively the responsibilities transferred at county or locality level. They will become “operational” throughout the study by means of the analyses and recommendations formulated therein.

1.1.1.1. The assignment/allocation of responsibilities to the local government

The way in which the transfer of responsibilities takes place is extremely important when we talk about fiscal decentralization. Generally speaking, in the international literature, a few major principles are acknowledged, which underlie the transfer of a coherent system of responsibilities towards the local government:

- ·*The efficiency of allocating the general resources of society to a responsible local government.* This obliges the public services provided by the local government to meet at their best the taxpayers' needs and preferences. Starting from this general criterion, the way of assigning these responsibilities must observe the following principles:
  a) subsidiarity - a responsibility will be assigned to the local government level which is closest to the citizen/taxpayer and which can fulfill it efficiently and effectively
  b) a responsibility must be supplied by the local government level whose jurisdiction is closest to the geographical area of the beneficiaries of that particular function
  c) a responsibility must be assigned to the local government level

Principles of allocating responsibilities to the local government

- Efficient allocation of general-purpose resources
- Fair provision of public services to the citizens
- Allocation of responsibilities regarding revenue redistribution and social protection to the central government
- Macroeconomic stability and economic growth

Principles of allocating revenue sources to the local government

✍Autonomy
✍Matching the revenues to the responsibilities
✍Equity (fairness)
✍Predictability
✍Efficiency
✍Objectivity
✍Revenue collection-related incentives
✍Meeting the funder's goals

which can manage it effectively and which can grant economies of scale for the provision of that particular public service

d) a responsibility must be assigned to the local government level which has the necessary fiscal capacity to finance that particular function and which can ensure a reasonable degree of financial equity (fairness).

- ✍ *The equitable provision of public services to the citizens, no matter where they live*
- ✍ *The responsibilities whose goals regard the redistribution of revenues and social welfare must stay within the central government's scope of competence*
- ✍ *Maintenance of macroeconomic stability and pro motion of economic growth.*

1.2. The assignment/allocation of revenue sources to the local government

Worldwide, in the studies developed under the aegis of international bodies such as: the European Union, the World Bank, OECD or IMF, a few basic principles are generally accepted, which regard the system of revenues transferred to the local government:

- ✍ *Autonomy: t*he local government must have independence and flexibility in determining its priorities. To this effect, in the field of revenues there is also a version of the subsidiarity principle in place: a certain tax must be granted to the local government level which is closest to the taxpayer, which can implement it and for which it is not inadequate.
- ✍ *Matching the revenues to the responsibilities:* the local government must have available revenues which are enough in relation to the transferred expenditures
- ✍ *Equity (fairness):* the revenues transferred to the local government vary directly with the financial needs and indirectly with the fiscal capacity
- ✍ *Predictability:* the system of revenues transferred to the local government must allow for the development of 5 year-forecasts
- ✍ *Efficiency: t*he system of transferred revenues must be neutral in relation to the options of local government regarding the allocation of resources by sector and by activity
- ✍ *Objectivity*: the allocation of funds to the local government must rely

on objective factors which cannot be influenced (distorted) significantly by the local government, on an individual basis

- *Provision of incentives:* the system of revenues transferred to the local government must provide incentives to the latter, in order to have a healthy and efficient management. Likewise, the system must allow the development of “hard” budgetary constraints i.e. it must not grant special transfers for covering the final deficits of local budgets
- Meeting the *funder's requirements/goals* (the central government) in the case of using specific-purpose transfers.

To implement such principles two methods can be applied, which are not mutually exclusive, but are rather complementary to each other; what is crucial here is their combination recipe::

- *The method of assignment/allocation* (transfer of competence) of revenues to the local government
- *The method of sharing revenues* between the central government and the local government

The first method implies the definition of a range of public finances which belong to the local government and which grant it enough autonomy for the fulfillment of its responsibilities and for structuring the way of their financing. In the literature (Bird 2000), assigning a certain competence to a certain level of local government is defined as being its ability to design and implement specific policies. From this point of view, there are three main elements function of which we can examine a tax: determining the tax base, setting the tax level and managing (collecting) the tax.

The central factor in the description of a certain revenue belonging to a local government as being part of the assigned financial resources system is the chance of getting some marginal revenues from that particular source, as a consequence of the local government's own decisions. Two major groups of LG resources (taxes) are part of the system of assigned revenues:

- *The own revenues* made up of local taxes and fees for which the local government can (as a rule) determine the tax base, the tax level and it can also manage (collect) them; obviously, depending

Categories of local government revenues

- Own revenues derived from local taxes and fees
- Piggybacks added to central level taxes

on the country, there are differences concerning the actual way in which these three features are to be found in real life.

- *Piggybacks* to certain taxes set at central level. In such circumstances, the local government may add to the national level of taxation a flexible piggyback, thus enjoying the funds collected in this manner. As a rule, setting the tax base and managing the taxes fall within the central government's scope of competence.

The second method implies that the revenues are set at central level (decisions on the tax base, the tax level and the tax management), and the funds thus obtained are shared among the various levels of local government according to certain rules. In such a case, the local government has a small chance to decide on the base or level of a tax whose sources it shares with the central government and only in an indirect manner (negotiations, lobbying). Thus, the local government level of fiscal autonomy depends a lot on the nature of the inter-governmental transfer system.

The system of shared revenues can be designed in several ways. The most frequent are the taxes set at central level and then shared among the local government units:

- On a derived basis (the origin of collection)
- As transfers (grants) distributed according to a formula, according to the re-imbursement of the costs of the public services provided (standard cost/actual cost) or according to an ad-hoc decision.

Bahl & Linn (acc. to Bahl 2000) have come up with a classification of the inter-governmental transfer system mentioned above. First, they took into account the establishment of the total volume of funds to be distributed to the local government in one year, through the system of inter-governmental transfers. The international practice in place has shown that there are three methods to determine this volume of financial resources: as a quota calculated from the revenues derived from a central (state) tax, based on an ad-hoc decision (such as a certain value set annually by the Parliament) or as a re-imbursement of the approved expenditures. Secondly, once the volume of the total funds dedicated to the local government has been set, the allocations among various types of local government are usually determined in four ways: by the transfer of a quota from the collected revenues according to a derivation principle; by applying a certain formula; by an ad-hoc decision or by reimbursing the costs of the public services provided (standard costs/actual costs). The result is a classification model with nine theoretical types of inter-governmental transfers, as shown in the Table on the next page. standard/actuale).

The examination of these types of transfers shows that the degree of decentralization and autonomy decreases from transfer A to transfer K. Therefore, transfers A and B are the ones that meet best the requirements of fiscal decentralization imposed on a coherent system of inter-governmental transfers. One has to note that type A transfer has an anti-equalizing effect, favoring the rich local government units, with a big fiscal capacity, whereas the type B transfer can be used to reduce the gaps among the various types of local government units (horizontal balance). The type H transfer is the most centralized, while types E, F, G and K are centralized in principle, but they do have a certain level of predictability and objectivity in their distribution by LGU. Types B, E and F are general-purpose (unconditional) transfers, the C, G and K types are specific-purpose (conditional) transfers, while transfers D and H can be both conditional and unconditional, being distributed among local government units based on an ad-hoc decision (discretionary). In the following pages, type A and type E transfers will be called national shared taxes, while the rest of the transfers will be called grants, regardless of the shape they take.

There are two aspects which are closely connected to the process of substantiating the intergovernmental transfer system and to the equalization system: the vertical unbalance and the horizontal unbalance. The vertical unbalance shows up when the responsibilities assigned to the local government exceed its fiscal capacity. Consequently, the vertical balance implies a correlation between the expenditures triggered by the responsibilities assigned to each level (tier) of local government and the financial resources which are available for their accomplishment. This correlation is applied not only to each local government unit but to the entire local government as a whole. The methods used to insure the vertical balance or to diminish this type of unbalance are the following:

- ✍ Assigning new financial resources to the local government
- ✍ Developing the system of national shared taxes
- ✍ Increasing the volume of resources dedicated to equalization and allocated as unconditional grants, at national level..

Unbalances

- ✍ Vertical unbalance the responsibilities exceed the fiscal capacity
- ✍ Horizontal unbalance the own local government fiscal capacities vary

Methods for determining the volume of transfers to the LG / **Methods for allocating the transfers to the eligible local authorities**	**A specific quota from a central tax**	**An ad-hoc decision**	**Re-imbursement of approved expenditures**
Transfer according to a derivation principle	Type A transfer	Type E transfer	N.A.[1]
Transfer according to a formula	Type B transfer	Type F transfer	N.A.
Transfer according to re-imbursements of costs	Type C transfer	Type G transfer	Type K transfer
Transfer according to an ad-hoc decision	Type D transfer	Type H transfer	N.A.

Table 1.1. Classification model of inter-governmental transfers

The horizontal unbalance shows up when the own fiscal capacities of various local government units differ from one another. The horizontal unbalance appears when there are huge economic and financial discrepancies among regions (counties) the inter-regional (or inter-county) unbalance or within the same region (county) among localities of different sizes, especially between the rural and the urban areas the intra-regional (or intra-county) unbalance. An increased decentralization of the local government financial resources may lead to an increased horizontal unbalance; therefore, it is very important that other elements of the system of inter-governmental fiscal transfers, the equalization system in particular, keep this type of unbalance under control.

The methods used to diminish the horizontal unbalance are the equalization grants and the national shared taxes based on the number of inhabitants or on any other type of formula (not based on the source/origin of collection). The inter-region (or inter-county) horizontal unbalances can be diminished by perfecting the equalization system, by avoiding the artificial homogenization of these entities (counties or regions). The intra-region (or intra-county) unbalances can be reduced by focusing the equalization system onto the poorest localities or by using the national shared taxes according to the number of inhabitants a method with a strong equalizing effect, unlike the source of collectiontype of sharing.

In this context, there are two critical points, open to debates and several options:

- ✍ Which is the most efficient and/or effective type of grant (see Chart 1.1.)
- ✍ Which of the two types of equalization approaches is to be used in Romania

.

The answer to the first question is not a simple one, and the literature (Bailey 1999, R.A. Musgrave & P.B. Musgrave 1989) reflects it. So, the choice of the type of grant must consider the objectives that the funder (i.e. the central government) wants to reach, as well as the way in which the beneficiary (the local government) is urged to act in one direction or the other. From the viewpoint of the funder's (central government) objectives, the conditional grants are more efficient/effective than the unconditional ones, if the objective is to improve (quantitatively or qualitatively) the supply of a certain public good or service. From the same perspective, the matching grants are more efficient/effective than the lump-sum grants. All these statements start raising problems if we change the point of view..

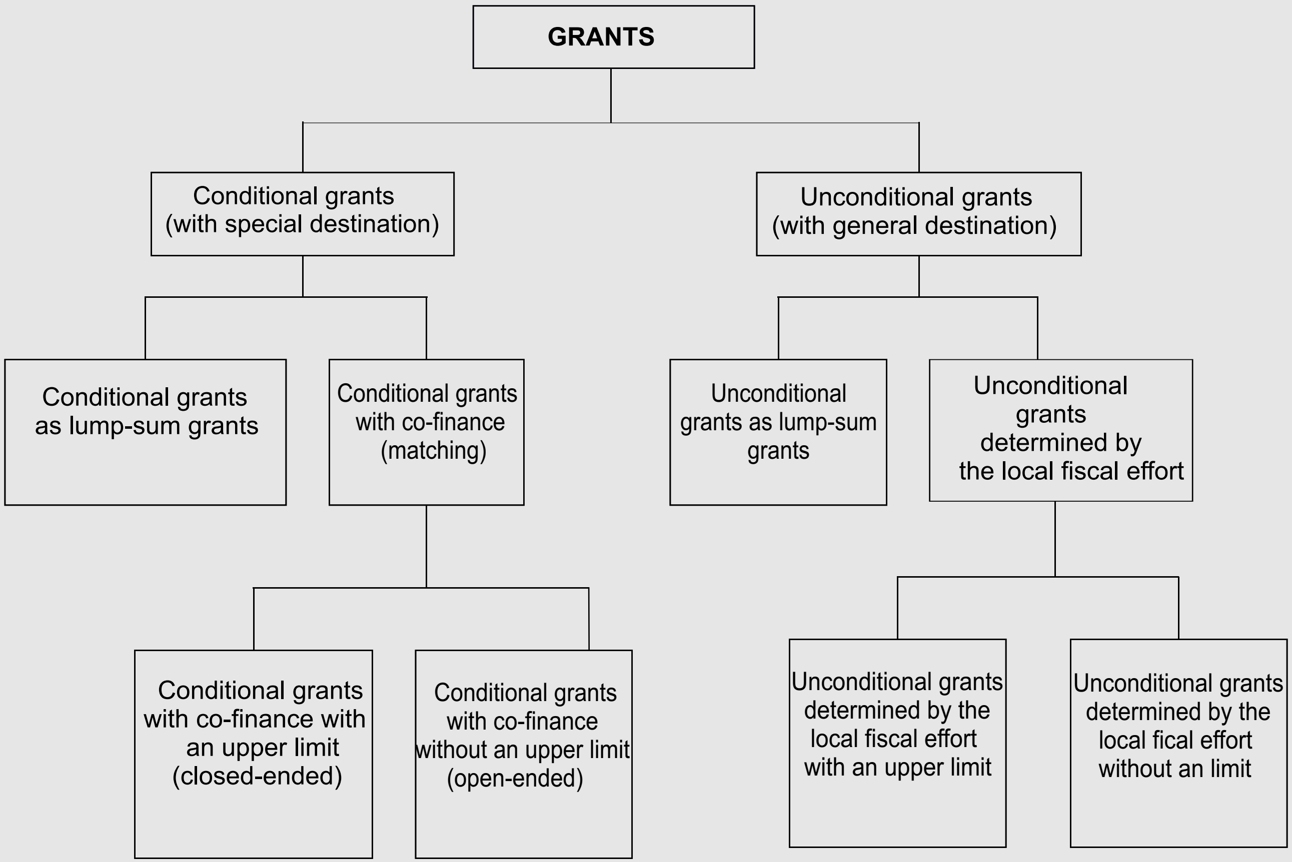

Chart 1.1. The general chart of grants (cf. Bailey, 1999)

Thus, from the viewpoint of the local government, conditional grants set limits to local autonomy and diminish the chances to take into account as well the preferences and wishes of the consumer/taxpayer from a certain community. In this framework, it is impossible to determine accurately which type of grant is more efficient/effective in the allocation of resources, from the standpoint of society at large. One has to underscore yet another aspect of such a type of comparison (see R.A. Musgrave & P.B. Musgrave 1989): if the transfer substantiation policy desires the funding of the general public services provided by the local government, then one has to use the unconditional grants. If, on the contrary, the wish is to support or spur the supply of a specific type of public service (public good), then the conditional grant (especially the matching grant) is more efficient/effective. At the same time one has to note that the distinction between a lump-sum grant and a matching grant is very clear, while the distinction between a conditional and an unconditional grant (for general needs) is far more blurred, as it is more a matter of nuance.

We can see in Table 1.2. a description of the way in which different types of grants meet best certain objectives of the public policies in the field of transfers and equalization of the local government financial resources.

As regards the following table, two elements must be highlighted: the values YES, NO and OPTIONAL refer to the way in which a certain type of grant meets better (YES) or less well (NO) a particular public policy objective. One can also see that the unconditional (equalization) grants have a lot of OPTIONAL values, which means that they can meet certain objectives of the fiscal policies of transfers towards the local government according to the way in which those funding programs are substantiated: the eligibility criteria, the allocation formula, the incentives generated, etc.

The second critical point mentioned above (see Box 1.1. General principles in the allocation of equalization grants) refers to the type of approach to be used in the case of local budget equalization: the equalization of the financial resources per inhabitant or the equalization of the local expenditure needs per inhabitant. The first approach means the equalization of the differences resulting from the different potential per inhabitant of the local government financial revenues and it requires the measurement of the local tax base and the local fiscal effort (the level of local taxes).

Approaches related to local budget equalization

- ✍Equalization of financial resources per inhabitant
- ✍Equalization of local expenditure needs per inhabitant

- ✍The implementation of a *uniform equalization grant system*: the vertical and horizontal unbalances must be remedied simultaneously by the recommended system, including both unconditional (general-purpose) and conditional (special-purpose) grants.

- ✍ The equalization grants must be supplied in a *predictable manner*, understood in dynamic terms. The formula must be determined for a multi-year period, to promote revenue predictability and overall budget certainty.

- ✍ The transferred funds should look more like the *unconditional global sums* (lump sums) meant to finance the general responsibilities of the local government. The goal of the equalization process is better fulfilled if the local government receives the financial equivalent of its own source deficit, which should be used, in principle, without any restrictions.

- ✍In the process of equalization grant or conditional grant allocation to the second tier of local government (urban and rural localities), *the first tier* (county councils) must play *a role confined only* to special interventions in case of extra-ordinary circumstances or it should spur local economic development within the scope of specific county or regional programs..

- ✍ Various approaches can be used for equalization purposes: *leveling out the fiscal capacity per capita and the local expenditure needs per capita*. The first approach implies the measurement of the local tax base and the local fiscal effort. In such a case, the equalization formula is simpler and easier to understand, but the system can fulfill only a limited number of goals. With respect to the second approach, the equalization system is based on the different expenditure needs per capita, which reflect the differences among the local governments in terms of their demographic, socio-economic and geographical features. In this latter case, the formula becomes more complicated and harder to understand, but the system is able to meet more goals.

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Box 1.1. General principles of the equalization grant allocation process

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✍ In the decentralization process, the transfer of new responsibilities onto the local government and the limited utilization of conditional grants require *an increased number of indicators* included in the equalization formula. These indicators must reflect the beneficiaries of the transferred public services (local government responsibilities).

✍ *The equalization formula must not generate disincentives* in the process of local government own revenue (local taxes and fees) collection nor should it induce inefficient choices as to how to spend the funds.

Pre-requisites for an objective system of assessing local government expenditure needs

The expenditure needs indicators must be:

- ✍Common to all local government units
- ✍Determined easily and objectively
- ✍There has to be a clear link between each indicator, the expenditure need and the variation of the indicator level
- ✍Must not be liable to manipulation
- ✍Must not record cyclic variations
- ✍Must not have a high level of interdependence

The second approach originates in the discrepancies among the expenditure needs per inhabitant, which reflect the discrepancies among the local government units in demographic, geographic and socio-economic terms. There are a lot of variables which influence the expenditure needs per capita: the weight of the school-age and elderly population, the percentage of unemployment-stricken or single-wage-earner households, rural and urban density, economic and demographic growth/decline. Even if these factors can be considered "objective criteria", the cost of public services is nonetheless difficult to quantify due to the varying preferences of the local communities, as well as to the different local government policies. Three main difficulties appear when one wishes to apply this approach:

- ✍ The lack of accurate and adequate data makes difficult the measurement of the differences among the levels of the expenditure needs per capita triggered by each factor
- ✍ The current expenditures reflect to a large extent the local preferences and they cannot be used as an accurate measure of the expenditure needs for each local government unit it is therefore difficult to determine the *standardized expenditure needs per inhabitant* for each LGU
- ✍ It is hard to establish *which factors are more important* and must be included in the calculation of the standardized expenditure needs per inhabitant. It is equally difficult to distinguish between the factors which are independent and those which are dependent in statistical terms such calculations are extremely complex and they request a huge amount of data. A model which is easier to manage involves taking into account only some factors, which raises in turn another difficult issue: which indicators are to be included and which ones are to be excluded. This decision is not only technical in nature, but also political, as it allows the manipulation of the formula used for the calculation of the expenditure needs. This is particularly true in the case of the indicators which favor a certain type of local government unit (urban or rural).

Despite these hardships, one can identify (Bailey, 1999) a set of prerequisites for the setup of an objective system to be used in the assessment of the expenditure needs for the local government and also in the grant allocation process:

- ✍ The expenditure needs indicators must be the same for all the local governments

Objectives of the grant substantiation policy	Ear-marked grant with co-finance	Ear-marked grant as a global sum	Non ear-marked grant
1. To make available for the local government all the revenues collected from determined state taxes	No	No	No
2. To reduce the financial disparities/inhabitan between the local government	No	No	Yes
3. To increase the general level of the public services delivered by the local government	Yes	No	Optional
4. To equalize the conditions in which the local government can deliver the public services under its responsibility	Yes	Yes	Optional
5. To increase the level of delivering a specific public service	Yes	No	Optional
6. To equalize the conditions for delivering a specific public service	Yes	Yes	Optional
7. To correct the externalities	Yes	Yes	No

Table 1.2. The way in which various types of grants meet the objectives of the grant substantiation policy

- The expenditure needs indicators must be determined easily and objectively
- A clear link must exist between each indicator on the one hand and the expenditure need and its level of variation on the other
- The expenditure needs indicators must be free of any suspicion of manipulation, both from the part of the central and the local government
- The expenditure needs indicators must not be subject to a cyclic variation, or prone to large variations from one year to the next
- The expenditure needs indicators must not evince a high level of interdependence.

The European experience shows that most of the European countries use the first approach and try to equalize the financial resources per capita. One has to note though that there are also mixed equalization systems (Great Britain). Likewise, some European countries (the United Kingdom, Norway, Denmark) have put in place a local government overall equalization system, even if this system makes local governments more dependent on the central government. Some other European countries (the Netherlands, France, Ireland, Italy, Switzerland) have set up a partial equalization system, either due to insufficient resources or because they wished to preserve the local autonomy. In yet other cases (Denmark, Germany), what they use is the “Robin Hood” type of equalization method: the richer local governments transfer on the basis of a formula part of their own financial resources to the poorer local governments. Even if this approach implies a higher level of autonomy towards the central government, it is less used due to the political hurdles met in the process of imposing it to the richer communities.

One has to note that there is a current trend within the European countries to limit the use of conditional grants and replace them with the unconditional ones (the so-called block-grants, where there is a specified general purpose (for instance, funds for education) but the local government has the autonomy to determine the amount of expenditures for various purposes: staffing, materials, capital, subsidies). There is also a trend to use on an increasingly broader scale the lump-sum grants, which are easier to manage.

Both approaches have certain weaknesses: the equalization of the financial resources per capita can discourage the local authorities from developing their own fiscal capacity, while the equalization of the expenditure needs per inhabitant can generate a certain inefficiency in the management of the public service costs (it does not create incentives for their reduction).

In practical terms, there are three different methods to determine the volume of grant-type transfers:

- The volume of a grant for a local government unit is the difference between the estimated level of expenditures and the planned volume of the own revenues ($G_i = Ce_i - VPp_i$), where: G_i = grant volume for locality i, VPp_i = planned own revenues for locality i. This method implies the use of certain indicators to enable a fairly accurate estimate of the needs; they can refer to the potential beneficiaries of public services (such as the number of children up to 15 years old to estimate the education-related expenditures or the number of people over 65 to estimate the social services-related expenditures). By using this method, the central government has direct control both over the revenues and over the expenditures.
- The volume of expenditures for a certain locality is equal to the sum total between its own revenues and the grants received by that locality ($C_i = VP_i + G_i$), where: G_i = grant volume for locality i, C_i = expenditures of locality i, VP_i = own revenues in locality i. By using this method, the central government has direct control over the volume of transfers and indirect control over the volume of LG expenditures.
- The grant volume for a certain locality is equal to the difference between the volume of standard expenditures (accepted by the central government) and the own revenues estimated on the basis of the fiscal capacity determined by an average fiscal effort at national or regional level ($G_i = Cs_i - VLm_i$), where: G_i = grant volume for locality i, Cs_i = standardized expenditures for locality i, VLm_i = own revenues produced in the context of an average fiscal burden for locality i. Generally speaking, this type of grant is meant to diminish the discrepancies among localities, generated by their different fiscal capacities.

In most Central and East European countries, the first two methods are used on a broader scale, while the third one is being used only in incipient stages.[2]

Based on the principles described in this section, an assessment of the budget equalization system provided by the E.G.O. No. 45/2003 was carried out, in comparison to the system implemented before the enforcement of the Ordinance, and mainly regulated by Law No. 189/1998 on local public finances.

Notes :

[1] N.A. suggests that no comments are to be made on this particular issue.
[2] Gábor Péteri, *Mechanisms for allocation of general equalization grants,* PHRD Grant for Preparation of the Second Programmatic Adjustment Loan, Fiscal Decentralization Analysis of Central-Eastern European Experience, Report for Club Economika 2000, May 2004.

2. Evaluation criteria for the budget equalization system

The budget equalization system must be evaluated according to its two main objectives: the downsizing of the inter-county and intra-county horizontal unbalances. This evaluation must be underpinned by a coherent and common set of criteria that can be defined starting from the following elements:

- ✍ The general principles which must underlie the system of inter-governmental fiscal transfers in general and the budget equalization system in particular
- ✍ The overall solutions whereby the horizontal unbalance can be reduced
- ✍ The specific problems facing the two types of horizontal unbalance, at inter-county and intra-county level, given the local government system in Romania
- ✍ The way in which the budget equalization system was built in Romania, from the viewpoint of the two general approaches to equalization mentioned above: the equalization of financial resources per inhabitant and the equalization of the expenditure needs per capita.

The analysis of the current budget equalization system, enforced by the E.G.O. No. 45/2003 demonstrates that it is built on two tiers: from national level to county level and from county level to local level. The budget equalization from national level to county level is based on two indicators: the one - indirectly proportional to the fiscal capacity and determined exclusively by the personal income tax per inhabitant, with a 70% weighing coefficient, and the other - directly proportional to the county surface area, with a 30% weighing coefficient. The budget equalization from county level to local level is based on the following indicators: first indirectly proportional to the fiscal capacity, determined exclusively by the personal income tax per inhabitant, with a 30% weighing coefficient; second directly proportional to the locality surface area, with a 30% weighing coefficient; third directly proportional to the locality population number, with a 25% weighing coefficient, plus other criteria specific to the county in question, with a 15% weighing coefficient. If we examine all these indicators we can see that the present system joins together the approach based on the equalization of financial resources per capita (by using the fiscal capacity derived from the PIT per inhabitant) and the approach based on the equalization of the expenditure needs, by using the population number, the surface area and other specific criteria as indicators which approximate these needs, which must be financed according to the responsibilities transferred onto the local government.

Allocation criteria

National to county level

✍The county fiscal capacity (70%) indirectly proportional

✍The county surface area (30%) directly proportional
County to local level

The locality fiscal capacity (30%) indirectly proportional
.

✍The locality surface area (30%) directly proportional
.

✍The locality population (25%) directly proportional
.

✍Specific criteria (15%) set by means of a County Council Decision

- ✍ *Autonomy* - does the equalization system adequately meet the needs and preferences of local communities, both at county and at local level?

- ✍ *Predictability and stability* - does the equalization system enable an effective short-term and mid-term budget planning?

- ✍ *Transparency and objectivity* - doest the equalization system enable a clear and transparent allocation of the equalization resources, based on objective criteria which resist manipulation?

- ✍ *Adequate amount of equalization resources* - does the equalization system provide sufficient resources to the local governments which are in the greatest need of funds?

- ✍ *Equity (fairness)* - does the equalization system allocate the equalization resources in direct proportion to the lack of own resources and the expenditure needs?

- ✍ *Allocation efficiency* - does the equalization system enable the fulfillment of the funder's (central government) goals?

- ✍ *Nondistorsion of the local fiscal effort* - does the equalization system not distort the localities' and counties' own fiscal effort? Does the equalization system generate incentives for the local governments to increase their own financial resources?

- ✍ *Encouraging an efficient financial managemen*t - does the equalization system encourage the local governments to efficiently and effectively manage their own financial resources?

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Box. 2.1. Evaluation criteria for the budget equalization system

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✍ *Simplicity and ease, in terms if system management* - is the equalization system easy to understand by all the stakeholders? Are the costs of running the system high?

✍ *Concentration* - does the equalization system enable the concentration of the available resources and their flow towards the local governments which need them most? Which is the dissemination rate of the equalization resources (i.e. the ratio between the number of local government units that receive equalization resources and the sum total of the latter)?

✍ *Elasticity in relation to the economic growth/the evolution of central budget revenues* - does the volume of equalization grants vary in direct proportion to and at the same rate, relative to the economic growth/the evolution of central budget revenues? Or, in other words, are the equalization grants elastic (elasticity greater than or equal to 1) relative to the economic growth/the evolution of central budget revenues?

To conclude, the current system is a mixed one, which allocates the equalization resources in direct proportion to the indicators which reflect the size of the expenditure needs and in indirect proportion to the indicators which reflect the size of a portion of the own resources. Thus, in the current allocation formula, in terms of eligibility, all local government units qualify as recipients of equalization grants, for all the criteria, irrespective of their own resources or their needs.

The same feature from the standpoint of equalization from county level to local level becomes a source of problems insomuch as we are now dealing with localities which can be examined on an individual basis; therefore, we can set criteria which exclude them from the equalization process.ą This would enable the concentration of the equalization resources towards the localities which are the poorest and have the greatest expenditure needs. To accomplish this process in Romania we must take into account the specificity of each locality: its size, its economic activity, its being located in a rural or urban area, the public services it provides in real terms. Due to this county-level situation, the equalization process should be applied according to the type of locality: municipality, town and commune. All this will be presented in more detail when proposals to improve the current system are made. Table 2.1. on the next page shows the results of the evaluation[2].

Some of the above-mentioned criteria can be quantified in an equalization model, either at national or at county level, as can be seen in the following text. Others can be analyzed only in qualitative terms; the answers collected during the study visits disclose significant information which is not included in the current database management system, either at national or at local level, but which regards to an equal extent the improvement of the present budget equalization model. Throughout the study, we will describe in detail the references to the database management system at national and at local level (see Section 5. The transparency of the budget equalization grant allocation process at local level and Section 6.
The allocation criteria for the budget equalization grants and the simulation models). The results included in Table 2.1. reflect an overall evaluation of the specific elements taken into account. The following sections include details about the analysis as such, focusing on the weaknesses of the current equalization model and making recommendations for improvement.

Criteria for evaluation	Old system[2]	New system	Evolution
1. Autonomy	Satisfactory	Satisfactory	Unchanged
2. Predictability and stability	Non satisfactory	Satisfactory	Improvement
3. Transparency and objectivity	Non satisfactory	Good	Improvement
4. Adequate pool of equalization resources	Satisfactory	Satisfactory	Unchanged
5. Equity	Non-satisfactory	Satisfactory	Improvement
6. Allocation efficiency	Non-satisfactory	Non-satisfactory	Unchanged
7. Nondistorsion of local fiscal effort	Non-satisfactory	Satisfactory	Improvement
8. Encouraging an efficient financial management	Satisfactory	Satisfactory	Unchanged
9. Simplicity and ease, in terms of system management	Non-satisfactory	Satisfactory	Improvement
10. Concentration	Non-satisfactory	Non-satisfactory	Unchanged
11. Elasticity in relation to the economic growth/the evolution of central budget revenues	Satisfactory	Good	Improvement

Table 2.1. Evaluation of the budget equalization system

Speaking about the conclusions detached from the field research activity, the interviewees said that, all in all, the equalization process based on the Ordinance was better, but their judgment referred mainly to the absolute value (amount) of the sum received, and less to certain specific criteria which assess the impact of the Ordinance, like the ones included in the above-mentioned Table.

The IPP evaluation of the two budget equalization systems considers mainly the legal provisions of the two local public finance laws from 1999 and 2003. The evolution in the interval between these two key points in time - of the two main indicators which reflect the dependence of local government (LG) on the central government as well as the differences between the fiscal capacities of the various types of LG, is described in the next section (in the analysis of the vertical balance in Section 3. The stage of fiscal decentralization in Romania, the indicators included in the study also cover the interval.

Notes :

[1] The concentration principle based on the set-up of a coefficient of exclusion (exemption) from equalization is described in operational terms in Section 6. *The allocation criteria for the budget equalization grants & the simulation models*.

[2] The evaluation based on these criteria was conducted by experts from the Ministry of Administration and Interior, the Ministry of Public Finances, the Association of County Council Economic Directors in Romania, the Corps of Economic Directors within the Association of Municipalities in Romania, the Corps of Economic Directors within the Association of Towns in Romania, as well as other experts on matters of fiscal decentralization and local government.

[3] By the old system we understand the system in use before the enactment of the E.G.O. No.45/2003, while by the new system we understand the system in keeping with the provisions of the Ordinance under scrutiny.

3. The stage of fiscal decentralization in Romania

The first steps in the field of fiscal decentralization were made in 1994, once the Law on local taxes and fees was passed; this moment in time actually triggered the creation of the local communities' own revenues in Romania. Ten years later, one can see, due to the legislative progress which enabled both the decentralization of certain revenues and the access to other financial instruments meant to supplement the existing funds, that local communities enjoy a much greater fiscal autonomy.

The local public finance law of 1998 (Law No. 189/1998) played the major role of describing in a coherent manner a solution to the process of budget equalization by producing a set of equalization criteria and by assigning specific tasks to certain local authorities. Both the criteria and the role of the county council president were broadly challenged by the local authorities due to the fact that they had enabled the interference of the political factor. Quite popular in this respect are the reactions of some former county council presidents who made public statements disclosing their discretionary power on the allocation of funds. The rural local communities had to suffer most on this account.

Nonetheless, pursuant to the implementation of Law No. 189/1998 on local public finances, certain progress was made with respect to the fiscal capacity of local communities in Romania, which explains the evolutionary trend of the latter's revenues in recent years. The E.G.O. No. 45/2003 on local public finances has also contributed, even if not to a great extent, to this situation, by increasing the income tax percentages which go to the local communities.

This chapter shows at national level the evolution of the LG degree of autonomy in terms of the transfers from the central budget, by an analysis of the vertical balance, as well as the differences between the fiscal capacities of the county councils, the municipalities of towns and communes, by an analysis of the horizontal balance. Section 4 presents in more specific terms some of these indicators, in order to highlight the consequences of the system of inter-governmental transfers for the local budgets.

3.1. The analysis of the vertical balance of local budgets between 1999 and 2003

In this given legislative context, with respect to the general equation of resources and needs, the analysis of the vertical (un)balance is based on the following indicators: the weight of the general consolidated budget in the GDP, the weight of the central budget in the GDP, the weight of the local budgets in the GDP, the weight of the local budgets in the general consolidated budget, the weight of the local budgets in the central budget, the weight of the central budget transfers in the GDP and the weight of the equalization transfers in the central budget. Likewise, the Hunter coefficient has also been calculated. The next diagrams show the evolution of these indicators between 1994 2003 and 2004 (forecasts).

Against the same background of the discrepancies between the available resources and the existing needs, this section also includes a description of the weight of the outstanding payments (arrears) in the total expenditures, this time only for 2003, for each county.

The weight of the local government-related expenditures in the GDP has practically doubled in 2004 (6.75%) as against 1994 (3.49%) see Diagram 3.1. The evolution (trend) of this weight had a very interesting route: it grew between 1994-1996 due to the transfer of new responsibilities to the local government. Between 1997-1999 the weight of the LG -related expenditures in the GDP has dropped slightly, but constantly, due to the difficulties attached to the structural adjustments of the public sector in that interval. The upward trend of the LG-related expenditures in the GDP was resumed in 2000, while in 2001 a major leap took place (from 4.12% to 6.04%) following the transfer of the salary payments from education to the local government. Another leap, of a smaller extent, occurred in 2003 (from 6.12% to 6.78%) following the enhancement of the social protection expenditures under the LG responsibility (see Box 3.2.4. LG items/chapters of expenditure).

The same format was taken by the trend of two other indicators: the weight of LG expenditures in the general consolidated budget and in the central budget see diagrams 3.2. and 3.3. The previous explanations are also valid for this situation. It is interesting to note that in 2003 the LG budget is almost half (45.58%) of the central budget, which reflects the scope of the decentralization process developed in recent years.

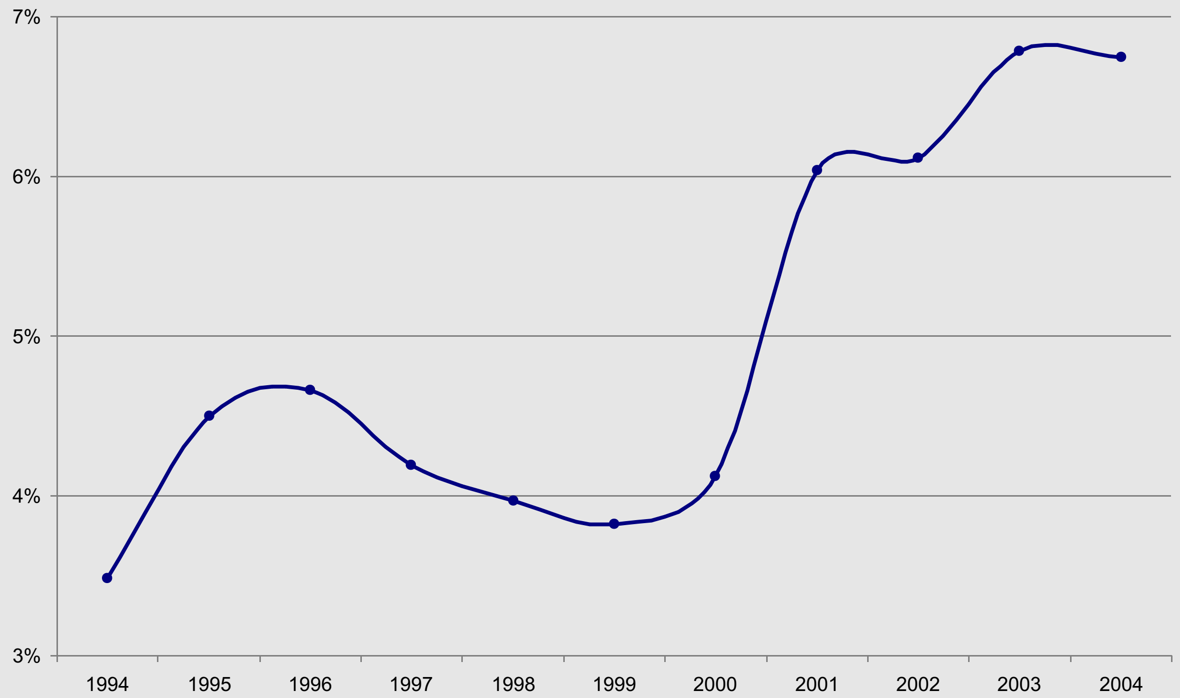


Diagram 3.1. Weight of LG expenditures in the GDP

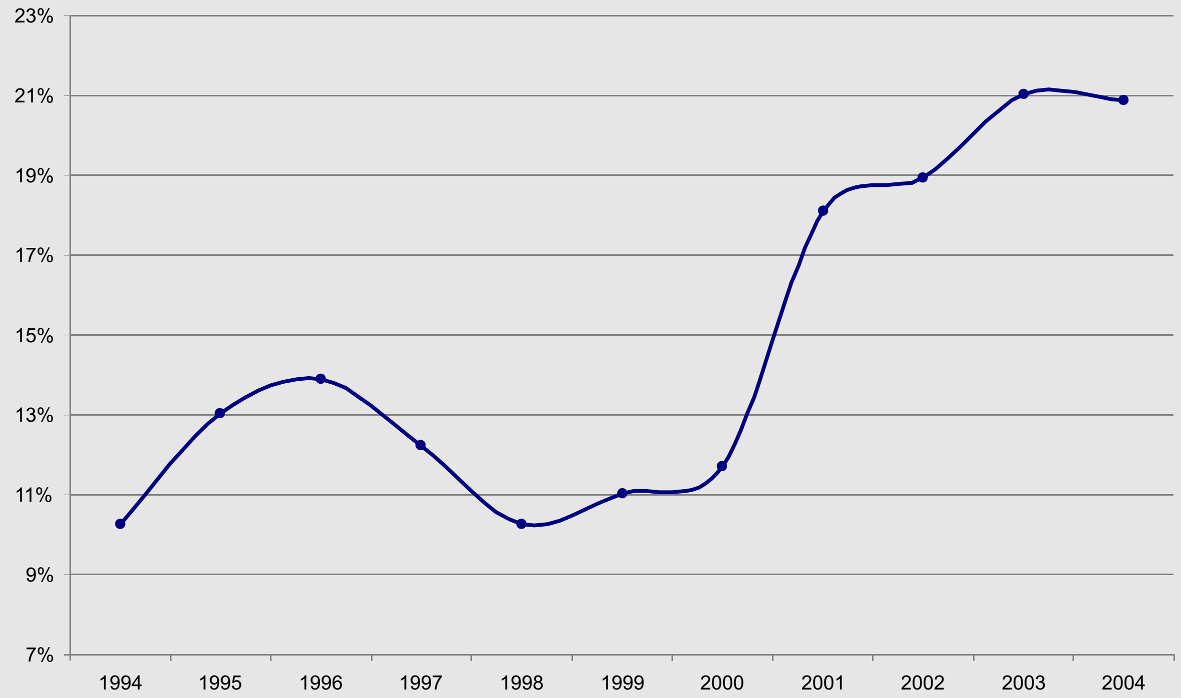


Diagram 3.2. Weight of LG expenditures in the general consolidated budget

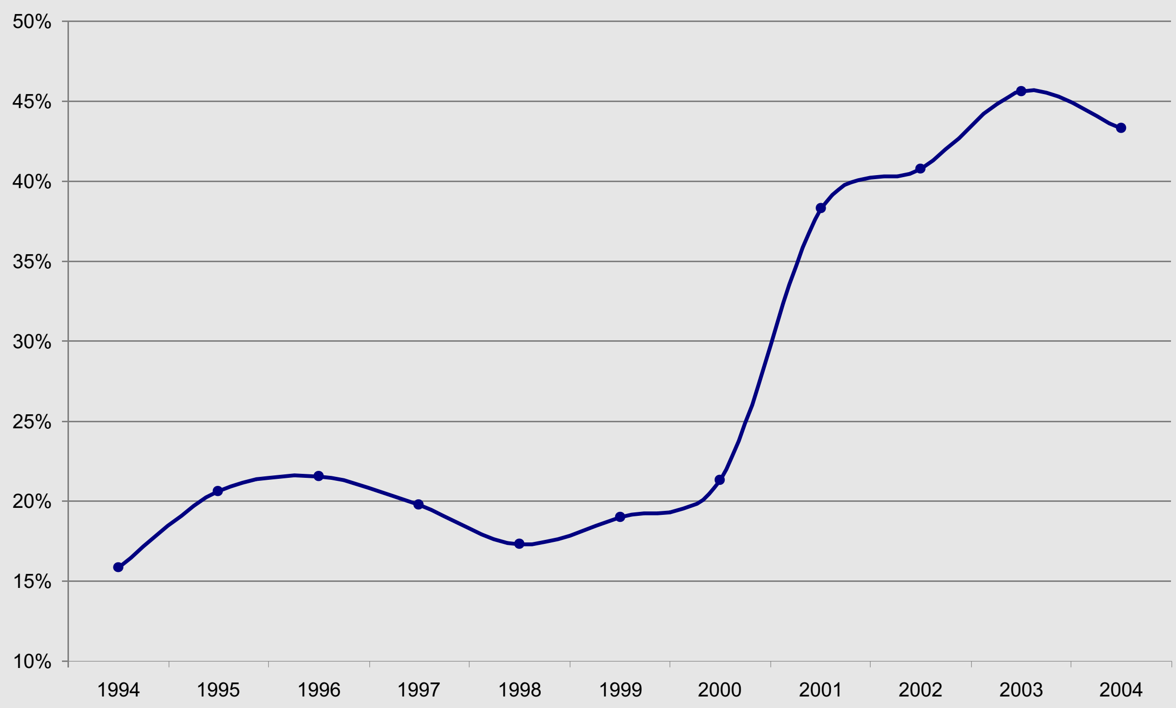


Diagram 3.3. Weight of LG expenditures in the central budget

Dependence

The local government dependence on transfers from central budgets has increased between 1999 - 2004.

Diagram 3.4. shows the evolution of the transfers from the central budget to the local government. The shape of this diagram is quite similar to the previous ones. One has to note the much more obvious minimum value of 1999 which is due not only to the general contraction of public spending, but also to the introduction of a new legislation which has brought about a spectacular growth of LG revenues derived from local fees and taxes as well as a matching diminution of the central budget transfers. This is also reflected by the evolution of the Hunter coefficient (see Diagram 3.5.) which had a maximum value in 1999.

The trend of the equalization transfers (see Diagram 3.6.) displays a major leap in 2002. This is due to the introduction of certain special-purpose amounts in the equalization transfers, which makes them conditional transfers. Thus, the amounts dedicated to the payment of the minimum income, the heating subsidies for poor families and the salaries of the caretakers of people with disabilities were introduced in the chapter called in generic terms “grants deducted from the personal income tax (PIT) for local budget equalization” although the central budget legislation provided the specific amounts for each specific purpose as well as the obligation to observe .

Diagram 3.6. shows the trend of the Hunter coefficient. This coefficient reflects the LG dependence on the transfers from the central budget. The trend of the Hunter coefficient is quite interesting: between 1994-1998 a low-range variation has taken place, reaching a value of 0.25 in 1998 from 0.175 in 1994. Then a spectacular increase of the Hunter coefficient occurred in 1999 up to about 0.5 following the inception of the fiscal decentralization process and the tremendous growth of the local fees and taxes collection process. A small decrease took place in 2000, followed in 2001 by a value of only 0.28, pursuant to the assignment of new responsibilities to the LG financed only from transfers (in their vast majority conditional grants) from the central budget. In 2004 the estimated value of the Hunter coefficient is 0.25, that is identical to the value of the same indicator before the inception of the fiscal decentralization process. This phenomenon, of the Hunter coefficient's return to values prior to 1999, is also due to the decrease of the LG ability to modify and adjust the local fees and taxes. Thus, by the legislation passed in 1999, the LG could modify the local taxes and fees by +/- 50%. Following the G.O. 36/2002 on local taxes and fees, the LG could only increase them by 50%, whereas the Fiscal Code cut this level down to 20%. At the same time, the LG was no longer allowed to adjust the tax base for the local fees and taxes by issuing its own resolutions. Moreover, the central government has introduced a set of incentives attached to the payment of local fees and taxes for the elderly and for people with low incomes.

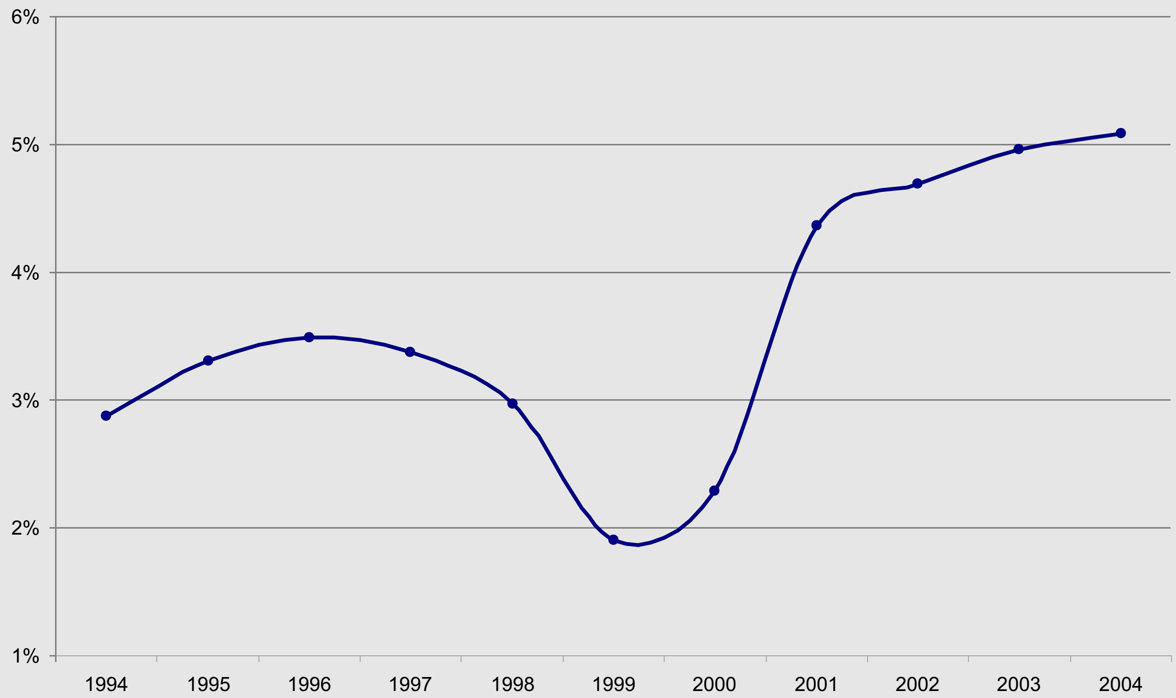


Diagram 3.4. Weight of central budget transfers to LG in the GDP

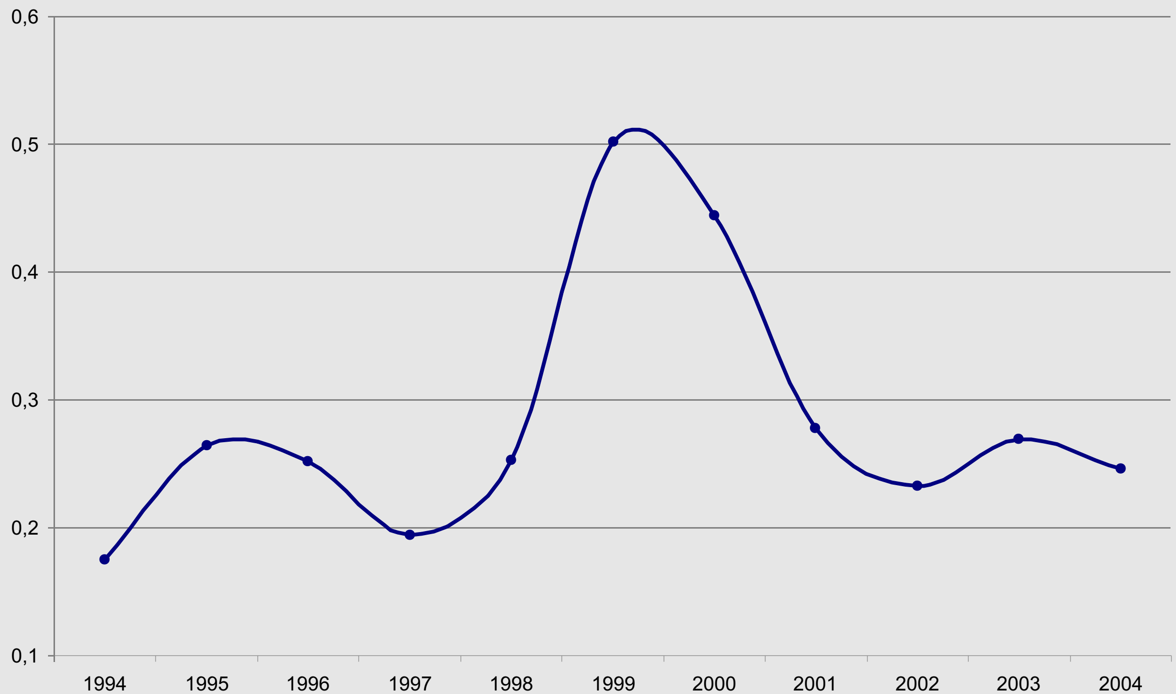


Diagram 3.5. Evolution of the Hunter coefficient

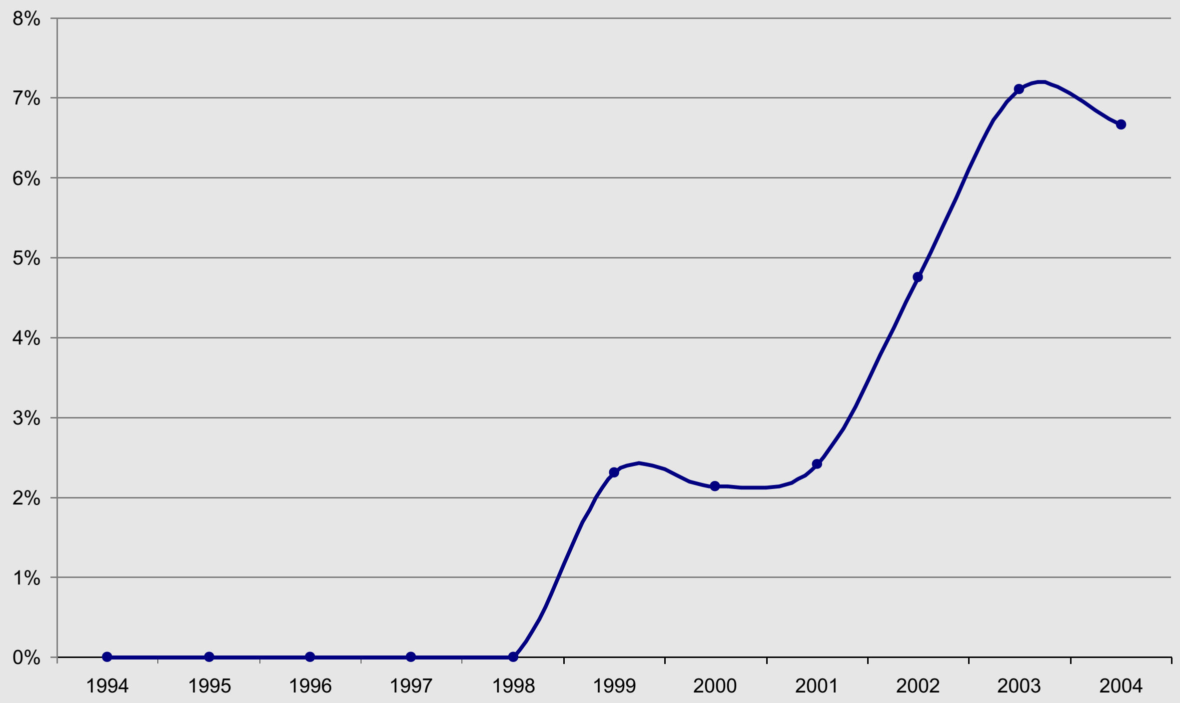


Diagram 3.6. Weight of equalization transfers in the central budget

All these measures have contributed to the growth of the LG fiscal dependence on the central government.

The information included in Diagram 3.7. reflects the weight of arrears in the total expenditures only for 2003 at county level, while as a national average, the percentage of arrears in the LG-related expenditures is not so significant: 2.81%. It is most likely that this percentage does not include yet other categories of LG debt:

- The price subsidy not paid to the heat suppliers
- The debt to the education system public utilities
- The sums not paid to the beneficiaries of the minimum income program
- The salaries not paid to the personal assistants of people with disabilities.

The assessment of all these debts is very difficult if we think in terms of the accounting system (based on cash settlements) used at local government level. Starting with 2004, once the E.G.O. No. 45/2003 on local public finances (endorsed by Law No. 108/2004) entered into force, the first elements of engagement-based public accounting were introduced.

The examination of the arrears at county level in 2003, by establishing their weight in the local government spending, shows us yet another interesting issue: in general terms, the poorer areas (with a lower PIT per capita than the national average: Braila, Giurgiu, Vaslui, Vrancea) are hit harder by this phenomenon and so are the counties whose economic activity relies greatly on large state-owned companies which are “involved” in the financial insolvency process that generally impacts the public sector (for instance Gorj county which is a “champion” in this respect, with a percentage of over 14% or, quite surprisingly, counties Prahova and Suceava).

The methods used to provide the vertical balance, or to diminish this kind of unbalance, are as follows:

- Assigning new financial resources to the local government
- Developing the system of national shared taxes
- Increasing the national-level volume of resources dedicated to equalization and allocated as unconditional grants.

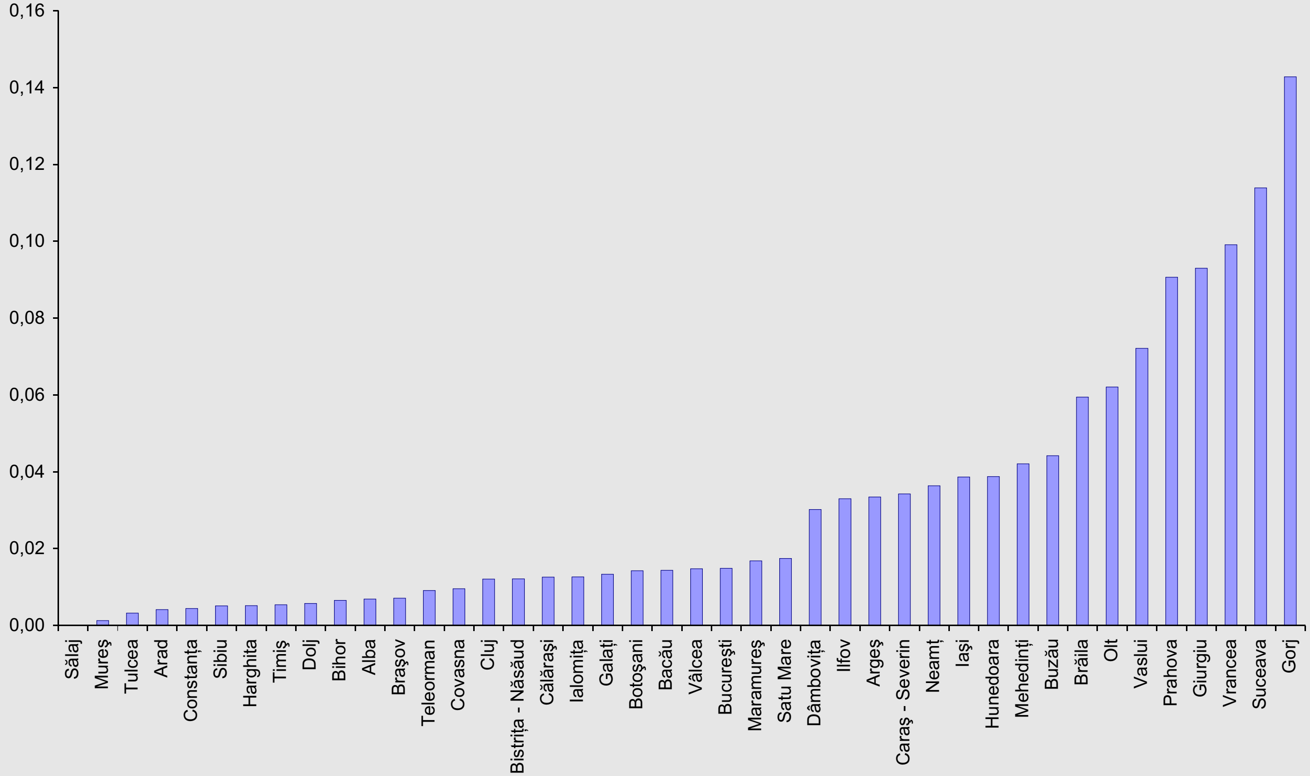


Diagram 3.7. Weight of arrears in the total expenditures for 2003 at county level

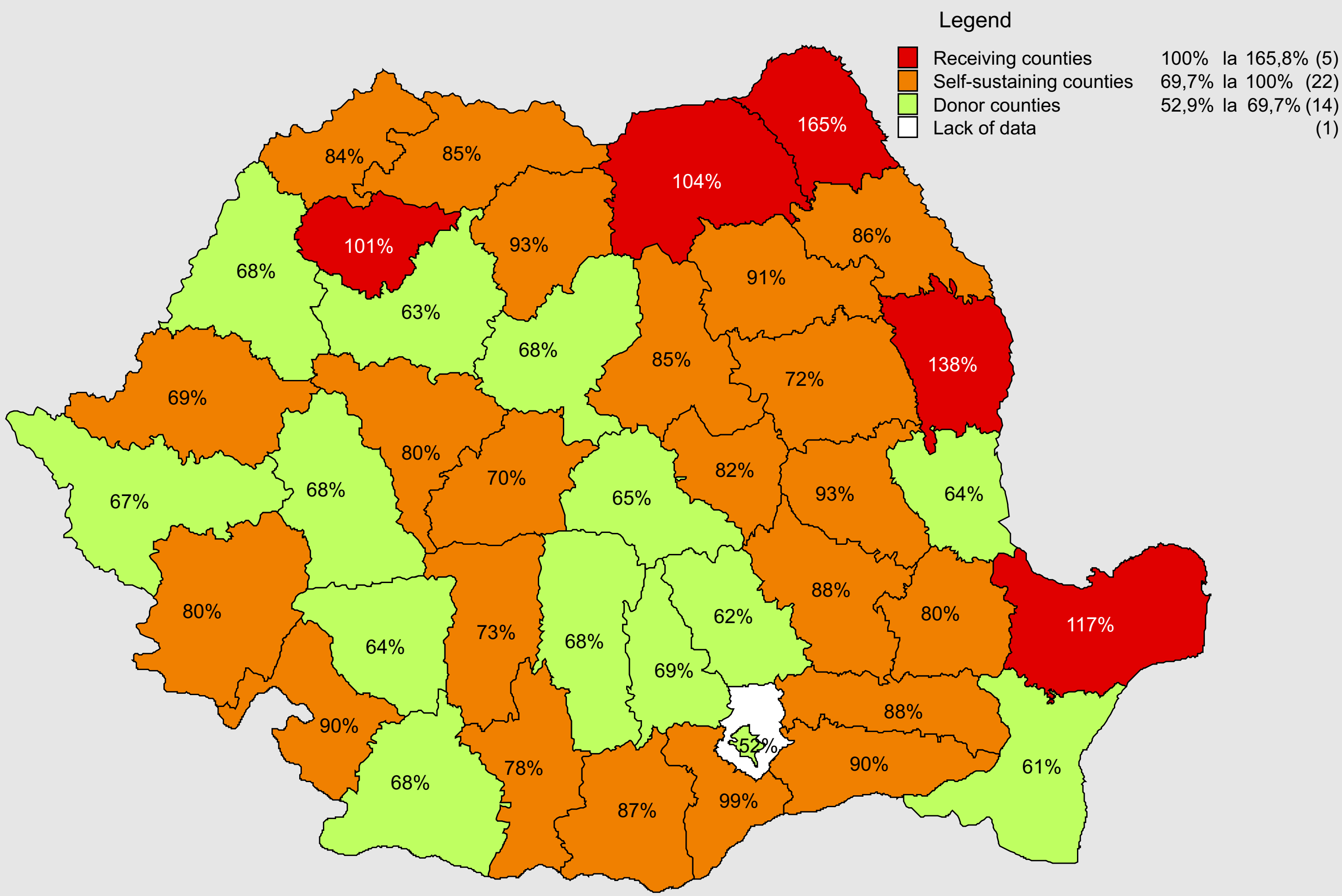
Dependence

The number of counties which consume PIT more than they collect has increased between 1999 - 2004.

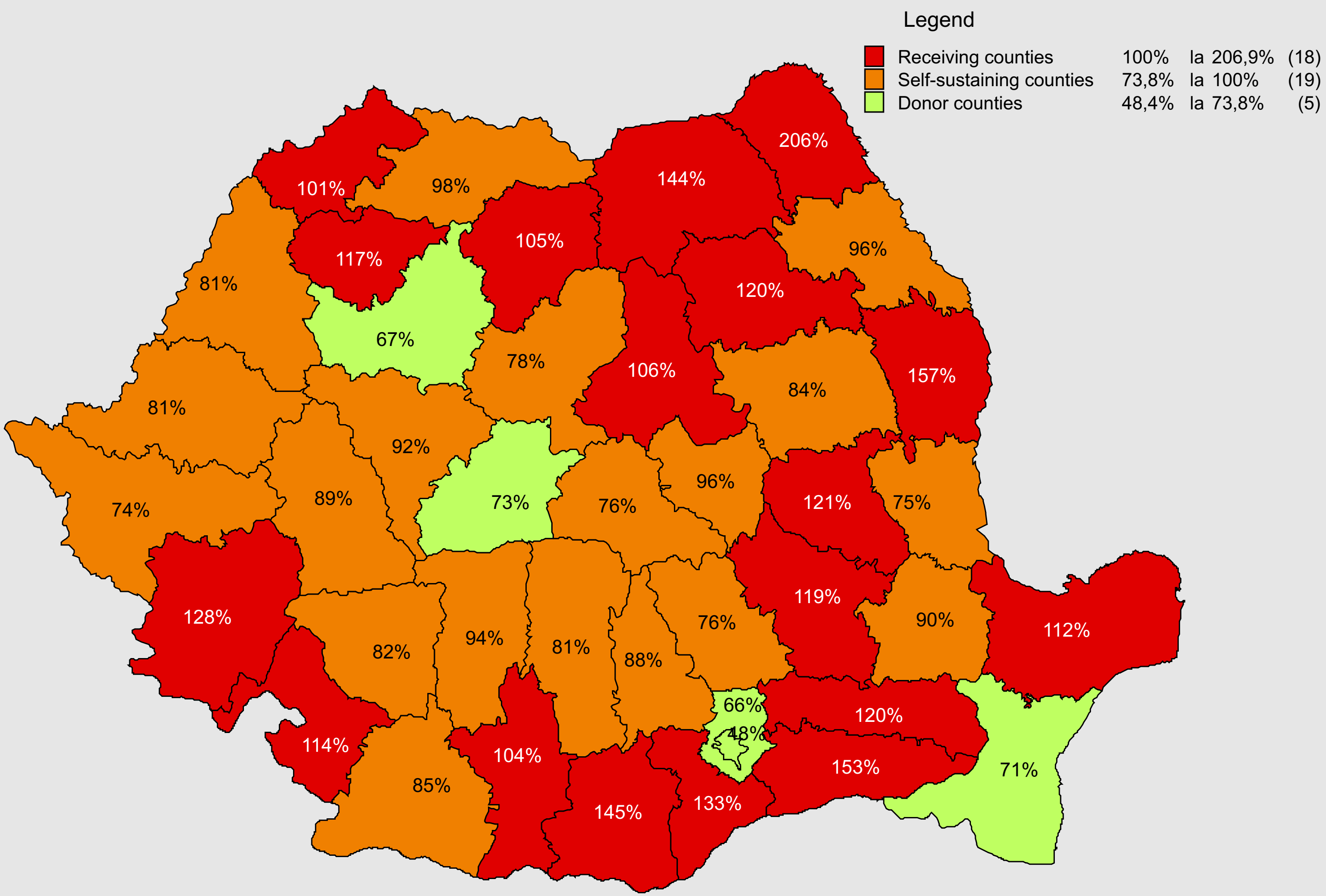
As policy recommendations meant to downsize the vertical unbalance (see the first section on Principles of fiscal decentralization in Romania) the methods used consider the allocation of additional financial resources to the local government, the implementation of a national shared taxes system or the national-level increase of the volume of local budget equalization resources (distributed as unconditional grants)[2].

For the time period examined, and based on the data available from the Ministry of Public Finances, one can note the progress of the ratio between the PIT used by the local government in all the counties (in all its categories: shares deducted from the PIT, equalization grants deducted from the PIT, conditional grants, etc.) and the PIT collected in the counties between 1999 - 2003 (see the Maps 1-5). One can see that the PIT utilization rate by the local government has steadily increased (from 68.2% in 1999 to 95.5% in 2003), and the number of counties which use the PIT (regardless of its shapes) more than they collect has increased from 3 in 1999 to 34 in 2003.

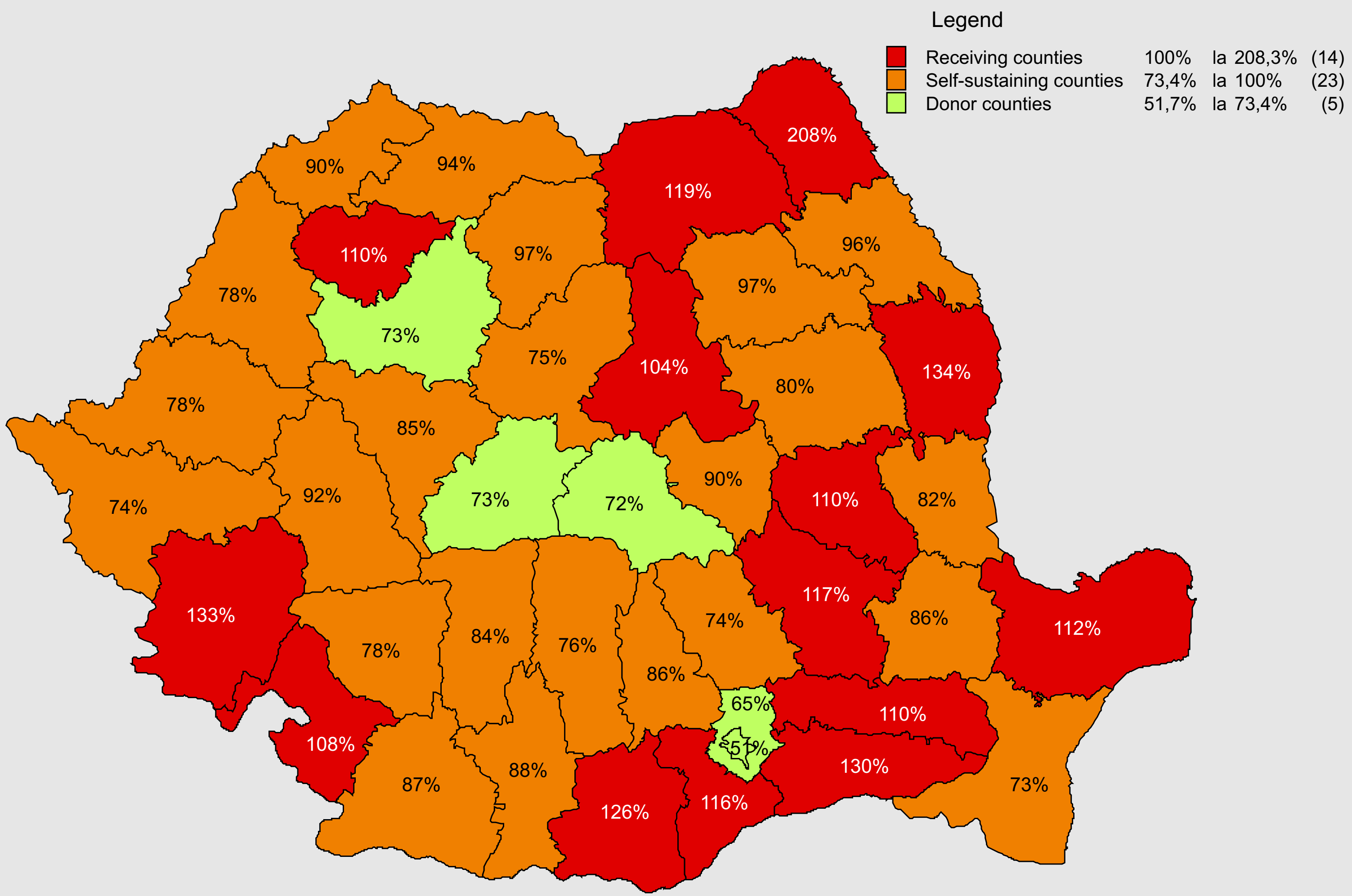
To conclude, we would like to mention that in close connection to the vertical balance, there is also the issue of the horizontal balance; the local budget equalization policy is meant to downsize both the inter-county and the intra-county horizontal unbalances. In the following pages you will find a detailed analysis of the evolution of the horizontal unbalance-related indicators in the 1999 -2003 interval.



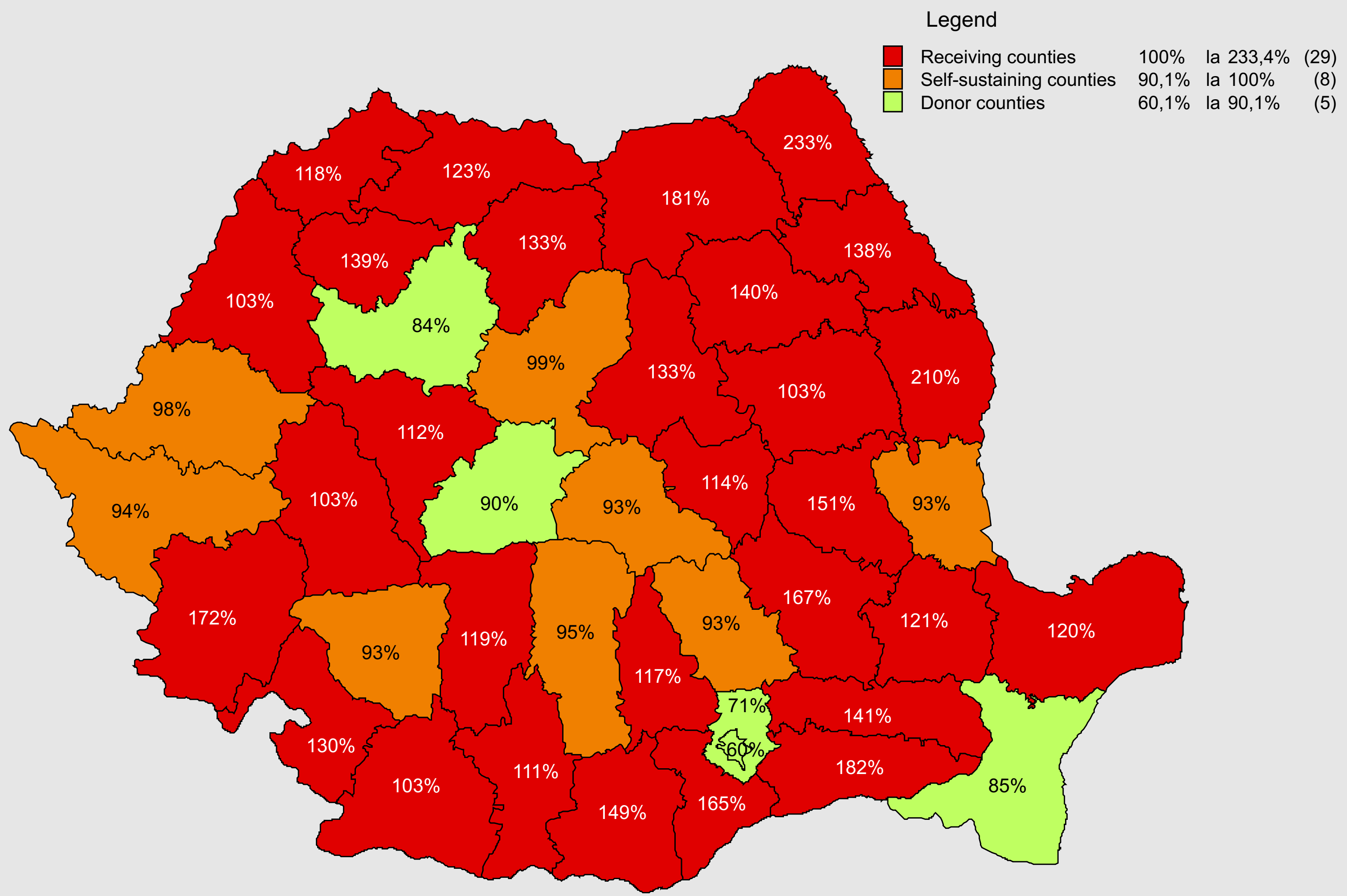
Map 1. The ratio between the PIT used/PIT collected by the LG, by county, for 1999



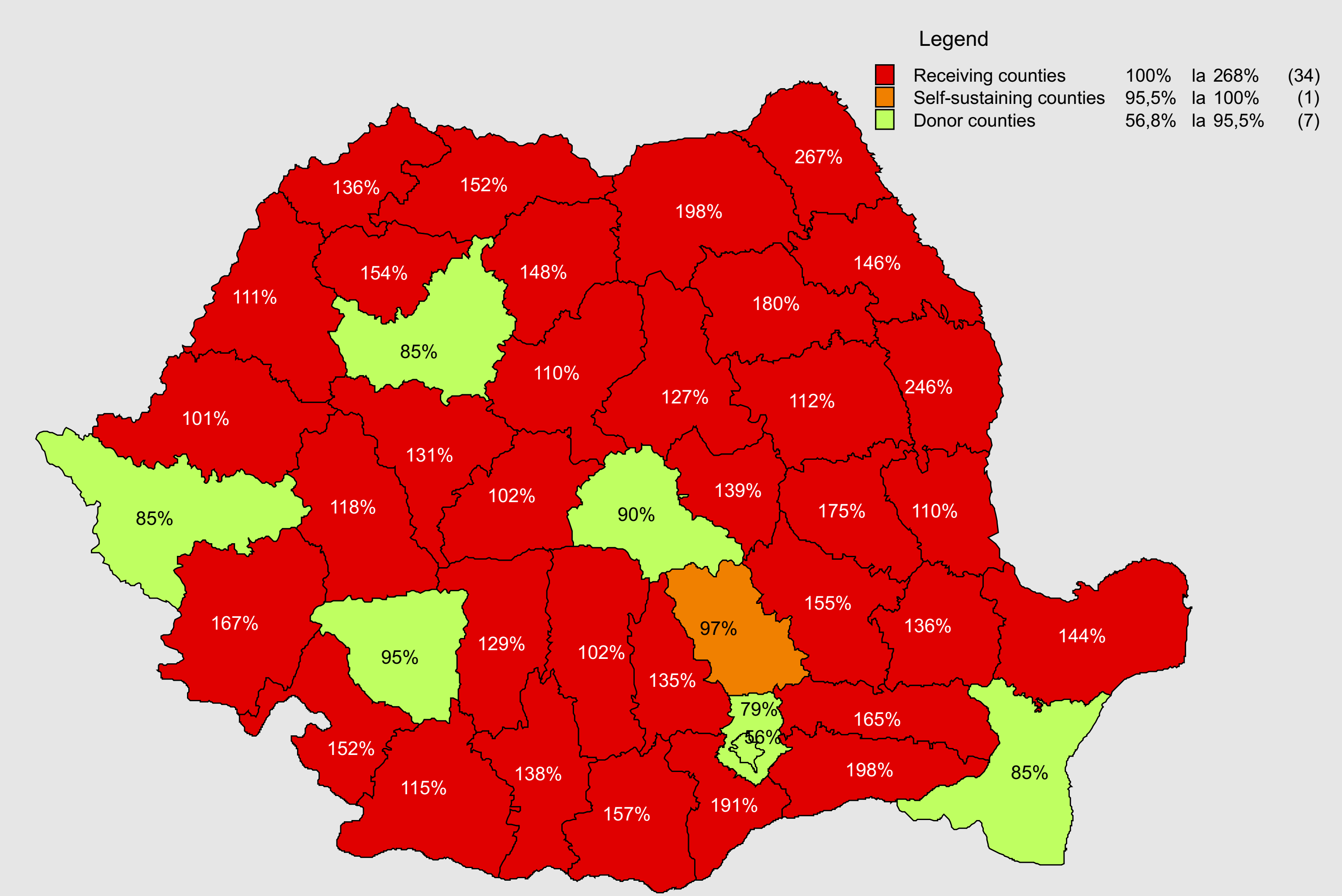
Map 2. The ratio between the PIT used/PIT collected by the LG, by county, for 2000



Map 3. The ratio between the PIT used/PIT collected by the LG, by county, for 2001



Map 4. The ratio between the PIT used/PIT collected by the LG, by county, for 2002



Map 5. The ratio between the PIT used/PIT collected by the LG, by county, for 2003

1999

1999 is the year after the December 1989 Revolution when the process of fiscal decentralization has started in Romania.

3.2. The analysis of the local budgets horizontal balance between 1999-2003

The horizontal unbalance takes into account the discrepancies among the various types of local government units; its analysis within the framework of an efficient local budget equalization policy in Romania underscores the importance of defining in terms as accurate as possible the responsibilities incumbent on municipalities, towns and communes. The differences which exist among the fiscal capacities of municipalities, towns and communes are doubled in Romania by similarities among the types of responsibilities incumbent on them; hence a strong horizontal unbalance of the local budgets.

Between 1999 - 2003 the total revenues of local and county budgets have recorded an increase by 240% (see Diagram 3.2.1.). 1999 was the first year when Law No. 189/1998 on local public finances was implemented. We can say that this was the first year after December 1989 when the first and principal step forward in fiscal decentralization was made in Romania.

From the data collected and processed at the level of the entire local government in 1999 concerning the total revenues collected by the latter, one can see that the own revenues had the largest weight and recorded a substantial growth as against the previous year, once they took over the tasks related to the establishment, the monitoring, the collection and the control of local taxes and fees (see Diagram 3.2.2.).

One can say that this was the fiscal year from the period under examination in which the local government in Romania has accomplished the highest percentage of its own revenues in the total collected revenues, which proves that it was in this year that the principle of local autonomy started to work.

If we examine the revenues according to the type of local government unit, we can see that percentages quite similar to the ones recorded for the entire local government were achieved in the fiscal year 1999. Starting from the two crucial factors which underlie the development of revenues (the tax base and the degree of revenue collection) the municipalities record the highest percentage of revenues, followed by towns and communes. The factors which are responsible for this situation are to be found on the one hand the in the legal framework (the high number of legislated local taxes and fees), and

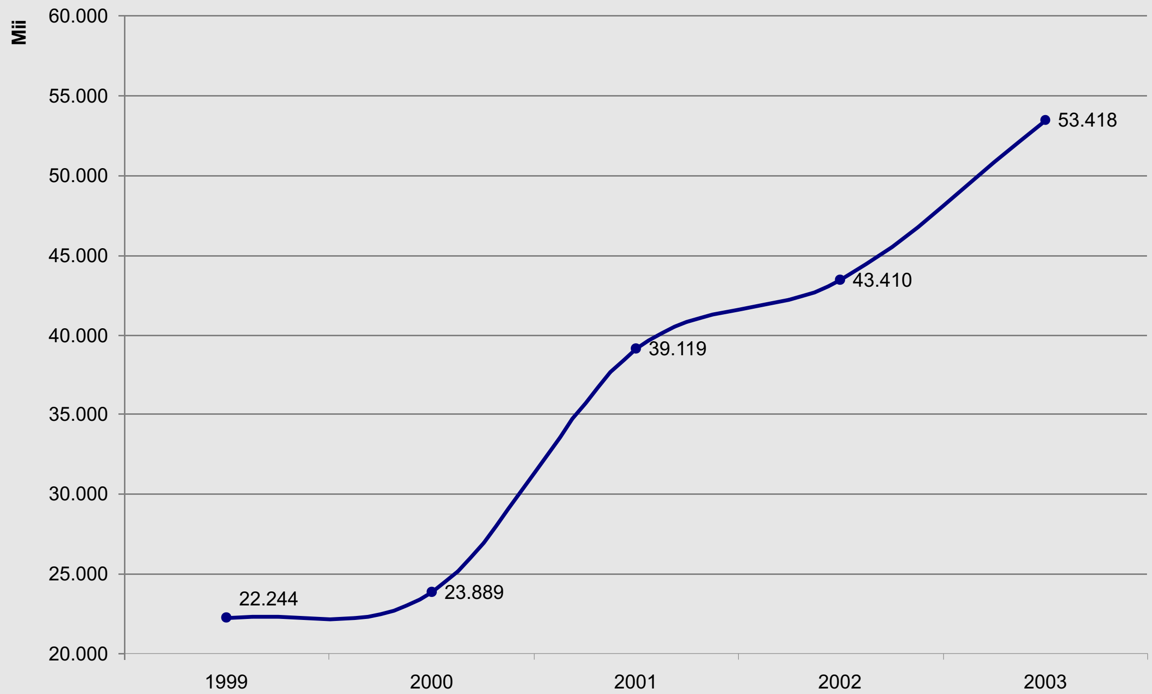


Diagram 3.2.1. Evolution of LG total revenues between 1999-2003 (ROL in constant value)

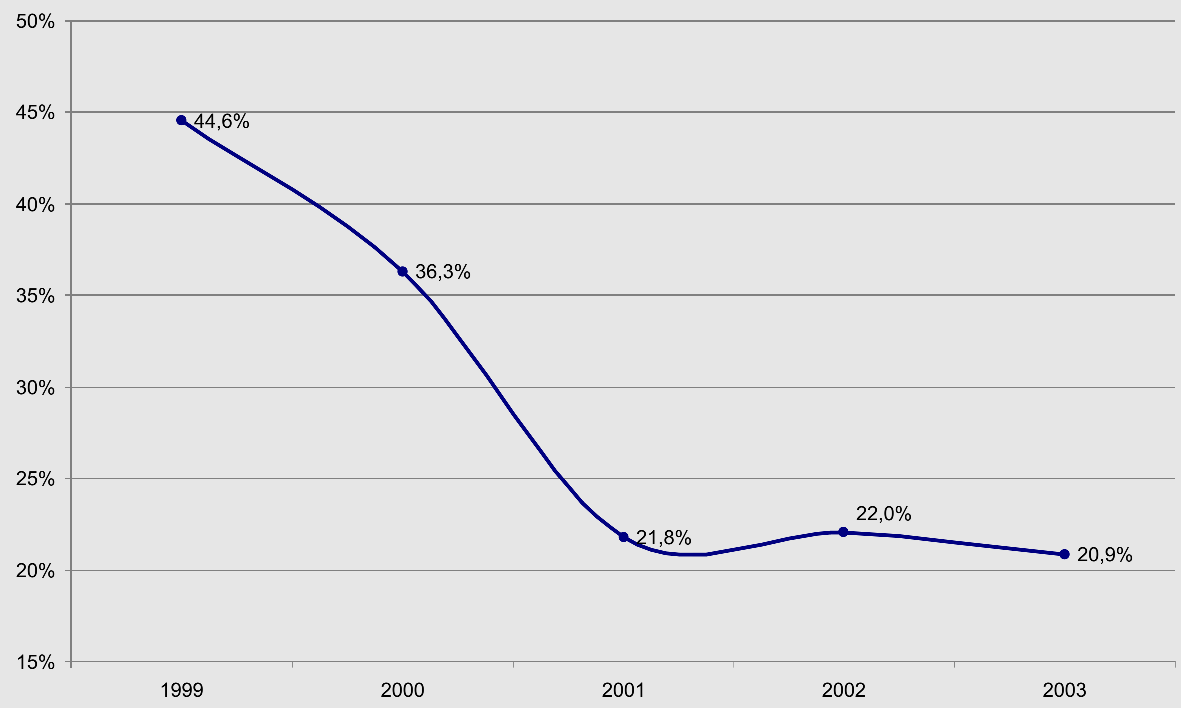
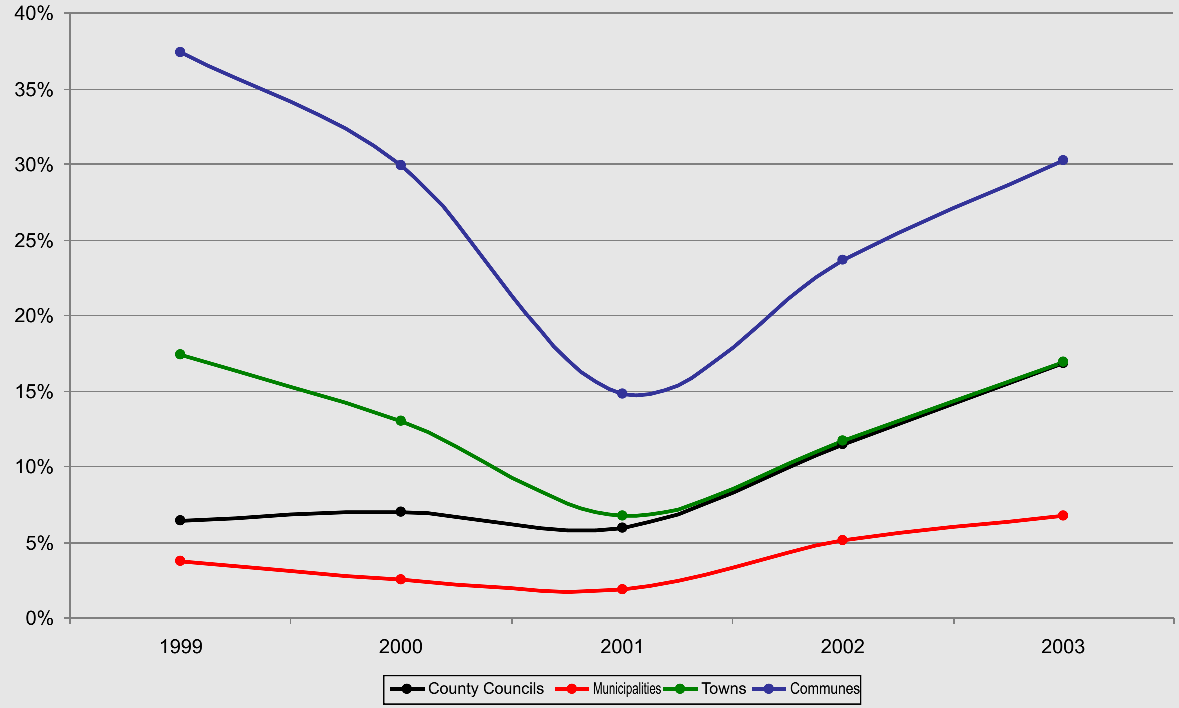


Diagram 3.2.2. Evolution of LG own revenues weight between 1999-2003 (% of total revenues of LG types)



Weight of grants deducted from PIT/salary tax for equalization purposes)	**1999**	**2000**	**2001**	**2002**	**2003**
County Councils (% of County Councils total revenues)	6,4%	7,0%	6,0%	11,5%	16,8%
Municipalities (% of municipalities total revenues)	3,7%	2,5%	1,9%	5,1%	6,8%
Towns (% of towns total revenues)	17,4%	13,0%	6,7%	11,7%	16,9%
Communes (% of communes total revenues)	37,4%	29,9%	14,8%	23,7%	30,3%

Diagram 3.2.3. Evolution of weight of grants deducted from PIT/salary tax for equalization purposes between 1999-2003 (% of total revenues of LG types)

on the other in the socio-economic conditions which favor a larger tax base. Likewise, we can add to this the much higher number of municipal experts trained in the field of establishing, monitoring, controlling and collecting the revenues, in comparison with those in towns and communes.

The analysis of the amounts which contributed to the local budget equalization yields the fact that special attention was paid to the communes (Diagram 3.2.3.) which, due to the lack of funds derived from own revenues or shares deducted from the salary tax, had the greatest need of financing to develop the activities they had been assigned.

3.2.1. The analysis of the local budget revenues trend (evolution)

3.2.1.1 The categories of revenues transferred to the local government between 1999-2003

The legal framework that has governed the local government activities starting with the year 2000 has triggered significant changes, first of all in the structure of the revenues expected and collected by the local government units in Romania. The local government decentralization process consisted in the transfer of certain responsibilities to the local communities regarding the provision of several public services. This transfer should have been equally followed by the decentralization of (re)sources, so as to provide the financial support of these responsibilities. The evolution (trend) of the revenue categories transferred to the local government can be seen in Box 3.2.2.

In 1999 the central government has introduced as a new source of local government funding the share deducted from the salary tax. As of 2000, within the process of decentralization, a greater number of responsibilities have been transferred from central level to local level. Part of the income tax, collected in each local government unit, stays directly within the unit, through the shares deducted from the PIT, while from the difference, which is added to the central budget, the manager of this source, grants deducted from the PIT are allocated, both unconditional ones, for equalization purposes, and conditional ones, for specific purposes. Consequently, starting with this fiscal year, we can talk about a new budget “philosophy” as new terms are being introduced in the budget legislation: special-purpose revenues, shares deducted from the PIT,

- ✍ Own revenues
- ✍ The own revenues category between 1999-2003 also included the special-purpose revenues, and as of 2004, according to the provisions of the E.G.O. No. 45/2003 on local public finances, the same category includes as well the shares deducted from the income tax, although local government authorities have no competence to exercise any control upon these shares.
- ✍ Shares deducted from the salary tax (1999) and, as of 2000, from the income tax.
- ✍ Sums deducted from the salary tax (1999) and, as of 2000, sums deducted from the income tax, allocated to local budget equalization
- ✍ Sums deducted from some central budget revenues, allocated to the local budgets in order to subsidize heating supplied in a centralized manner to the population (i.e. the income tax between 2000-2002 and the VAT as of 2003)
- ✍ Sums deducted from the VAT allocated to the local budgets in order to finance certain expenditure categories assigned to the local governments
- ✍ Sums deducted from the share (between 15%-17%) of the income tax, collected and distributed by each county council to balance the local budgets
- ✍ Subsidies for investments partially financed through foreign loans
- ✍ Other revenues generated according to the legal provisions in force.

Box 3.2.1. Categories of local government revenues

2000 - Law No. 216/1999 stipulates the collection of a share deducted from the income tax, into a separate account available to the County Council, for local budget equalization purposes (intra-county equalization)

- to run the social protection government program for the population, a new source appears in the local budgets, as a special-purpose revenue sums deducted from the income tax to subsidize the heat supplied to the population

2001 - sums deducted from the VAT to finance pre-university education, to cover the staffing, school books and other supplies-related expenditures

- sums deducted from the PIT to provide the minimum income guarantee, sums deducted from the VAT to protect the rights of children with special needs and to pay the personal assistants of the disabled, to cover the expenditures that match the purposes for which the financing sources were set up

2002 - under the State Budget Law for 2002, the sources which cover the conditional (special-purpose) expenditures from the previous year are preserved, to which one adds the sums deducted from the VAT to finance agricultural consulting services at community level

2003 - sums deducted from the PIT to cover the contributions of non-clerical staff

- grants given by the NAD (National Agency for the Disabled) to cover the payments to the disabled (people with disabilities) made by the local and county authorities

- as of the 2003-2004 school year and having a specific reflection in the State Budget Law for 2004, the responsibility to manage and finance the government program on the supply of dairy and bakery products to pre-university education facilities has been transferred to the county councils as well; to this effect, sums deducted from the VAT were provided to finance the purchase of the dairy and bakery products.

Box 3.2.2. Evolution of revenue categories transferred to the local government sums/amounts deducted from certain central budget revenues (PIT and VAT), equalization grants deducted from the PIT.

The local budget equalization process has taken place via the sums deducted from the PIT and has influenced their execution only as much as 10%. The local government decentralization consisted specifically in the transfer of certain responsibilities to the local communities, such as the provision of certain public services. This transfer had to be followed by the decentralization of (re)sources, to ensure the financial support of these responsibilities. From the analysis conducted with regard to the structure of the total revenues determined and collected by the various types of local government units in 2000, one can see that the local budget equalization grants consisted in high percentages, quite significant to the communes.

The novelty attached to the revenue structure consists in the allocation of a new funding source for a social program of national interest sums/amounts deducted from the PIT to subsidize the cost of heating for the population. Next to the own revenues, that have recorded a slight decrease in the year 2000, we have the special-purpose revenues used only to finance certain activities for which special fees were set. The same is true for the slight drop in value of the shares deducted from the PIT compared to the shares deducted from the salary tax and collected the previous year.

The local government preparation period with respect to the management (setup, monitoring, collection and control) of their own revenues has continued by the adjustment of the entire organizational structure to the new requirements of the reform in this field. The experience gained by the elected officials and the experts employed by the local government on previous occasions with respect to the management of the revenues and expenditures proposed and approved by the local budgets, has set the premises for a real and gradual growth of the weight of LG own revenues in the total revenues collected.

If we consider the definition of the LG own revenues according to which they represent the revenues for which the setup, monitoring, collection and control competence belongs to the local authorities from the local government unit where the revenues are generated and collected, one can easily see (Diagram 3.2.2.) that between 2001 - 2003, in the case of the entire local government, its own revenues (the taxes and fees collected from the

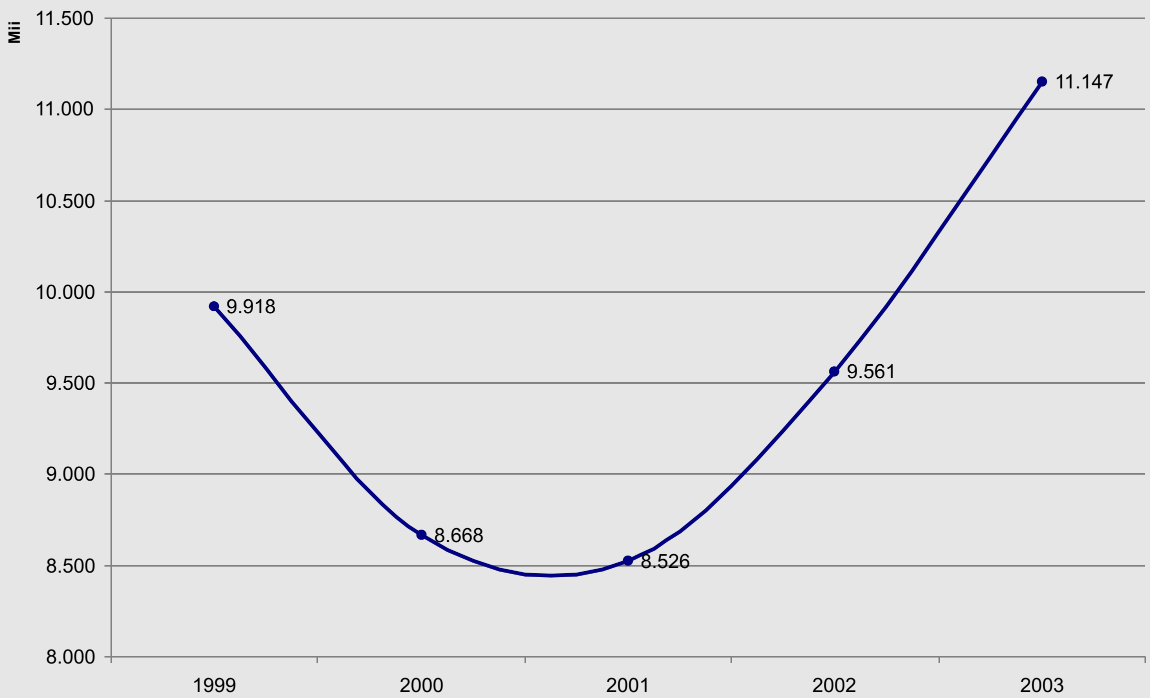


Diagram 3.2.4. Evolution of LG own revenues between 1999-2003 (ROL in constant value)

physical and legal entities that operate in the LGU area) had a relatively steady growth, at a level of almost 20% of the total revenues (for the trend of the own revenues total sum, as ROL in constant value, see Diagram 3.2.4)

One should note that, as of the year 2003, new financing sources as own revenues are being transferred to the local budgets (municipalities, towns and communes): duty stamps, legal and notary fees. The principle of local autonomy has become more and more prevailing in the current local government activities developed in this interval. The legal framework in place allows the decision-making bodies at local level to adjust the local community taxation policy to its needs, such as the diminution or the growth of the local taxes and fees, according to the case. The fiscal management differs from one local government unit to the next, depending on the training, the elected officials' capacity to adjust themselves to their new positions, or on other constraints and concerns which exist on a local level. The vast majority of local communities have fully enjoyed their local autonomy, hence making additional own revenues to cover their increasing needs in the framework of the local government reform process.

During this interval, on a yearly basis, in the process of decentralization, the local government was assigned new responsibilities from the central level; another timid attempt was made, to also decentralize the financing sources. The association-based structures of the local government have constantly reported that the assignment of responsibilities to the local communities during this period was not correlated to a genuine transfer of financing sources.

In the same interval, a negotiation and consultation mechanism started working between the central government and the local government association-based structures, whose main objective was the correlation between the transfer of responsibility onto certain community-interest public services and the financing sources attached to the latter. At present, there are several diverging opinions as to the local government's ability to provide a specific quality for the services taken over in the process of decentralization. The local government representatives taken upon themselves to an increasingly greater extent the responsibility of taking over the entire range of decentralized services, even if, to start with, the quality they can provide is not at its best. Some of the central government representatives are still quite reluctant as to the local government's capability to provide public services of the same quality as theirs.

Following several debates between the representatives of various ministries and those of the local government association-based structures, every year, between 2001 and 2003, additional funding sources were obtained to match the tasks transferred onto the local communities. In this context, we can mention the percentage-based growth of the shares deducted from the PIT and the sums deducted from certain central budget special-purpose taxes, accounting for the activities transferred in this interval the sums deducted from the VAT for staffing expenditures in the education system, the sums deducted from the PIT for providing the minimum income guarantee (MIG) and the sums deducted from the VAT for upholding the protection of children and the disabled (the payment of the disabled' personal assistants).

Starting with the year 2003, following the transfer of some of the National Authority for the Disabled' responsibilities onto the county councils, including the funding of their financial rights (needs), a new specific-purpose source is added to the local budget a transfer for the protection of the disabled.

The entire interval under scrutiny was governed by the provisions of Law 189/1998 on local public finances. The implementation and evaluation of the outcomes resulting from the application of this piece of legislation have brought about a few significant changes in the latter by the appearance of the E.G.O. 45/2003 on local public finances.

The association-based local government structures, the central government and its representatives in the field ministries, domestic and international financing agencies involved in the monitoring of the local government reform process in Romania have agreed on the following major changes in the local public finance legislation:

- ✍ Defining all the terms used by the local government in its financing of the activities assigned to it
- ✍ Developing a new concept about the principle of local budget equalization, by setting uniform criteria, based on which the equalization is conducted both from central to county level and from county to local level.
- ✍ Strengthening the local government units' capacity to access loans for local or regional interest investments
- ✍ Increasing the fiscal discipline by legislating the application of the principle of separation between the engagement, liquidation and ordering payment tasks and the tasks related to making payments from the local budget;

introducing additional monetary responsibilities and penalties for breaching the fiscal discipline.

All these changes are reflected in the E.G.O. 45/2003 on local public finances, as follows:

- ✍ The number of terms and expressions defined by this piece of legislation has increased
- ✍ An attempt was made, after several negotiations with representatives of all the association-based structures and of the line ministries, to legislate several equalization criteria in order to diminish to the extent possible the subjectivity attached to the operation of this process
- ✍ A more detailed legal framework was developed, to facilitate the contracting and operation of loans by the local government
- ✍ A timid attempt was made to set up sanctions for the credit users as well (e.g. Art. 70 of the E.G.O. 45/2003).

The fiscal year 2004 can be regarded as a step forward in the local government reform processł. It is the first year when the provisions of the E.G.O. No. 45/2003 on local public finances were applied.

3.2.2. The evolution of the local government revenue categories at national and local government unit level

The evolution of LG own revenues. In the 1999 - 2004 interval, an upward trend from a value point of view is recorded, i.e. from 9,918,090 thousand ROL in 1999 to 11,147,402 thousand ROL in 2003, which represents an increase by 112% when the local budget total revenues grow by 240%. Although these revenues grow in value terms, as a weight in the total revenues they do record a decrease from 45% - their level in 1999 to 21% in 2003 (Diagram 3.2.2.).

For the county councils, the weight of their own revenues in the total revenues drops considerably from 37% - the level in 1999 to 8% in 2003; the evolution of the total amounts expressed as ROL in constant value can be seen in Diagrams 3.2.5. and 3.2.6. In value terms, an increase by 152% is recorded (see Diagram 3.2.7.), but the weight of this category of revenues in the total revenues of municipalities has recorded a decrease from 53% in 1999 to 26% in 2001, followed by an increase up to 29% in 2003 (Diagram

Local government own revenues

In value terms, the local government own revenues have increased in the 1999 - 2003 interval. In terms of weight in the local budget structure, they have decreased over the same period.

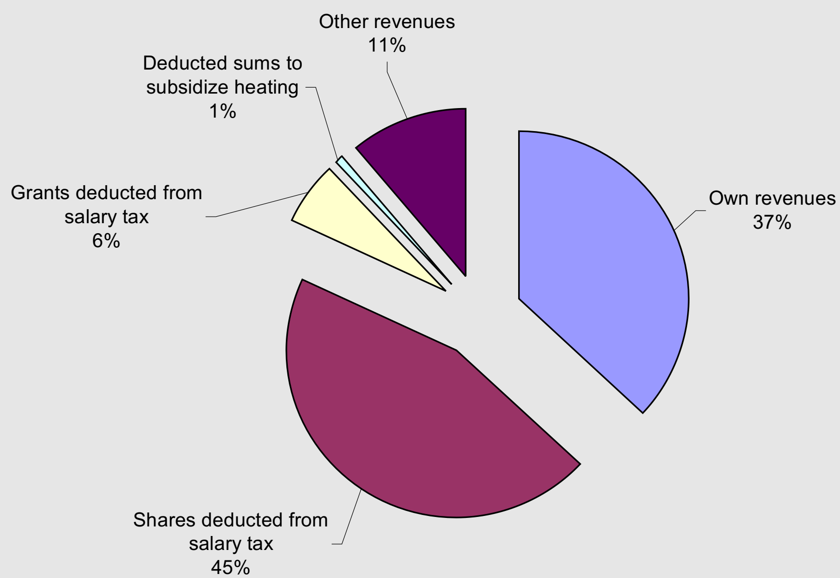


Diagram 3.2.5. Structure of county council revenues for 1999

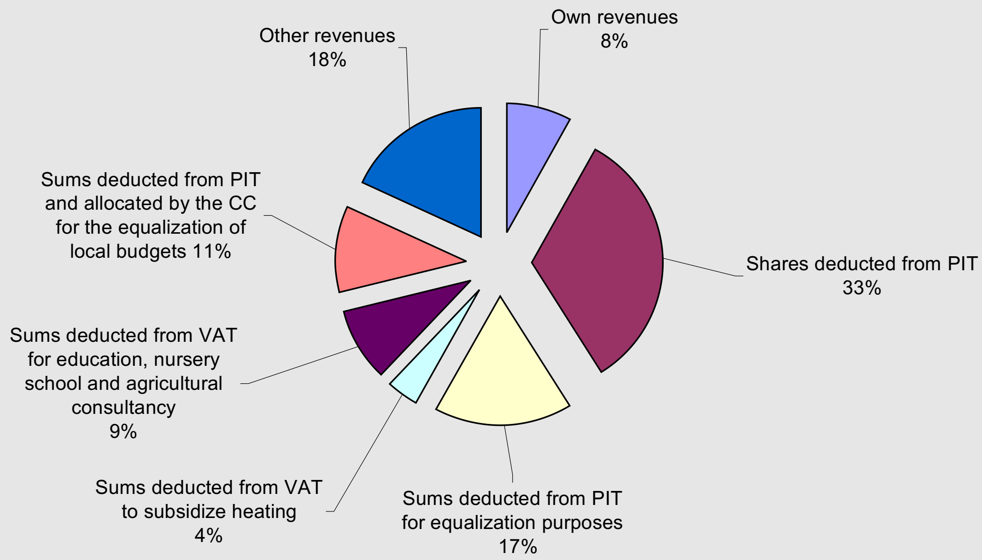


Diagram 3.2.6. Structure of county council revenues for 2003

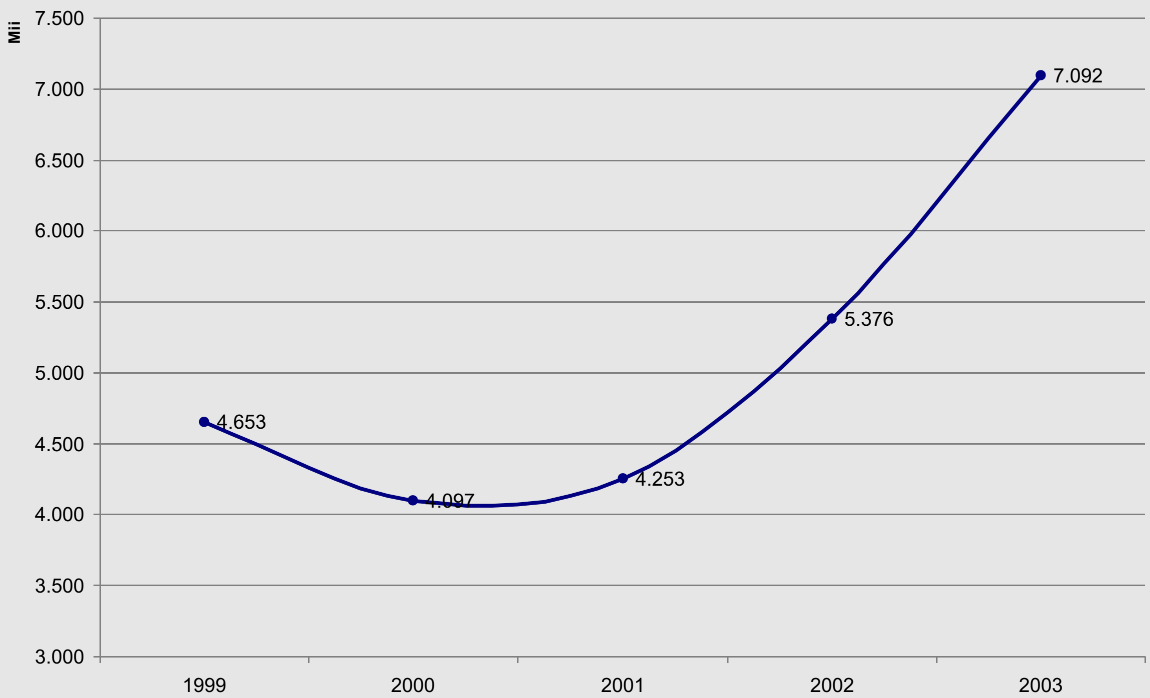
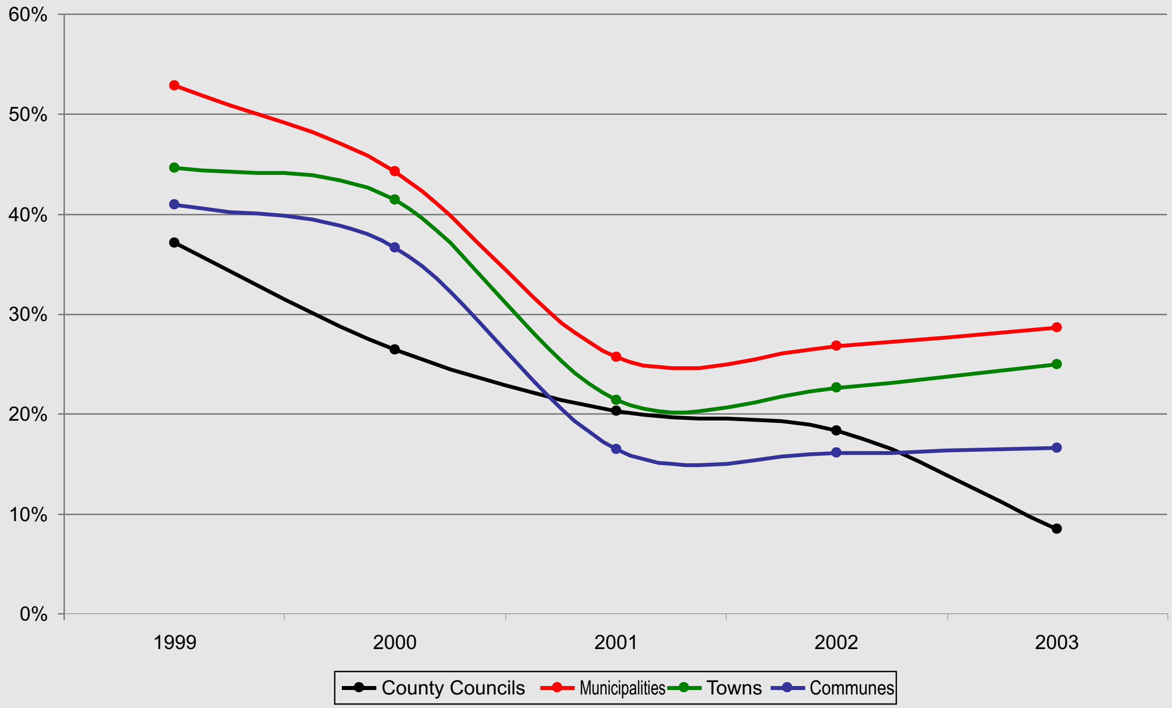


Diagram 3.2.7. Evolution of municipal budget own revenues between 1999-2003 (ROL in constant value)



Own revenues	**1999**	**2000**	**2001**	**2002**	**2003**
County Councils (% of County Councils total revenues)	37,1%	26,5%	20,3%	18,3%	8,5%
Municipalities (% of municipalities total revenues)	52,9%	44,2%	25,6%	26,8%	28,6%
Towns (% of towns total revenues)	44,6%	41,4%	21,4%	22,7%	25,0%
Communes (% of communes total revenues)	41,0%	36,7%	16,4%	16,1%	16,6%

Diagram 3.2.8. Evolution of own revenues weight (% of total revenues) by LG type, between 1999-2003

3.2.8.). The local budgets of *towns* have also recorded a decline in the weight of their own revenues in the total revenues from 45% - their level in 1999 to 21% in 2001, followed by an increase up to 25% in 2003. As in the case of the other local government unit categories, in value terms, the town own revenues grow by 118% while their total revenues grow up to 211%. The same situation of an increase in value terms of the total amounts expressed as ROL in constant value of the own revenues is equally recorded in the case of communes, but the weight in the total revenues of communes is faced with a considerable drop (Diagram 3.2.8.).

The trend of the LG own revenues between 1999 - 2003 was influenced by several legislative amendments in the field of local taxes and fees, especially as a consequence of the G.O. No. 36/2002 applied in 2003. For a detailed view on the evolution of the main pieces of legislation about the regulation of the local taxes and fees see Box 3.2.3.

The decrease in the weight of own revenues in the total local budget revenues for all the categories of local government in Romania was caused by the transfer of new responsibilities onto the local government, for which certain specific-purpose grants were allocated as financing sources, taken from the central budget revenues.

The evolution of the shares deducted from the salary tax (1999) and the shares deducted from the income tax (2000-2003). This revenue source was regulated by Law No. 189/1998 on local public finances and its level was settled as follows: 40% of the amounts collected within the local government unit to be allocated to each municipality, town and commune budget; 10% of the amounts collected within the county to be allocated to the county council own budget. Although the level of the above-mentioned rates was stipulated in the Law, they have been modified starting with the year 1999, by the annual state budget laws; their evolution is described in Table 3.2.1.

The local government unit revenues derived from the shares deducted from the salary tax/PIT between 1999 2003 recorded in value terms an increase from 7,480,298 million ROL in 1999 to 10,393,375 million ROL in 2003; as a weight in the total revenues, they have decreased from 34% - their level in 1999 to 26% in 2001 and to 19% in 2003. This revenue source has higher values and it benefits more the more developed local government units that enjoy a greater stability of their local economy. The trend of this revenue category was influenced on the one hand by the level of the shares allocated to the local budgets and set by the annual budget legislation and on the other by the salary

Year	Share of PIT tax for municipalities, towns and communes	Share of PIT tax for county budget	Share of PIT tax/ county for the local budgets equalization (%)
1999	35	15	
2000	35	10	15
2001	36,5	10	15
2002	36,5	10	16
2003	36	10	17
2004	36	10	17

Table 3.2.1. Evolution of the shares deducted from PIT/salary tax between 1999-2004

tax regulations (the global income as of the year 2000).

The drop in the weight of this type of revenue in the total revenues is due to the growth of the conditional or equalization transfers (grants), caused by the decentralization (devolution) of new responsibilities to the local government. Here is the situation in this respect, by type of local government unit (Diagram 3.2.10): county councils record a decrease in the weight of this revenue in the total revenues from 44% in 1999 to 32% in 2003; nevertheless, the shared deducted from the salary tax/income tax represent the main source of the county council budget revenue for 1999 - 2003 (Diagram 3.2.5. and Diagram 3.2.6.); municipalities(cities) - the weight of this revenue source in the total revenues of municipalities is lower than the counties' and it represents 30% in 1999, 26% in 2001 and only 21% in 2003; towns the weight of revenues derived from this source drops from 29% in 1999 to 18% in 2001 and to 13% in 2003; communes they represent the local government unit with the lowest weight of this revenue source in the total revenues, namely, 20% in 1999 and only 6% in 2001 and 2003, the main reason being the low level of economic development for this local government category.

If we consider these two types of revenues: the own revenues and the shares deducted from the PIT and if we examine their weight in the total revenues of each type of local government unit, we can ascertain the following: in 1999 the local government units provided from these sources a 78% financing for the responsibilities assigned to them, which dropped in 2003 to 40%; the counties covered in 1999 81% of their expenditures, in 2002 57% and in 2003 41%; the municipalities(cities) covered in 1999 83% of their expenditures, in 2002 49% and in 2003 49%; the towns financed in 1999 76% of their expenditures, in 2002 37% and in 2003 - 39%; the communes financed in 1999 76% of their responsibilities, in 2002 23% and in 2003 23%.

The evolution of the sums deducted from the VAT for local budgets. The sums deducted from the VAT have started being allocated to the local budgets to finance certain activities or responsibilities that have been decentralized (devolved) towards the local government units as of 2001.

In 2001 the sum of 11,983,967 million ROL in constant value 1999 was allocated to the local budgets for financing nurseries, pre-university education and consultancy centers, an amount which, in keeping with the Law on the central budget for 2001, was distributed by the county councils to the local government unit budgets. The allocated

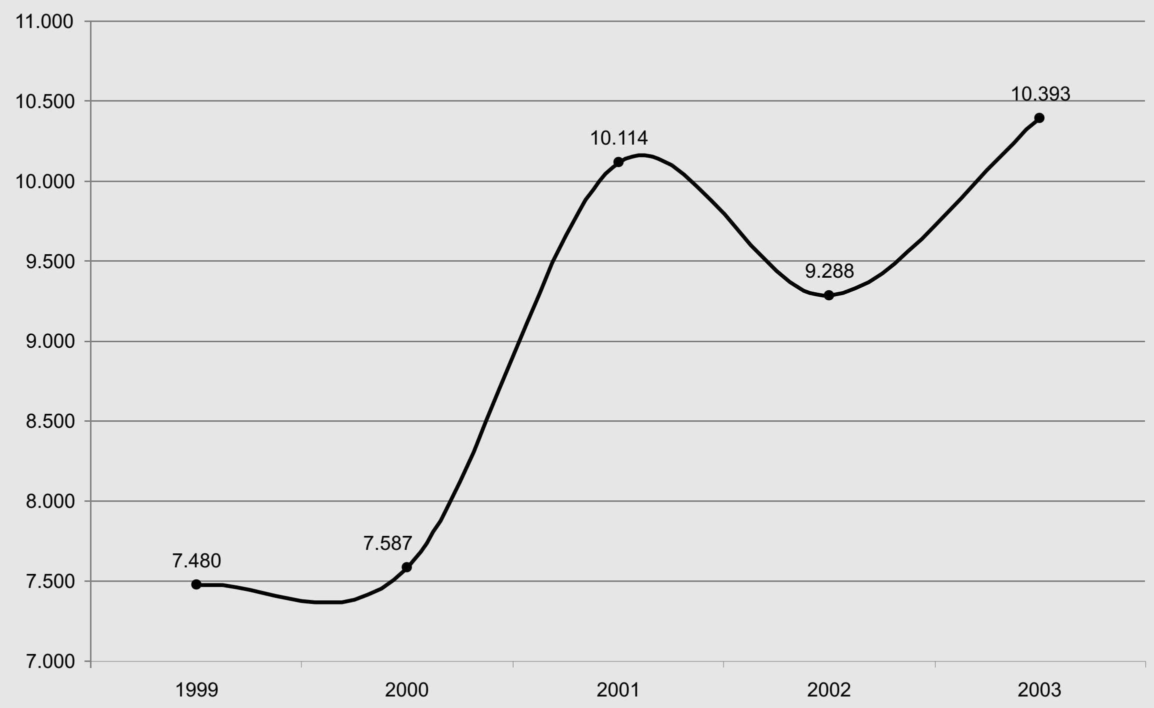


Diagram 3.2.9. Evolution of shares deducted from PIT/salary tax between 1999-2003

sum represented 31% of the local budget total revenues.

According to the distribution undertaken by the county councils, the amounts were allocated as follows:

- 9% of the total sum to the county council budget
- 47% of the total sum to the municipality (city) budget
- 10% of the total sum to the town budget
- 34% of the total sum to the commune budget.

Starting with the year 2002, the same amount contributed to the funding of yet other expenditures: child protection, the disabled' protection, minimum income guarantee, culture, cults, consultancy services. Lacking the data for each type of local government unit about the number of beneficiaries of such services or other criteria considered when the respective amounts were distributed, one cannot judge if the distribution process met the needs of each type of local government unit.

The evolution of the sums deducted from the income tax or from the VAT to subsidize heating. To subsidize the heating (thermal energy) supplied within a centralized system to the population in the 1999 2003 interval, the local budgets were allocated from the central budget sums deducted to supplement their own revenues and hence to help them finance these responsibilities. The sums allocated from the central budget have increased from 395,757 million ROL to 2,736,927 million ROL in 2003, thus growing by 691% in 2003 as against 1999. Considering that the centralized supply of heat takes place mainly in urban areas, this amount has been distributed to cities, towns and to a lesser extent to counties or communes.

The sums deducted from the shares of the income tax allocated by the county council for local budget equalization. Starting with the year 2000, sums meant to equalize local budgets were distributed from the 15% share collected by each county council from the income tax. The allocation criteria for these sums were stipulated in Law No. 189/1998 but also in the annual budget legislation; the county councils had the authority to divide these sums. From the data examined, one can see that the sum derived from the 15-17% of the PIT dedicated to local budget equalization, has increased in value terms from 1,292,564 million ROL in constant value in 2000 to 3,009,982 million ROL in constant

- ✍ Law No. 27/1994 on local taxes and fees with its subsequent amendments and additions
- ✍ Ordinance No. 36/2002 on local taxes and fees which has entered into force as of 2003 and has abrogated Law No. 27/1994
- ✍ The Fiscal Code approved by Law No. 571/2003 which also regulates local taxes and fees and which abrogates Ordinance No. 36/2002

We must emphasize that the taxation levels for rural localities according to the regulations in force are lower than those for the urban localities. The afore-mentioned regulations lend a certain degree of autonomy to the local governments in determining their own taxation, although this autonomy is only partial, as the central government, through its given regulations, has produced certain limits within which the local authorities may establish the level of local taxes and fees.

Throughout the time period under debate, although part of the local budget own revenue categories have been withdrawn (for instance, by the coming into force of Ordinance No. 73/1999 on the personal income tax, as of the year 2000, the tax on the income of the self-employed, craftsmen and other independent natural persons/individuals, as well as the tax on rent-derived incomes have been included in the personal income tax), there have been regulations which generated a value increase of this category of revenues.

Thus, by means of Ordinance No. 36/2002, the land tax was regulated so that to be determined according to the area and the utilization category; in addition, the land under concession or lease was also taxed. The same legislation has determined a different level of taxation in terms of the share of the tax on buildings owned by legal persons, for the re-appraised versus the non-reappraised buildings; this situation has generated increased own revenues.

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Box 3.2.3. Main pieces of legislation regulating local taxes and fees between 1999-2003

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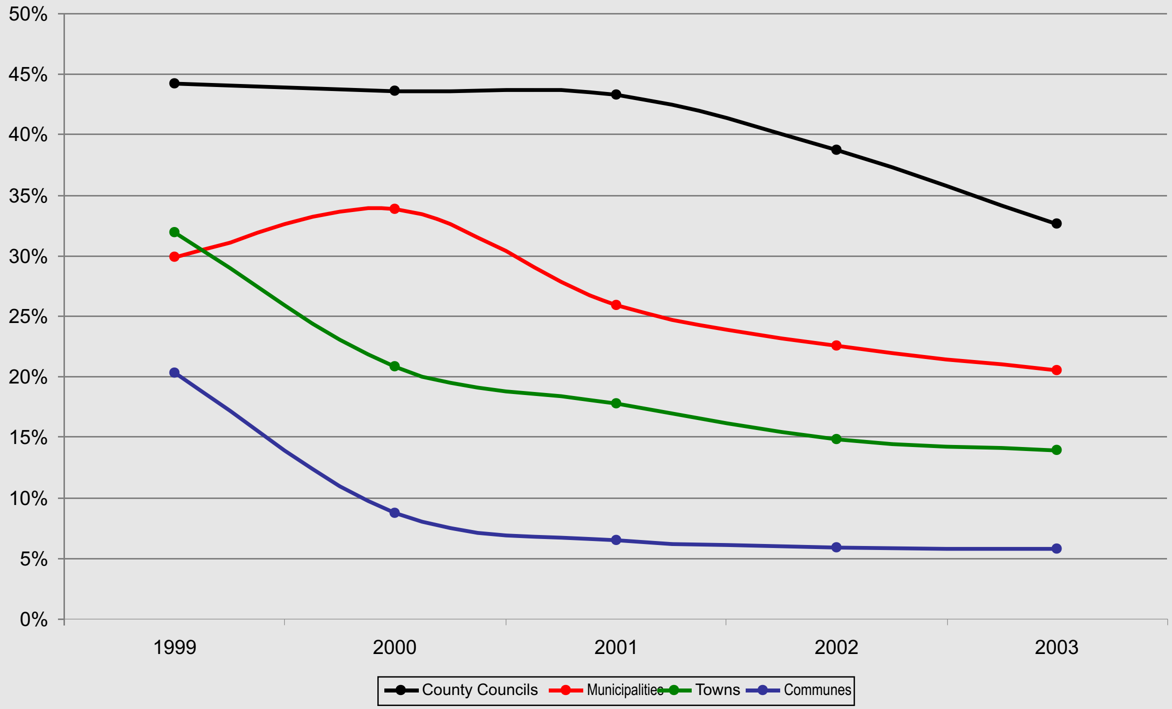
Between 2001 2002, the building tax owed by legal persons was determined as a flat tax.
As of the year 2003, natural persons owe an increased tax for the dwelling-purpose buildings, apart from the buildings used as place of residence. Since the year 2003 as well, the hotel fee was introduced, while the judicial stamp duties and the notary fees which represent main sources of own revenues, especially for towns and municipal cities, have been transferred.

As in the case of the shares deducted from the income tax, local budget own revenues are influenced by the specific legal regulations in force, by the rural or urban local government unit category, by the degree of economic development of the locality in question, and also by the local government management skills.

All these factors make municipal cities and bigger towns report higher own revenues, which results in a higher weight of their own revenues in the total local budget revenues.



Weight of shares deducted from PIT/ Salary tax by type of LG	**1999**	**2000**	**2001**	**2002**	**2003**
County Councils (% of County Councils total revenues)	44,2%	43,6%	43,3%	38,7%	32,6%
Municipalities (% of municipalities total revenues)	29,9%	33,9%	26,0%	22,6%	20,6%
Towns (% of towns total revenues)	31,9%	20,8%	17,8%	14,8%	13,9%
Communes (% of communes total revenues)	20,4%	8,7%	6,5%	5,9%	5,8%

Diagram 3.2.10. Evolution of weight of shares deducted from PIT/salary tax by type of LG

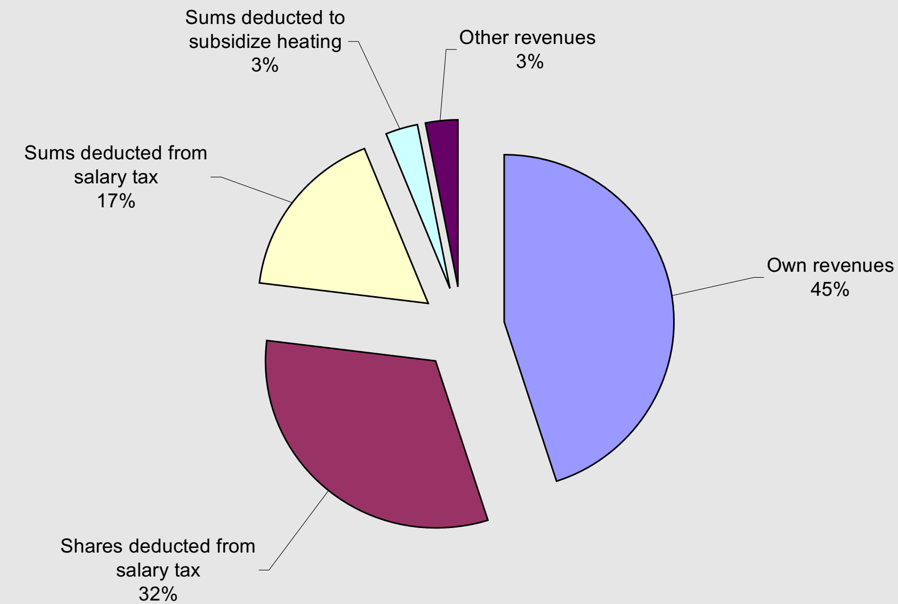


Diagram 3.2.11. Structure of town budget revenues for 1999

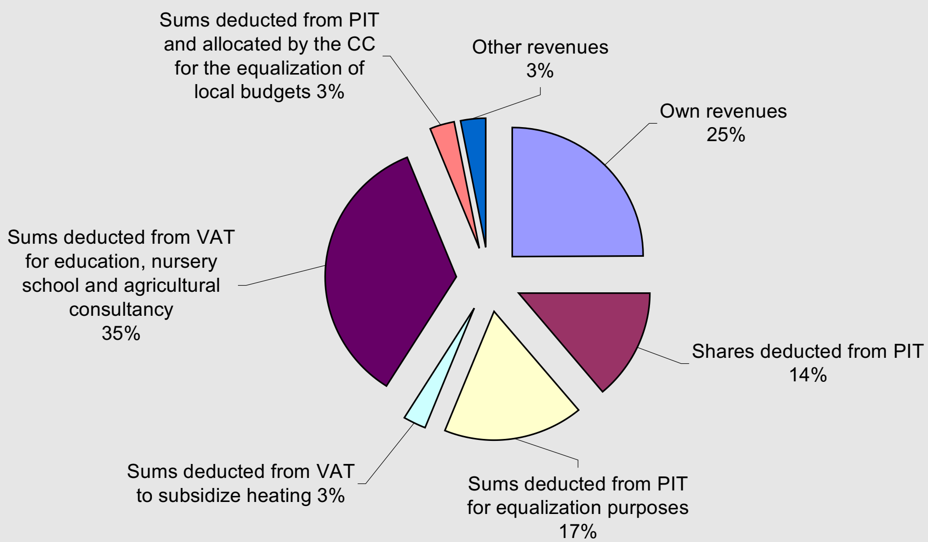


Diagram 3.2.12. Structure of town budget revenues for 2003

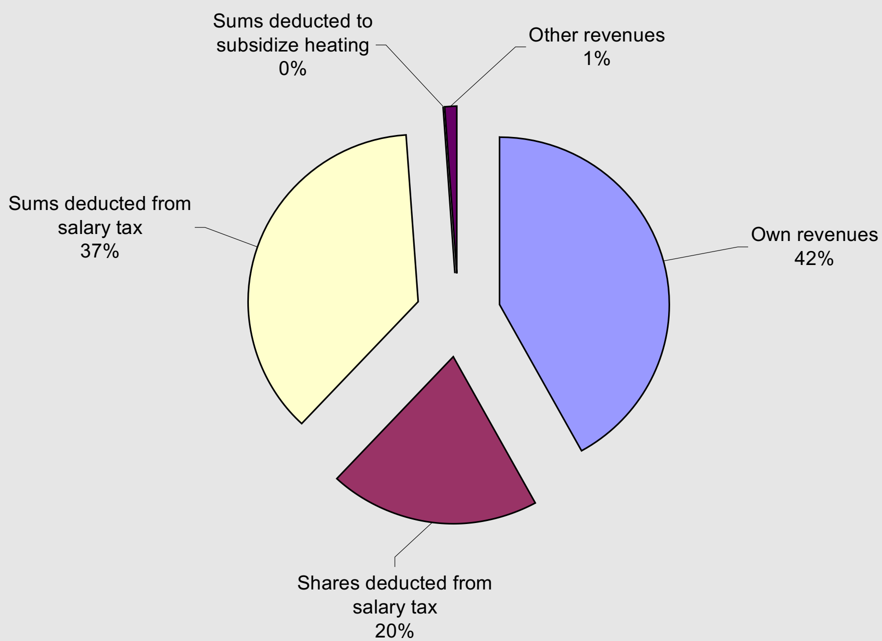


Diagram 3.2.13. Structure of commune budget revenues for 1999

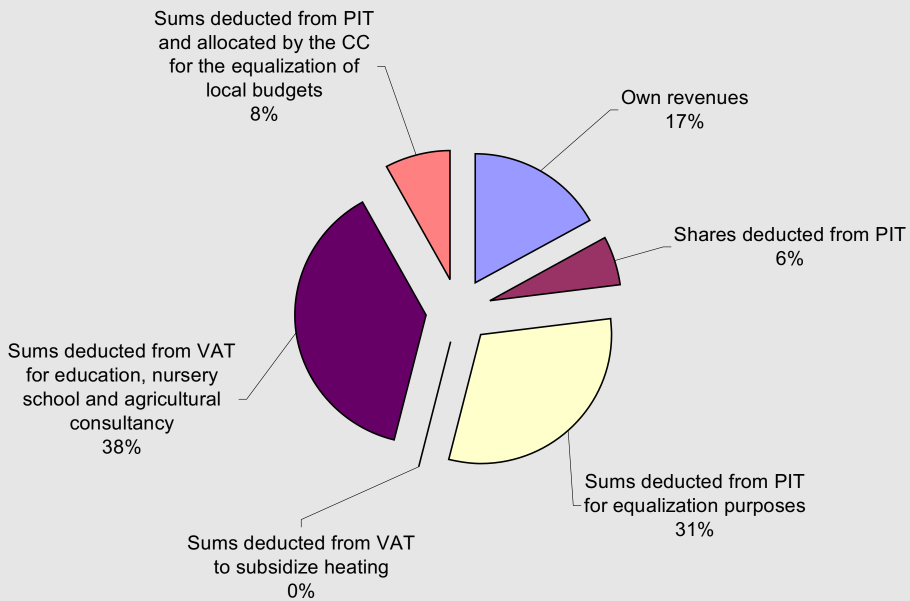


Diagram 3.2.14. Structure of commune budget revenues for 2003

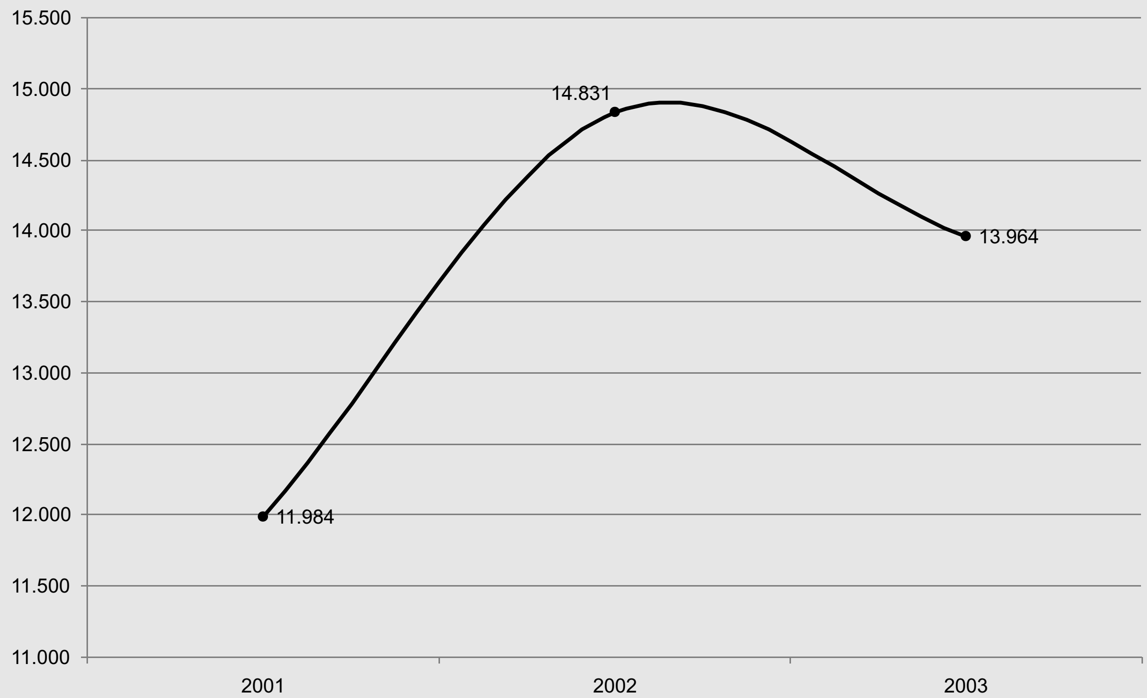
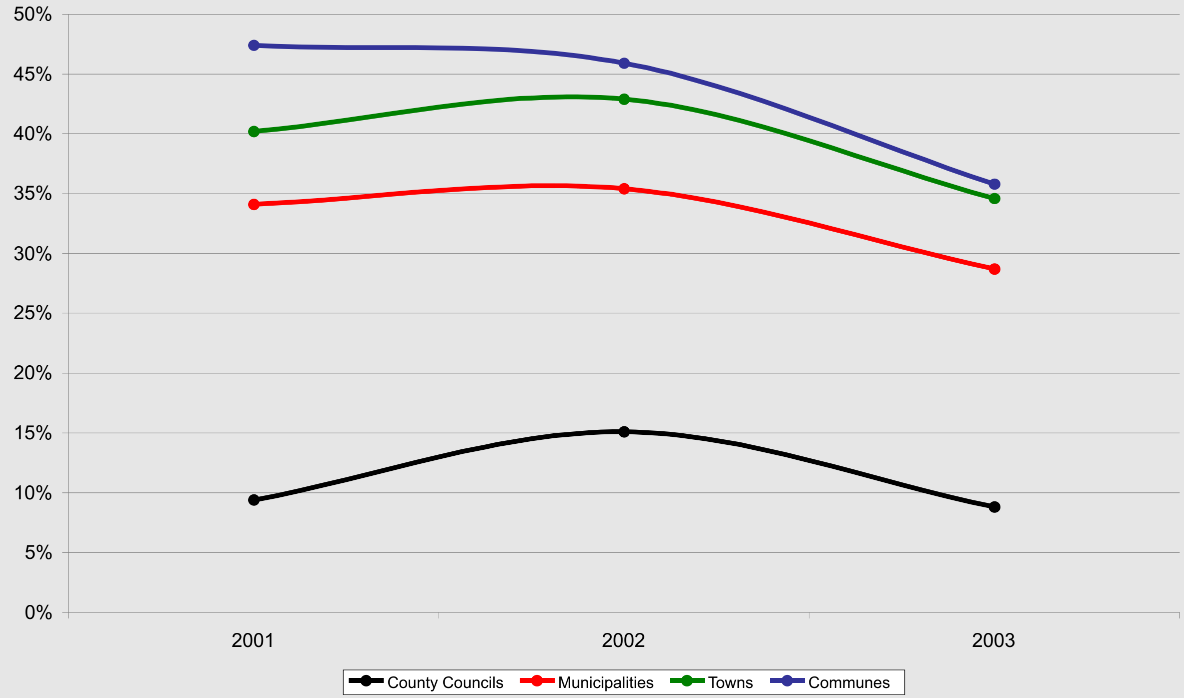


Diagram 3.2.15. Evolution of sums deducted from VAT for local budgets between 2001-2003 (ROL in constant value per total LG)



Sums deducted from VAT for local budgets	**2001**	**2002**	**2003**
County Councils (% of County Councils total revenues)	9,4%	15,1%	8,8%
Municipalities (% of municipalities total revenues)	34,1%	35,4%	28,7%
Towns (% of towns total revenues)	40,2%	42,9%	34,6%
Communes (% of communes total revenues)	47,4%	45,9%	35,8%

Diagram 3.2.16. Evolution of weight of sums deducted from VAT for local budgets, between 2001-2003

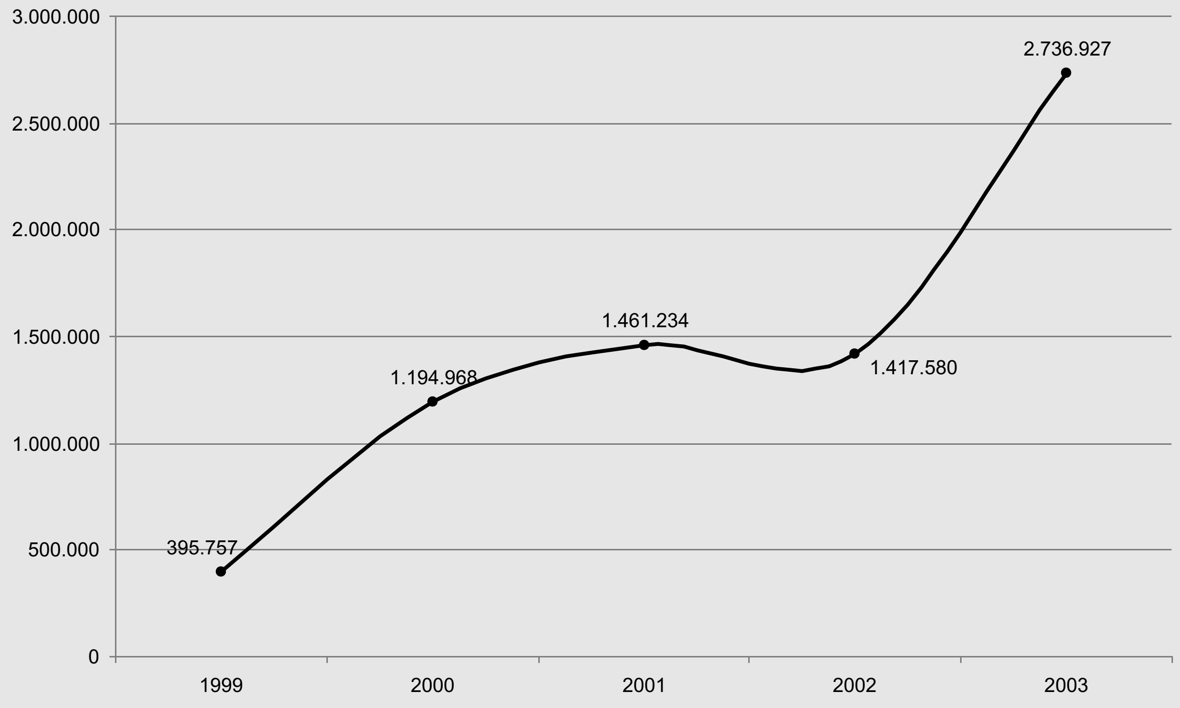
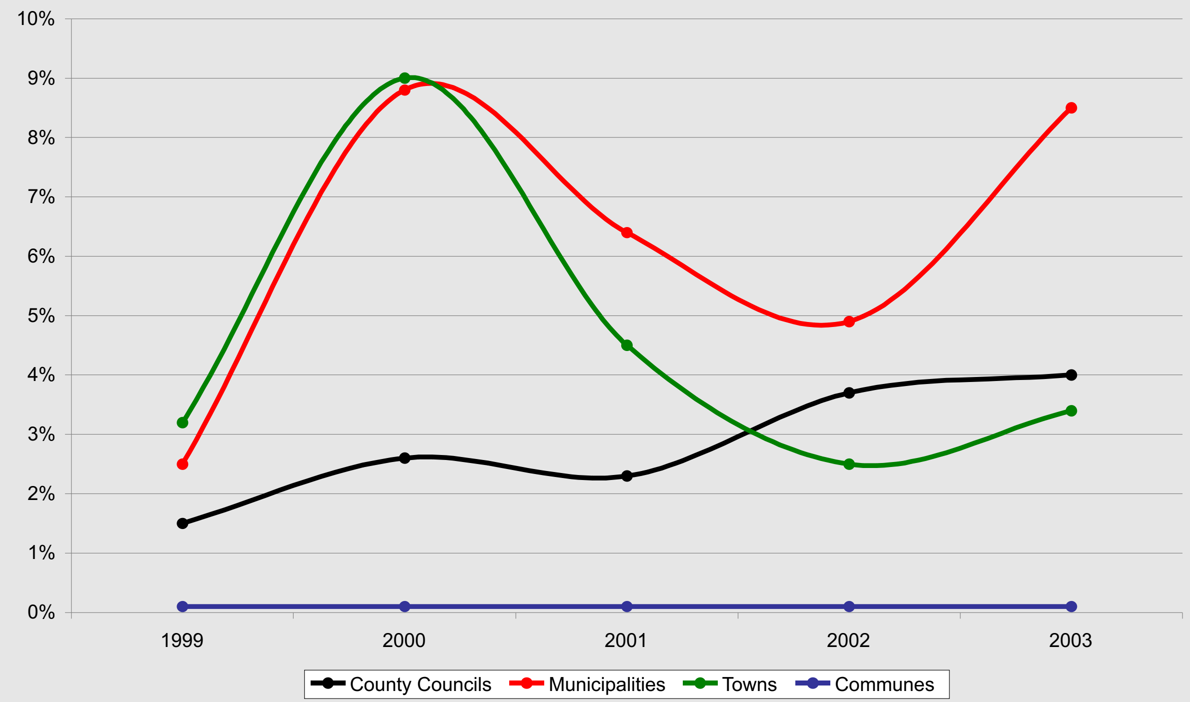


Diagram 3.2.17. Evolution of sums deducted from PIT/VAT to subsidize heating, per total LG, between 1999-2003 (ROL in constant value)



Sums deducted from PIT/VTT to subsidize heating	1999	2000	2001	2002	2003
County Councils (% of County Councils total revenues)	1,5%	2,6%	2,3%	3,7%	4,0%
Municipalities (% of municipalities total revenues)	2,5%	8,8%	6,4%	4,9%	8,5%
Towns (% of towns total revenues)	3,2%	9,0%	4,5%	2,5%	3,4%
Communes (% of communes total revenues)	0,1%	0,1%	0,1%	0,1%	0,1%

Diagram 3.2.18. Evolution of weight of sums deducted from PIT/VAT
to subsidize heating, by type of LG, between 1999-2003

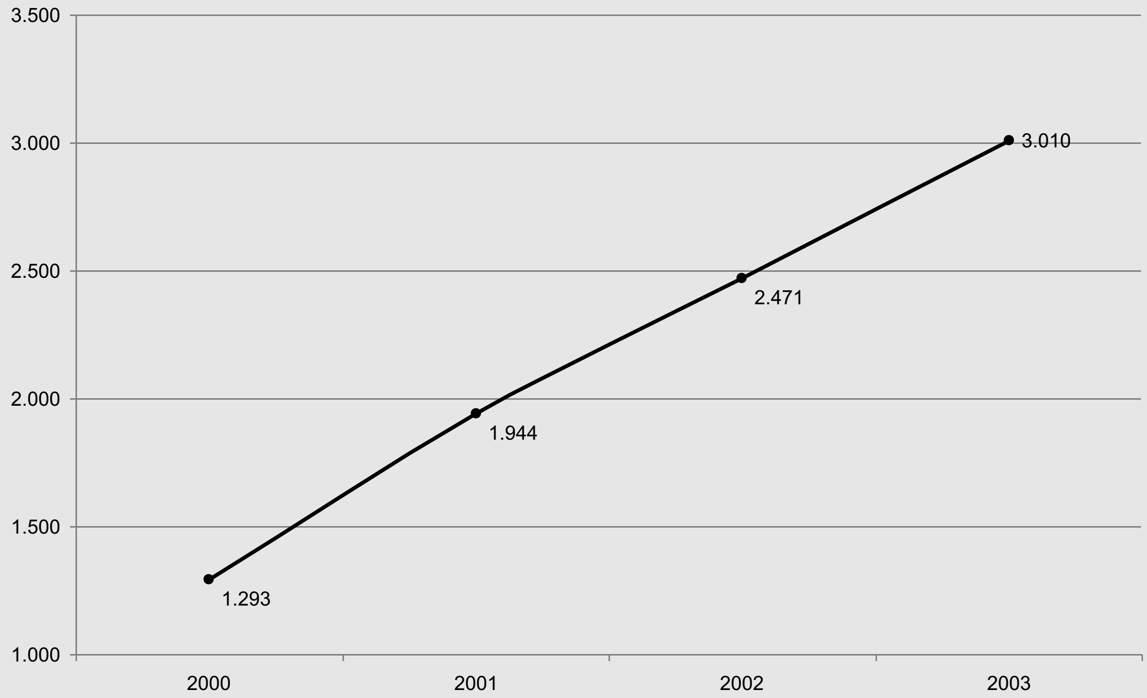


Diagram 3.2.19. Evolution of sums deducted from PIT and allocated by the CC for the equalization of local budgets (ROL in constant value)

value in 2003, which represents a 233% increase (Diagram 3.2.19.)

The sums deducted from the income tax for local budget equalization. Between 2000 -2004 certain amounts were allocated from the central budget for local budget equalization, amounts which increased from 2,373,699 million ROL in constant value in 2000 to 8,176,445 million ROL in 2003; the amount for 2000 represented 10% of the local government total revenues whereas the sum for 2003 represented 15% of the local government total revenues. The examination of the sum distribution per type of local government unit reveals the fact that commune budgets have received the highest amount from this revenue category, i.e. 56% of the total sum in 2000 and 46% in 2003, the weight of this type of revenue in the total revenues of communes being 30% in 2000, as much as in 2003 (Diagram 3.2.20).

If we analyze the amounts derived from the central budget transfers, from the sums deducted from the VAT, the sums deducted from the income tax for local budget equalization and the sums deducted from the PIT share available to the county council for equalization purposes, we reach the conclusion that at the entire local government level the weight of these revenues in the total local government revenues has grown from 13% - its value in 1999 to 52% - its value in 2003.

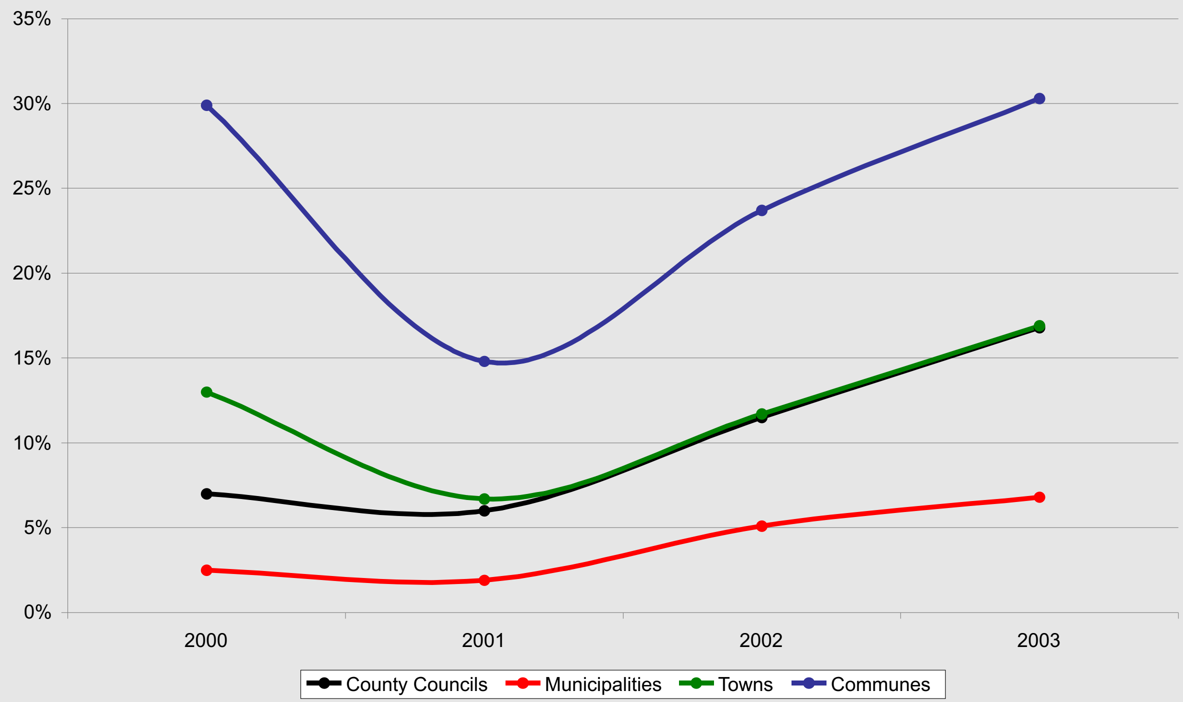
Conclusions:

- The total local budget revenues have recorded a significant growth of 240% (calculated by converting the sums in ROL in constant value) in the timeframe 1999-2003
- The weight of the revenues derived from local taxes and fees and from the share deducted from the PIT in the total local budgets has decreased, in favor of the specific-purpose grants (prevailingly) and the equalization grants
- The level of local government fiscal autonomy was diminished, with respect to the formulation of an autonomous fiscal policy in relation to local taxes and fees, by the gradual but strong diminution of the variation margins in the levels of such taxes, which the local authorities are empowered to decide upon

- New responsibilities have been transferred onto the local government,

Equalization grants

The weight of the revenues derived from local taxes and fees and from the share deducted from the PIT has diminished in the total local budgets, in favor of the special-purpose grants (mainly) and of the equalization grants.



Sums deducted PIT and allocated by the CC for the equqlization of local budgets	**2000**	**2001**	**2002**	**2003**
County Councils (% of County Councils total revenues)	7,0%	6,0%	11,5%	16,8%
Municipalities (% of municipalities total revenues)	2,5%	1,9%	5,1%	6,8%
Towns (% of towns total revenues)	13,0%	6,7%	11,7%	16,9%
Communes (% of communes total revenues)	29,9%	14,8%	23,7%	30,3%

Diagram 3.2.20. Evolution of weight of sums deducted from PIT and allocated by the CC for the equalization of local budgets between 1999-2003

LG type/ Financial year	**1999**	**2000**	**2001**	**2002**	**2003**
County Councils	9%	15%	25%	39%	41%
Municipalities	6%	12%	44%	49%	46%
Towns	21%	30%	56%	62%	59%
Communes	36%	44%	71%	76%	74%

Table 3.2.2. Weight of transfers from the central budget (sums deducted from PIT/VAT) in the total revenues, by category of LG

Revenues from sums deducted from the income tax, the VAT and the share of PIT available to the CC (% of total revenues)/ Financial year	**1999**	**2000**	**2001**	**2002**	**2003**
County Councils	22%	26%	15%	16%	18%
Municipalities	18%	24%	41%	40%	41%
Towns	12%	10%	9%	9%	8%
Communes	48%	40%	35%	35%	33%

Table 3.2.3. Weight of the distribution of revenues from sums deducted from the income tax, the VAT and the share of PIT available to the CC

hence the local budget weight has increased in the GDP and in the public sector total spending. These new responsibilities have been transferred particularly in the field of education and social protection. Unfortunately, not always have these transfers been accompanied by the matching financial resources.

- ✍ There are huge discrepancies of the general-purpose revenues, especially prior to equalization, between the municipalities (county-seat cities) and the rural localities. This is also reflected in the provision of public services, as their volume and diversity vary a lot between urban and rural areas.
- ✍ The equalization transfers (grants) go prevailingly towards the commune local councils (due to their low-level own revenues which are the consequence of their economic underdevelopment) and towards county councils due to the existing gap between the responsibilities transferred onto the latter (mainly in the field of social protection) and their general financial resources (revenues derived from the local taxes and fees and the share deducted from the PIT)
- ✍ Although the legislation stipulates the same types of responsibilities for communes, towns and cities (municipalities), the extent of the financial effort to provide the financing for such responsibilities yields the number of the respective public service beneficiaries as well as the means to provide those services
- ✍ There is no common database to include standard costs or indicators according to which the volume of the funds needed could be assessed, to finance the responsibilities for each local government unit category so that at least a minimum local government financing be assured, irrespective of the LG type or area. Likewise, there is no common database at national level to include the local taxes and fees, so that the substantiation of the equalization transfers be made in realistic terms.
- ✍ From the standpoint of the way in which the local budgets are determined, monitored, collected and controlled, one can say that the application of the local autonomy principle (by the transfer of competences related to local taxes and fees at local government level) has led to a significant increase in the collection of revenues derived from such sources and also to an increase of the collection rate.

3.2.2. The analysis of the local budget expenditures

According to the changes in the responsibilities which were assigned to the local government in this interval, the expenditure analysis has revealed a few very important features, which are described in the following paragraphs.

The evolution of local government total expenditures. The steady and significant growth of the local budget total expenditures by 243.1% for the whole period under scrutiny 1999-2003 (Diagram 3.2.21 illustrates the trend of the total amounts as ROL in constant value for the period examined). This positive phenomenon represents the cumulated effect of the fiscal decentralization process begun in 1999, of the constant transfer of new responsibilities (mainly the payment of salaries to the teaching staff in pre-university education starting with 2001) and of the economic growth process begun at the end of 1999, continued and accelerated throughout 2000 2003.

One does note positive rates of growth, though quite uneven, during the entire period, for all the items of local budget expenditures, as well as for different types of local government: county councils, municipalities (cities), towns and communes (see Diagram 3.2.22).

The evolution of staffing expenditures. In this interval a spectacular growth of the weight of the staffing expenditures took place, from 16% in 1999 to 36% in 2003, with a peak of 42% in 2001. This was particularly influenced by the transfer of the expenditures generated by the payment of the pre-university education staff salaries as of 2001 (see Box 3.2.4. on the evolution of the LG expenditure items).

The evolution of material and service expenditures. The steady but strong drop in the weight of the materials and services expenditures between 1999-2003, from 37% in 1999 to as little as 25% in 2003, with a peak of 38% in 2000. The same trend was recorded by the transfers and subsidies-related expenditures. These variations were due to the structural changes which took place in the whole set of local government expenditures in 2001. One has to note that in absolute terms these types of expenditures had a positive evolution, lower though than the total expenditures (Diagram 3.2.25).

The evolution of the social protection expenditures. The strong growth of the social

Total local government expenditures

In the interval between 1999 2003 a steady and significant growth of the total local government expenditures took place.

1991 -1992

- ✍local government
- ✍social protection
- ✍public services and development
- ✍transportation
- ✍other expenditures

Over the next period, the following responsibilities are added to the local government burden:

1993 -1994

- ✍healthcare

1997 - county council level

- ✍financing the special needs children protection system

1998

- ✍the healthcare-related expenditures are much reduced
- ✍responsibilities for financing local-interest airports and some cultural institutions are transferred to the local government

1999 -2000

- ✍plant protection
- ✍veterinary activities

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Box 3.2.4. Local government items/chapters of expenditure

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✍agricultural consultancy centers
✍subsidies for the heating (user) charges
✍payment to the personal assistants of people with disabilities

2001

✍pre-university education
✍minimum income guarantee
✍day-care centers

2002

✍new cultural and religious institutions
✍heating allowance
✍dairy and bakery products program for primary school children

2003

✍payment to the people with disabilities (the financing source comes from the National Authority for the Protection of the Disabled)
✍financing the local-interest public health units and the socio-medical institutions set up with the approval of the respective local government units

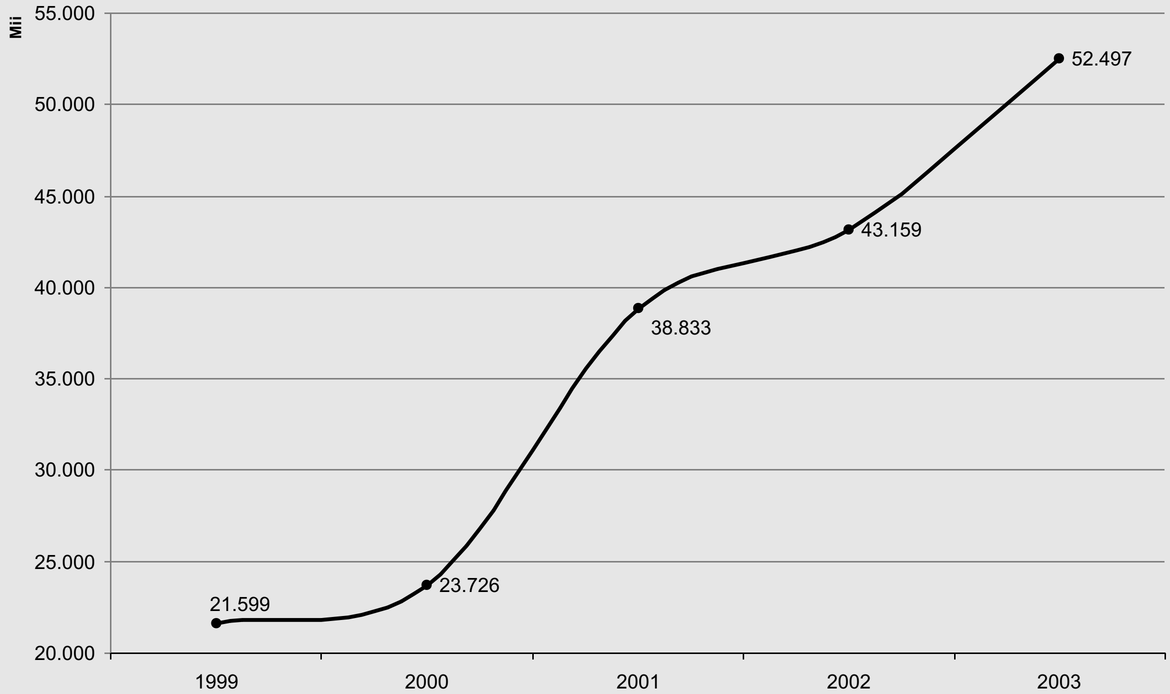
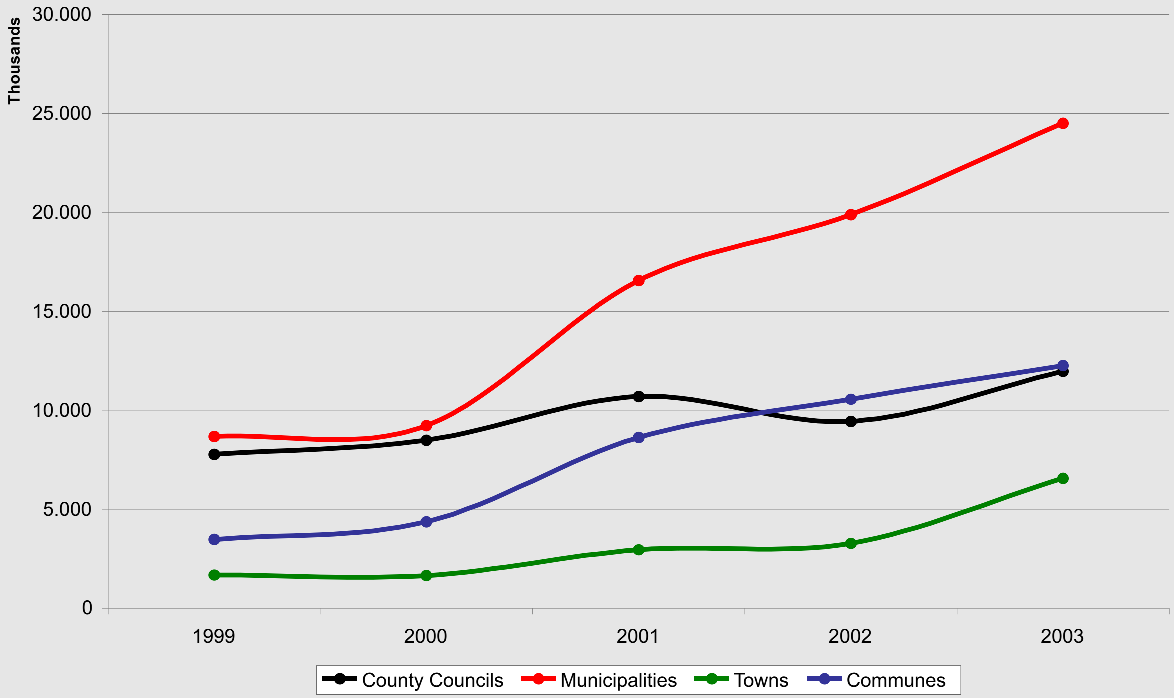


Diagram 3.2.21. Evolution of total LG expenditures between 1999-2003 (ROL in constant value)



Total expenditures by type of LG	1999	2000	2001	2002	2003
County Councils	7.775.067	8.489.797	10.692.257	9.438.897	11.976.409
Municipalities	8.673.005	9.226.418	16.558.948	19.877.703	24.505.437
Towns	1.674.174	1.646.281	2.953.338	3.279.794	6.565.778
Communes	3.477.033	4.363.693	8.628.103	10.562.665	12.260.669

Diagram 3.2.22. Evolution of total expenditures by type of LG between 1999-2003 (ROL in constant value)

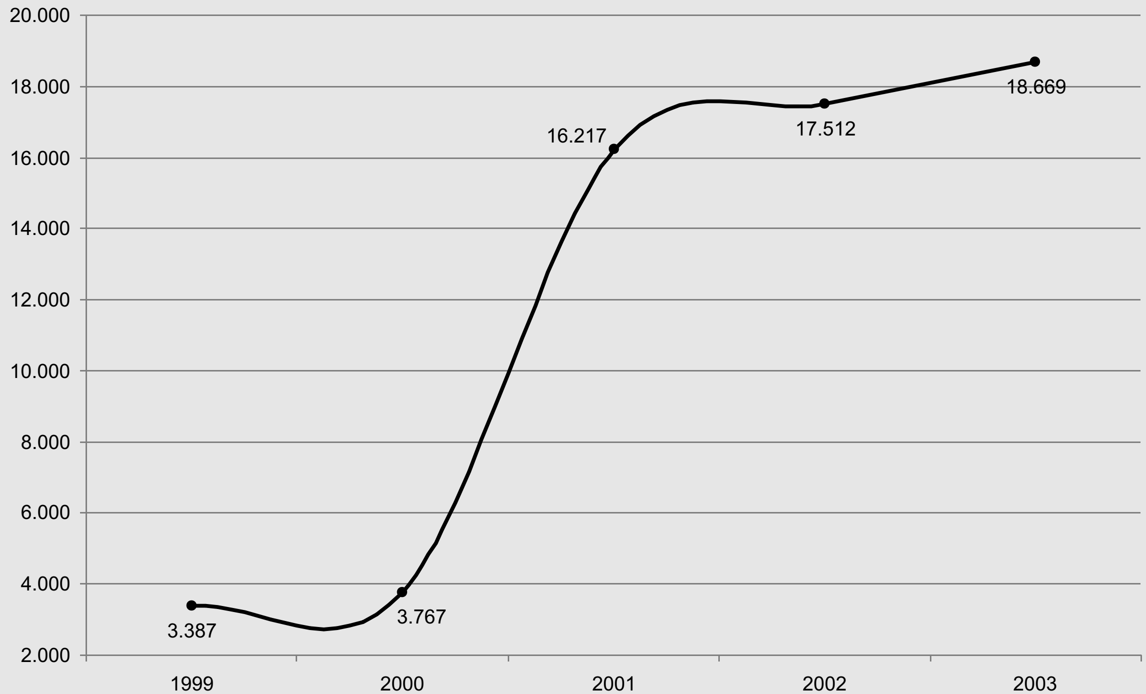
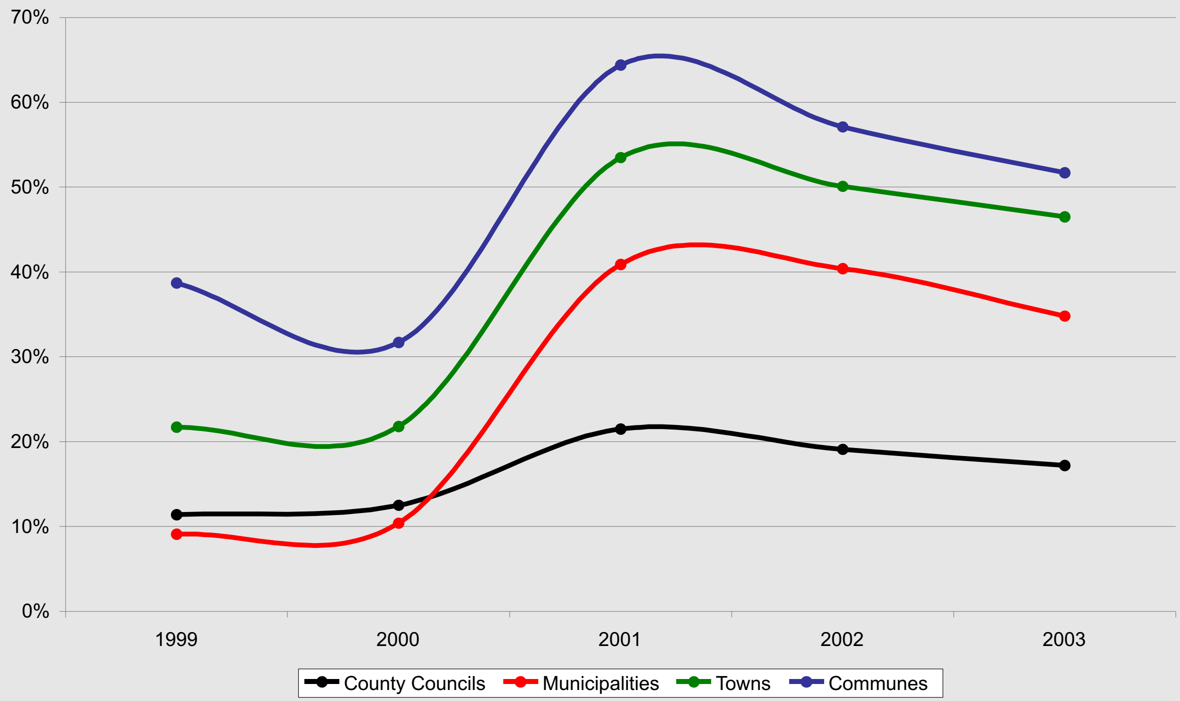


Diagram 3.2.23. Evolution of staffing expenditures per total LG between 1999-2003



Staffing expenditures	**1999**	**2000**	**2001**	**2002**	**2003**
County Councils (% of County Councils total revenues)	11,4%	12,5%	21,5%	19,1%	17,2%
Municipalities (% of municipalities total revenues)	9,1%	10,4%	40,9%	40,4%	34,8%
Towns (% of towns total revenues)	21,7%	21,8%	53,5%	50,1%	46,5%
Communes (% of communes total revenues)	38,7%	31,7%	64,4%	57,1%	51,7%

Diagram 3.2.24. Evolution of the weight of staffing expenditures, by type of LG, between 1999-2003

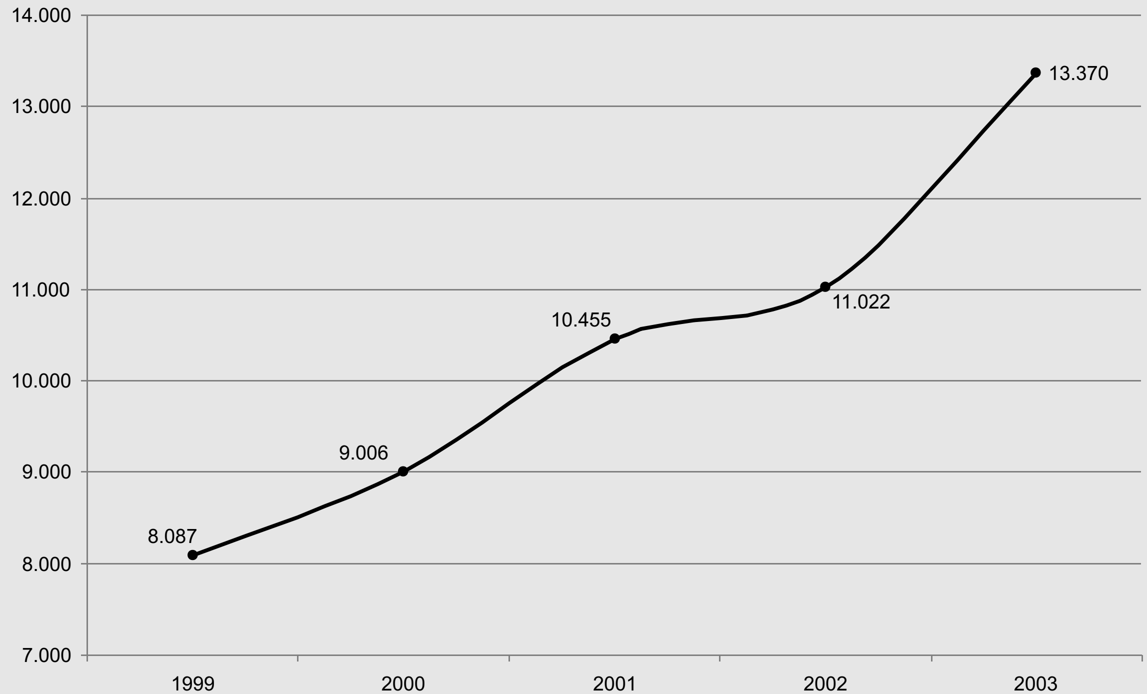


Diagram 3.2.25. Evolution of material and services expenditures per total LG between 1999-2003

protection expenditures which represented 15.2% in 2003 as against 11.5% in 1999. A worrisome aspect is worthwhile being mentioned here: in 2003 the social protection expenditures had a weight higher by over 1% in relation to the investment expenditures (14%) in the total local government expenditures (Diagram 3.2.26. and Diagram 3.2.27.)

Local government investment-related expenditures

In the 1999 2003 interval a major growth of the social protection-related expenditure was reported as well as a slow but constant drop in the weight of the investment-related expenditures in the total local government spending.

The evolution of the investment expenditures. The slow but steady decrease of the investment expenditures in the 1999-2003 interval: a 22% weight in 1999 and only 14% in 2003. If we wish to assess the local government own effort with respect to investments, we can deduct from the total weight of investments the weight of special-purpose expenditures, which are to an overwhelming extent specific-purpose transfers (grants) for central budget investments. We can notice that in this interval the local government own effort has varied from 12.52% in 1999 to 10.83% in 2003. These trends reflect the very high pressure put by the social protection expenditures on the local budgets. Generally speaking, these expenditures are very rigid, which makes the local government units equalize their budgets by cutting on the new investments and putting off the existing ones. This phenomenon does nothing but increase the total real investment costs within the infrastructure of local public utilities-related services.

The evolution of the expenditures on public services, development and housing. The weight of the public services, development and housing-related expenditures has dropped significantly from 36% in 1999 to 25% in 2003. A similar phenomenon occurred in the case of the public transportation-related expenditures: 11.7% in 1999 and not more than 7.5% in 2003.

The fact that the main beneficiary of the significant increase in real terms of the local budget expenditures was the social protection item (chapter) to the obvious detriment of the local public utilities-related expenditures and particularly to the detriment of investments is both worrying and relevant. This situation was caused by the transfer to the local government of certain additional responsibilities in the field of social protection, which were not accompanied by adequate financial resources, although this transfer had relieved the central budget.

The Government has continued to transfer to the local government various

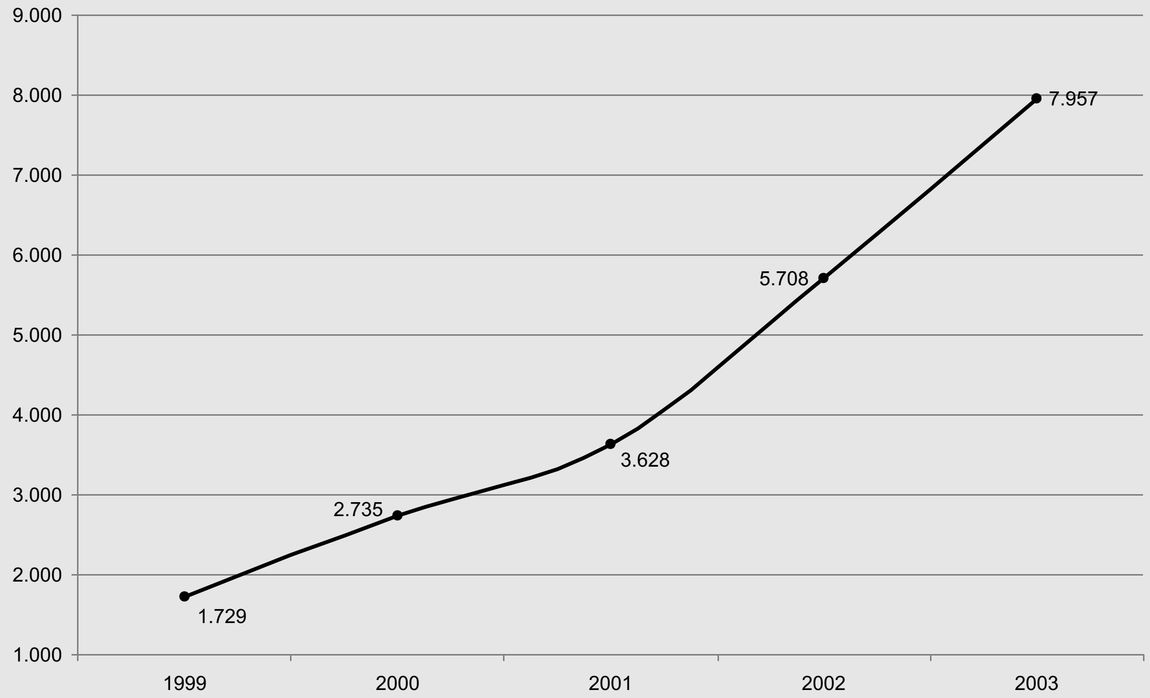
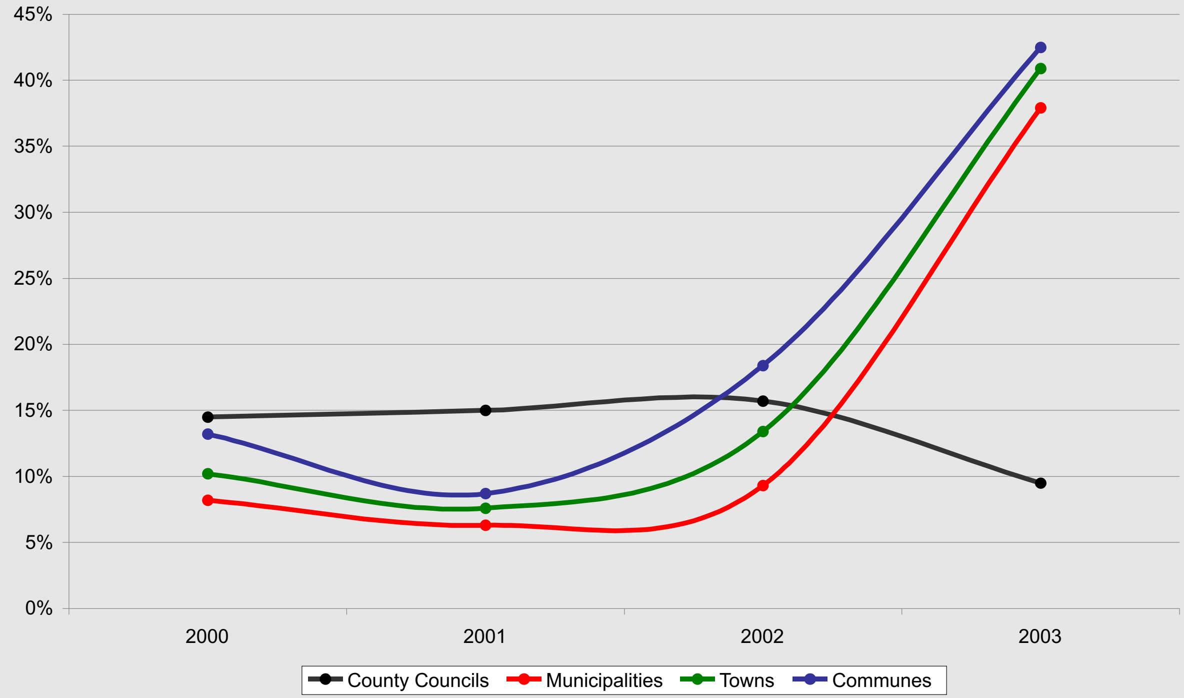


Diagram 3.2.26. Evolution of social protection expenditures per total LG between 1999-2003



Social protection expenditures	**2000**	**2001**	**2002**	**2003**
County Councils (% of County Councils total revenues)	14,5%	15,0%	15,7%	9,5%
Municipalities (% of municipalities total revenues)	8,2%	6,3%	9,3%	37,9%
Towns (% of towns total revenues)	10,2%	7,6%	13,4%	40,9%
Communes (% of communes total revenues)	13,2%	8,7%	18,4%	42,5%

Diagram 3.2.27. Evolution of the weight of social protection expenditures per total LG between 1999-2003

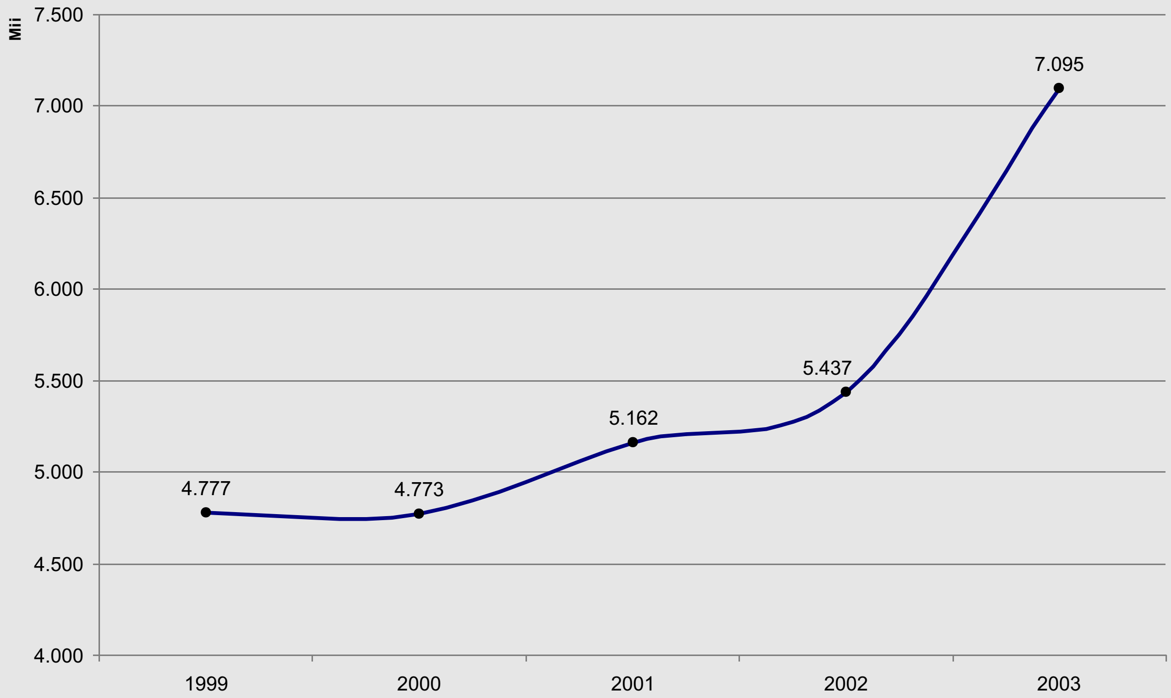
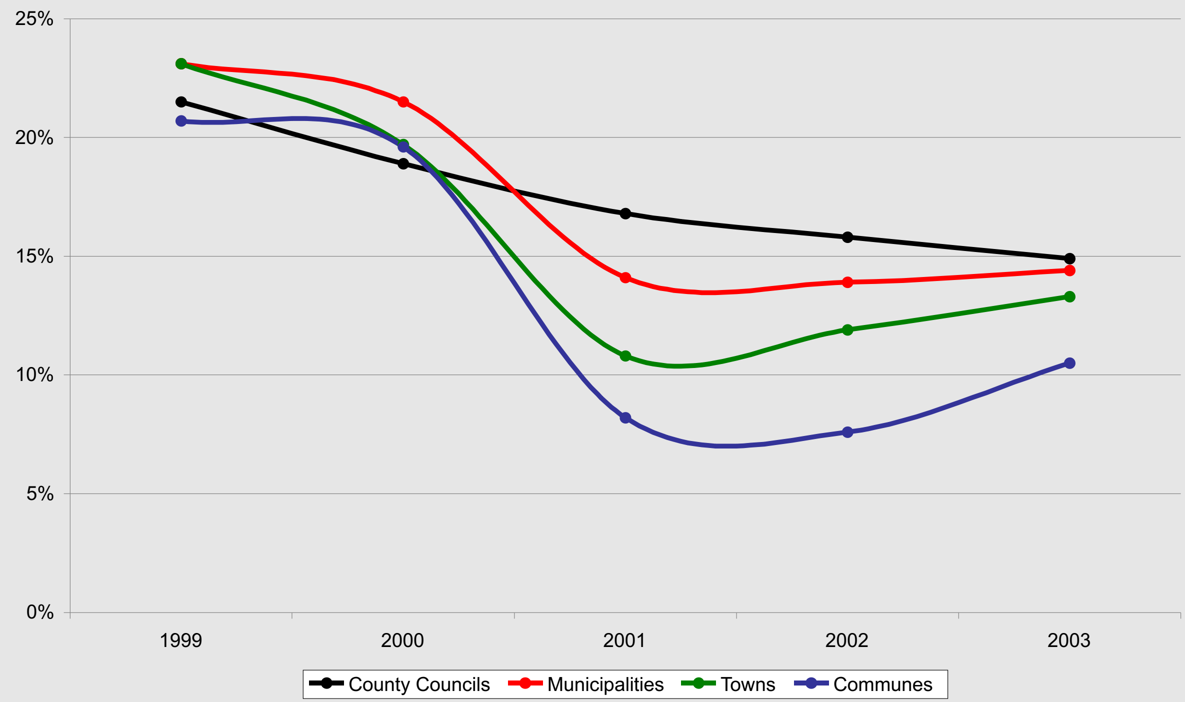


Diagram 3.2.28. Evolution of capital expenditures, by total LG, between 1999-2003 (ROL in constant value)



Capital expenditures	**1999**	**2000**	**2001**	**2002**	**2003**
County Councils (% of County Councils total revenues)	21,5%	18,9%	16,8%	15,8%	14,9%
Municipalities (% of municipalities total revenues)	23,1%	21,5%	14,1%	13,9%	14,4%
Towns (% of towns total revenues)	23,1%	19,7%	10,8%	11,9%	13,3%
Communes (% of communes total revenues)	20,7%	19,6%	8,2%	7,6%	10,5%

Diagram 3.2.29. Evolution of the weight of capital expenditures, by type of LG, between 1999-2003

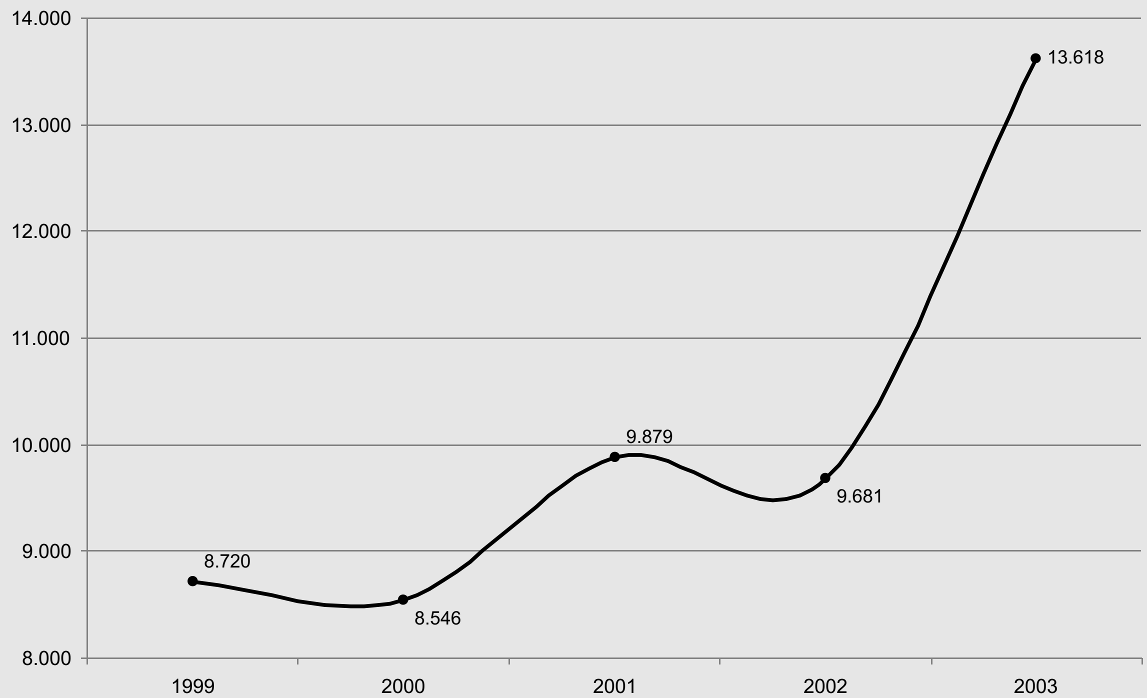
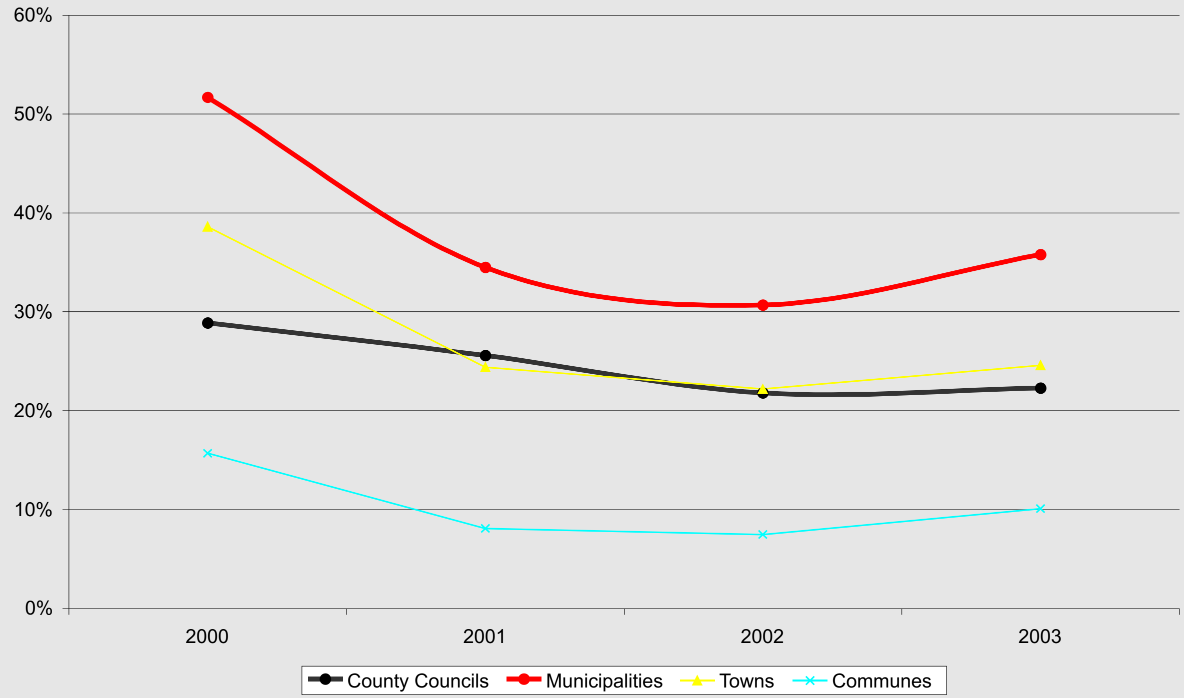


Diagram 3.2.30. Evolution of the public services, development and housing expenditures, per total LG, between 1999-2003 (ROL in constant value)



Public services, development and housing expenditures, by type of LG, between 1999-2003	2000	2001	2002	2003
County Councils (% of County Councils total revenues)	28,9%	25,6%	21,8%	22,3%
Municipalities (% of municipalities total revenues)	51,7%	34,5%	30,7%	35,8%
Towns (% of towns total revenues)	38,6%	24,4%	22,2%	24,6%
Communes (% of communes total revenues)	15,7%	8,1%	7,5%	10,1%

Diagram 3.2.31.Evolution of the weight of public services, development and housing expenditures, by type of LG, between 1999-2003

responsibilities, without matching them to the adequate resources, especially in the area of social protection. This becomes apparent if we try to assess the arrears at local government level. In spite of the great difficulties generated by the type of public accounting (the cash-based accounting instead of the commitment/engagement-based accounting) used, we can still say that the vast majority of local government arrears were generated by the social protection-derived expenditures: arrears to the settlement of the heating price subsidy and of the local public transportation price subsidy, arrears to the settlement of heating money allowances (cash benefits), arrears to the payment of the minimum income guarantee and of the salaries for the disabled' personal assistants, etc.

The application of Law No. 416/2001 on the minimum income guarantee has highlighted several aspects:

- ✍ There are no accurate assessments of the total volume of resources needed for the application of the Law and especially of the share which belongs to the central government and the share which belongs to the local government one talks about 80% funding from the state budget and 20% from the local budget. This is one of the reasons why few localities (from urban areas, mainly municipalities/cities) have provided in their local budgets the financial resources to cover their share from the sums needed to apply Law No. 416/2001.
- ✍ The budget balance is already being questioned, as the Government has extended permanently the granting of cash benefits for heating according to the former eligibility criteria based on the income levels, in force in 2001.

As a matter of fact, many of the local government responsibilities in the social field (the minimum income guarantee) are being financed through a kind of “matching grant” which operates in a flawed manner. The system used in Romania is based on a certain co-financing that lacks the expenditure-stimulation mechanism for the particular field thus financed. In compliance with the international practice and the theory specific to this topic, this type of financing is inadequate. Social protection, especially if it is expressed as cash benefits, must be financed one hundred percent by the central government, even if they are distributed (allocated) by the local government. This is an absolute must for the provision of universal rights and homogeneous services. Otherwise, and the Romanian practice in place is proof of that, the legal beneficiaries of these rights get them according to the financial resources available or to the local government will, which situation sets

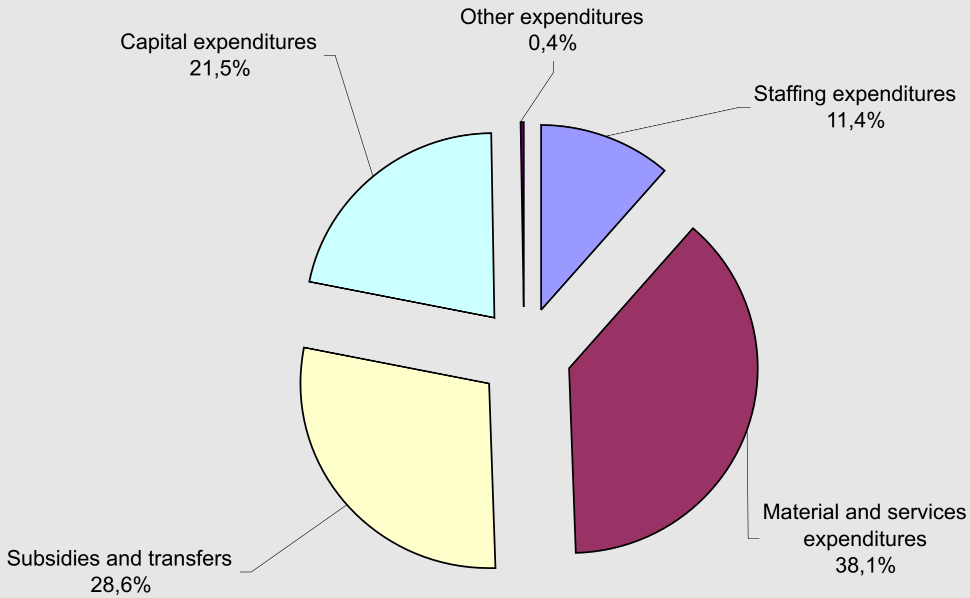


Diagram 3.2.32. Structure of CC expenditures in 1999

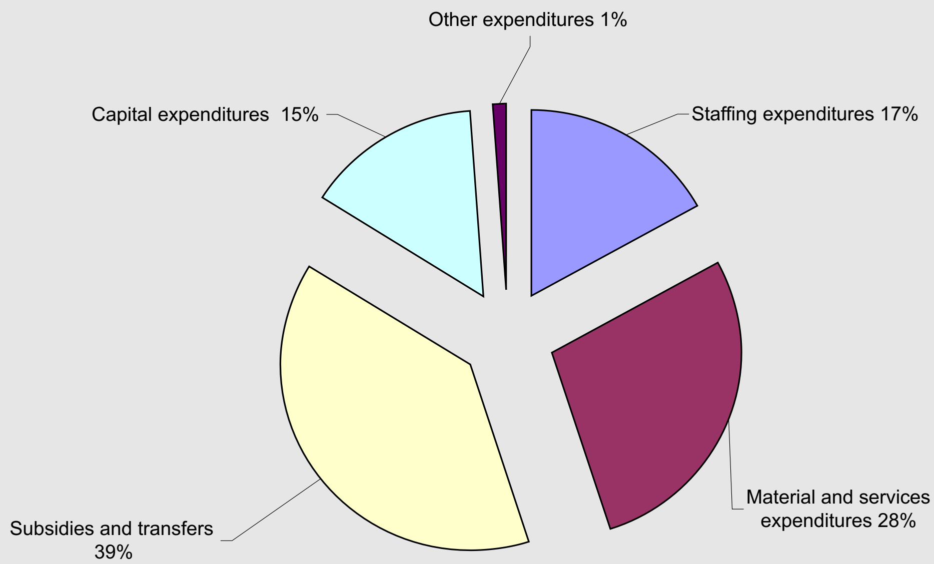


Diagram 3.2.33. Structure of CC expenditures for 2003

the premises of an unacceptable discrimination.

Conclusions

- The overall local government expenditures have followed the upward trend of the transfer of new responsibilities to the local government, also reflected by their evolution in the GDP in the 1999-2004 timeframe
- The examination of the local government expenditure structure organized by type of councils (county, municipal, town and commune) reveals the major distinction between the urban and the rural areas. Thus, the county and the municipal councils have high weights of the expenditures which reflect the public service and the infrastructure modernization (investments) costs. The local councils from small towns and the ones from rural areas have very high weights of the expenditures generated by local government operation and the staffing expenditures. The case-studies to be presented later on will describe all this in detail (see Section 4. *The analysis of the case-study locality budgets*).
- There is a clear tendency to increase the weight of the staffing and social protection expenditures to the detriment of the expenditures generated by local public utilities and the investment-related expenditures. Under the circumstances specific to Romania, especially in the rural areas, this evolution raises a lot of doubts as to the local government ability to modernize its infrastructure.
- The precise evaluation of the local government arrears is difficult to undertake due to the type of public accounting used at present (cash-based). The E.G.O. No. 45/2003 introduces the first elements of the engagement-based public accounting, but this system must be extended and generalized. The social protection expenditures of the cash benefits type must be transferred to the central government, whereas the local government must be left only with the responsibility of in-kind benefits (social services).

Revenues derived from local taxes and fees

For the budgets of the county-seat municipal cities under scrutiny, the revenues derived from local taxes and fees are more important than the share deducted from the PIT, distributed according to its collection area.

Notes :

[1] all the diagrams (except for Diagram 3.7) presented in this material have as data source the information sent to the IPP by the Ministry of Public Finances. For Diagram 3.7. Weight of arrears in the total expenditures for 2003 at county level, the data source is the Ministry of Public Administration and Internal Affairs.

[2] the 16% flat tax applied to the PIT as of 2005 is expected to impact the local budgets especially in the first half of the year (April May, July August) and less so in March, June, September due to the collection deadlines for the local taxes and fees.

[3] for a more detailed presentation of the specific issues that have been appraised as being improved following the application of the E.G.O. No. 45/2003, see Section 2. *Evaluation criteria for the budget equalization system*. The data on local government for 2004 are included in Annex 1. Local government revenues and expenditures for 2004 (second quarter). For 1999, The Ministry of Public Finances has supplied data for each type of local government, regarding the following items of expenditure: local government, education, culture, social protection, services and public development, housing, transportation and communications.

4. The analysis of the case-study locality budgets

The analysis of the local budgets belonging to the targeted localities in Arad, Calarasi, Dambovita, Prahova, Suceava and Timis counties helps us be more specific and describe much better the area for which we have made the proposal to improve the equalization sum allocation formula. This analysis, although not very extensive, offers a far more complete picture of the situation in which various localities (county-seats, cities, towns, poorer or wealthier communes) from the counties selected for the case-studies find themselves in. The indicators used for the purposes of this analysis are included in Box 4.1..

4.1. The horizontal analysis

4.1.1. The analysis of the county-seat municipal budgets

One can easily notice that the per capita values of the three revenue indicators (LOR=revenues derived from local taxes and fees, LR=Local Revenues, OR=Own Revenues) are grouped according to the status given to the county at the time it was selected for the case-study. Thus, we are dealing with high values for the county-seat cities (municipalities) in the counties considered wealthier (Prahova and Arad), somewhat lower values but rather close to the first group in the case of Targoviste Municipality (the county-seat of an average county) and much lower values (especially for the LR and OR which also include the share deducted from the PIT) for the county-seat cities (municipalities) in the poorer counties (Calarasi and Tulcea). One has to note that in the case of the LOR (revenues derived from local taxes and fees) the differences are much smaller, which fact reflects equally small differences in the level of taxation; this phenomenon was generated by a contraction of local government autonomy in this field, between 2002-2003; it is also worthwhile noting that variation in the collection level is small and the internal uniformity of the county-seat municipalities is large. All this is also due to the way in which the property tax is calculated, which tax does not take into account the market value of land and buildings, but the technical indicators, common to all the local government units of the same category.

The autonomy level of county-seat municipalities (cities) varies pretty much, from 62.06% in the case of Ploiesti Municipality to only 38.79% in the case of Targoviste. This

Locality	County	Year	Population	Weight of local own revenues in the total budget	Weight of local revenues in the total budget	Weight of own revenues in the total budget	Weight of local own revenues in the local revenues
Arad	Arad	2003	171.330	21,23%	42,20%	42,38%	50,32%
Arad	Arad	2004	171.330	28,23%	55,19%	56,64%	51,15%
Călăraşi	Călăraşi	2003	73.720	30,86%	44,88%	44,88%	68,76%
Călăraşi	Călăraşi	2004	73.720	46,52%	60,59%	61,07%	76,77%
Târgovişte	Dâmboviţa	2003	91.281	21,79%	38,79%	39,62%	56,18%
Târgovişte	Dâmboviţa	2004	91.281	25,93%	48,09%	48,77%	53,92%
Ploieşti	Prahova	2004	236.724	35,98%	62,06%	62,86%	57,98%
Tulcea	Tulcea	2003	95.266	23,01%	41,49%	41,49%	55,47%
Tulcea	Tulcea	2004	95.266	22,01%	40,24%	40,38%	54,70%
Suceava	Suceava	2003	108.144	25,99%	47,35%	47,49%	54,89%

Table 4.1. Weight of local revenue categories in the total budget for the county-seat municipalities in the case-study counties

Locality	County	Year	Population	Public authorities expenditures in the local own revenues	Public authorities expenditures in the local revenues	Public authorities expenditures in the own revenues	Local own revenues/ inhabitant	Local revenues/ inhabitant	Local revenues / inhabitant
Arad	Arad	2003	171.330	20,70%	10,42%	10,37%	1.772.588	3.522.551	3.537.631
Arad	Arad	2004	171.330	27,13%	13,88%	13,52%	2.198.436	4.297.776	4.410.749
Călăraşi	Călăraşi	2003	73.720	16,95%	11,65%	11,65%	1.808087	2.629.559	2.629.559
Călăraşi	Călăraşi	2004	73.720	10,44%	8,01%	7,95%	3.248.481	4.231.455	4.264.907
Târgovişte	Dâmboviţa	2003	91.281	12,67%	7,12%	6,97%	1.862.612	3.315.141	3.386.350
Târgovişte	Dâmboviţa	2004	91.281	13,54%	7,30%	7,20%	2.166.853	4.018.279	4.074.807
Ploieşti	Prahova	2004	236.724	11,49%	6,66%	6,58%	2.739.900	4.725.334	4.785.991
Tulcea	Tulcea	2003	95.266	16,00%	8,88%	8,88%	1.455.899	2.624.698	2.624.698
Tulcea	Tulcea	2004	95.266	20,53%	11,23%	11,19%	1.647.618	3.012.218	3.022.715
Suceava	Suceava	2003	108.144	37,11%	20,37%	20,31%	2.027.204	3.693.501	3.704.450
Suceava	Suceava	2004	108.144	20,10%	13,87%	13,77%	4.119.646	5.970.881	6.011.993

Table 4.2. Weight of financing the public authorities-related expenditures from the local government local revenues and the local revenues level per capita for the county seat municipalities in the case-study counties

- ✍ Local own revenues (LOR) are the sum total of current and capital revenues generated by a local government, namely those revenues upon which the latter holds the utmost control, and they reflect the local economic potential, the financial/fiscal policy decided by the local government and the quality of its financial management with respect to the determination and collection of local taxes and fees. The LOR per capita version enables us to draw vertical comparisons (among localities of different sizes and different status: urban versus rural) or horizontal comparisons (among localities of the same status, but belonging to different counties).
- ✍ Local revenues (LR) are the sum total of the local own revenues (LOR) and the share deducted from the PIT related to the collection area. These revenues reflect the capacity of the local economy to generate revenues from the number of jobs and salaries, the local fiscal policy (the level of local taxes and fees and their collection rate). The LR per capita version enables us to draw vertical comparisons (among localities of various sizes and different status: urban versus rural) or horizontal comparisons (among localities of the same status, but belonging to different counties).
- ✍ Own revenues (OR) are the sum total of local revenues (LR) and the sums received for equalization purposes from the county council, according to the fund made up of the 17% share of the PIT collected at county level. The OR per capita version enables us to draw vertical comparisons (among localities of various sizes and different status: urban versus rural) or horizontal comparisons (among localities of the same status, but belonging to different counties).
- ✍ The weight of local own revenues in the total budget this indicator measures the significance of these revenues within the local budget, the degree of autonomy of the local government in question, as these are revenues the local government has quite a large control on (it can influence the tax level, it determines the taxes and it also collects them).

next ➲

Box 4.1. Definition of indicators used in the study

next ➲

- ✍ The weight of local revenues in the total budget this indicator reflects the degree of autonomy or dependence of a local government in relation to the higher ranking public authorities (county or central).
- ✍ The weight of own revenues in the total budget this indicator reflects the significance of those revenues which one way or another have their source at local or county level.
- ✍ The weight of local own revenues in the local revenues this indicator shows whether the revenues derived from local taxes and fees or the share deducted from the PIT have a larger weight in the local budget.
- ✍ The weight of local government-related expenditures in the local own revenues
- ✍ The weight of local government-related expenditures in the local revenues
- ✍ The weight of local government-related expenditures in the own revenues

The last three indicators measure the extent to which the various types of revenues generated at local/county level cover the local government operation expenditures which as a rule hold the highest priority in the local budget structure.

Local government-related expenditures

The local budgets of the communes under examination reflect their ability to cover the local government-related expenditures, which ability varies a lot from one commune to the other, and which is much smaller than in the case of urban localities.

indicator reveals the level of vulnerability of the locality in question to the variation of the conditional or unconditional grants received from the central government and from the county council. Likewise, one has to note that the revenues derived from local taxes and fees have a greater significance than the share deducted from the PIT, which is distributed according to its collection area, especially in the case of Calarasi Municipality, where more than 2/3 of the LR are derived from these taxes (see Table 4.2.)

On the other hand, one can see that the county-seat cities (municipalities) are able to cover quite easily the expenditures generated by the local government operation, the latter's weight in the LOR ranging generally between 10%-20% while their weight in the LR and OR varies between 7%-14%.

4.1.2. The analysis of town budgets

One can notice that the values per capita of the three revenue indicators (LR, OR, LOR) are no longer grouped according to the status given to the county at the time it was selected for the case-study, but they depend upon the specific situation of the locality in question. One should mention that as far as the LOR (revenues derived from local taxes and fees) are concerned, the differences are much larger than in the case of the county-seat municipalities, which implies a far greater heterogeneousness in the situation of small towns (see Tables 4.3. and 4.4).

The autonomy level of small towns varies a lot, from 87.91% (Gaesti in 2004) and 61.53% (Fundulea in 2004) to 13.54% (Babadag in 2003). This indicator shows the level of vulnerability of the respective locality to the variation in the conditional or unconditional grants received from the central government and from the county council. Likewise, one should note that the revenues derived from the local taxes and fees have a weight in the local revenues (LR) greater than the weight of county-seat municipalities. One can easily see that the figures for 2004 are much higher than the ones for 2003 with respect to the LOR, OR and LR, namely revenues generated by the local economy and for whom the own effort is quite significant. This increase may be due to the fact that the figures for 2004 are planned while the ones for 2003 are achieved and there is quite a widespread tendency to overestimate the revenues in the planned budget so that the local authorities may access higher budget loans, even beyond their real fiscal capacity this phenomenon grows in the election years.

Locality	County	Year	Population	Weight of local own revenues in the total budget	Weight of local revenues in the total budget	Weight of own revenues in the total budget	Weight of local own revenues in the local revenues
Ineu	Arad	2003	10.037	23,52%	34,98%	36,78%	67,25%
Ineu	Arad	2004	10.037	36,03%	47,83%	52,26%	75,33%
Fundulea	Călăraşi	2003	6.570	17,03%	28,51%	30,40%	59,73%
Fundulea	Călăraşi	2004	6.570	33,23%	61,53%	62,43%	54,00%
Gaesti	Dâmbovița	2003	15.684	23,33%	87,91%	90,38%	26,54%
Gaesti	Dâmbovița	2004	15.684	24,36%	45,67%	47,91%	53,34%
Mizil	Prahova	2004	16.560	19,40%	28,27%	34,03%	68,64%
Babadag	Tulcea	2003	10.404	8,84%	13,54%	14,77%	65,32%
Babadag	Tulcea	2004	10.404	19,21%	29,49%	31,48%	65,15%
Gura Humorului	Suceava	2003	15.941	29,05%	35,11%	35,61%	82,75%

Table 4.3. Weight of local revenue categories in the total budget for the towns in the case-study counties

Locality	County	Year	Population	Public authorities expenditures in the local own revenues	Public authorities expenditures in the local revenues	Public authorities expenditures in the town revenues	Local own revenues/ inhabitant	Local revenues /inhabitant	Own revenues / inhabitant
Ineu	Arad	2003	10.037	51,30%	34,50%	32,81%	1.127.051	1.676.013	1.762.295
Ineu	Arad	2004	10.037	35,38%	26,66%	24,39%	2.611.580	3.466.757	3.788.236
Fundulea	Călăraşi	2003	6.570	113,98%	68,08%	63,84%	547.053	915.835	976.718
Fundulea	Călăraşi	2004	6.570	74,57%	40,27%	39,69%	2.377.346	4.402.643	4.466.927
Gaesti	Dâmboviţa	2003	15.684	44,05%	11,69%	11,37%	1.328.415	5.005.302	5.145.572
Gaesti	Dâmboviţa	2004	15.684	36,09%	19,25%	18,35%	1.749.184	3.279.406	3.440.717
Mizil	Prahova	2004	16.560	50,10%	34,39%	28,56%	989.493	1.441.667	1.735.688
Babadag	Tulcea	2003	10.404	77,70%	50,75%	46,51%	552.467	845.796	922.882
Babadag	Tulcea	2004	10.404	56,87%	37,05%	34,70%	754.806	1.158.497	1.236.928
Gura Humorului	Suceava	2003	15.941	67,74%	45,08%	44,62%	935.951	1.406.436	1.420.990
Gura Humorului	Suceava	2004	15.941	12,40%	8,36%	8,04%	1.492.506	2.213.917	2.302.431

Table 4.4. Weight of financing the public authorities-related expenditures from the local government local revenues and the local revenues level per capita for the towns in the case-study counties

On the other hand, one can notice that small towns are able to cover the expenditures generated by the local government operation, but the latter's weight in the LOR, LR and OR is much bigger than in the case of county-seat municipalities. This aspect reveals a relative deterioration of the local budget situation of small towns as opposed to municipalities, which is not at all surprising.

4.1.3. The analysis of communes with a high PIT per capita

We can note a high heterogeneousness in the situation of such localities, for instance: if we compare commune Blejoi (Prahova county) with commune Stejaru (Tulcea county) we see that the disparities between them are over 1:4 or 1:5, a ratio which reflects the big differences in their economic status. Likewise, we can note that in general terms the LR, OR and LOR weights in the local budget are much lower than in the case of towns and cities, which reflects the dependence of rural localities on the transfers from the central/county budget. We can equally spot the tendency towards an over-evaluation of budget revenues from local sources in 2004 as opposed to 2003 due to the reasons mentioned above (see Tables 4.5. and 4.6.).

With respect to the capacity to cover the local government-related expenditures, it is very different from one commune to the other and much lower than in the case of urban localities. There are communities which are unable to cover these expenditures from local sources (LR) Moneasa and Stejaru so they have very low means to provide the minimum range of public services needed in the rural areas.

4.1.4. The analysis of communes with an average PIT per capita

One can notice a smaller heterogeneousness than in the case of communes with a high PIT, for instance: if we compare, for 2003, commune Vulcana-Bai (Dambovita county) with commune Dor Marunt (Calarasi county) we see that the disparities between them are 1:1.5, a ratio which reflects the relatively small differences in their economic status. On the other hand, one has to highlight the fact that weight of revenues derived from local taxes and fees (LOR) in the local revenues (LR) is very high: between 74% and 95%. This implies that in these localities there are no economic activities to trigger the PIT collection. One can also note that in general terms the LOR, LR and OR weights in the local budget are much smaller than in the case of communes with a high PIT, which

Local government-related expenditures

The local budgets of the communes under examination reflect their ability to cover the local government-related expenditures, which ability varies a lot from one commune to the other, and which is much smaller than in the case of urban localities.

Locality	County	Year	Population	Weight of local own revenues in the total budget	Weight of local revenues in the total budget	Weight of own revenues in the total budget	Weight of local own revenues in the local revenues
Moneasa	Arad	2003	1.057	32,59%	36,02%	53,09%	90,47%
Moneasa	Arad	2004	1.057	29,57%	32,86%	52,30%	90,00%
Dragalina	Călăraşi	2003	8.710	9,24%	18,22%	18,22%	50,70%
Dragalina	Călăraşi	2004	8.710	14,87%	24,26%	26,26%	61,31%
I.L. Caragiale	Dâmbovița	2003	7.201	12,22%	34,57%	38,94%	35,34%
I.L. Caragiale	Dâmbovița	2004	7.201	16,31%	19,68%	24,31%	82,89%
Blejoi	Prahova	2004	7.882	51,75%	71,68%	72,48%	72,20%
Stejaru	Tulcea	2003	2.336	7,99%	11,58%	17,39%	68,93%
Stejaru	Tulcea	2004	2.336	13,67%	17,53%	24,97%	77,97%
Iacobeni	Suceava	2003	2.308	29,05%	35,11%	35,61%	82,75%

Table 4.5. Weight of local revenues in the total budget for the communes with a high PIT per capita in the case-study counties

Locality	County	Year	Population	Public authorities expenditures in the local own revenues	Public authorities expenditures in the local revenues	Public authorities expenditures in the own revenues	Local own revenues/ inhabitant	Local revenues/ inhabitant	Own revenues/ inhabitant
Moneasa	Arad	2003	1.057	103,66%	93,78%	63,64%	1.702.933	1.882.272	2.773.796
Moneasa	Arad	2004	1.057	119,44%	107,50%	67,55%	1.702.933	1.892.148	3.011.353
Dragalina	Călăraşi	2003	8.710	127,61%	64,70%	64,70%	294.756	581.356	581.356
Dragalina	Călăraşi	2004	8.710	103,18%	63,27%	58,44%	587.600	958.350	1.037.551
I.L. Caragiale	Dâmboviţa	2003	7.201	93,04%	32,88%	29,19%	411.903	1.165.613	1.312.815
I.L. Caragiale	Dâmboviţa	2004	7.201	103,17%	85,52%	69,21%	627.899	757.552	935.999
Blejoi	Prahova	2004	7.882	63,98%	46,19%	45,68%	2.470.946	3.422.482	3.460.670
Stejaru	Tulcea	2003	2.336	291,35%	200,84%	133,76%	271.867	394.387	592.161
Stejaru	Tulcea	2004	2.336	153,86%	119,96%	84,21%	593.750	761.558	1.084.760
Iacobeni	Suceava	2003	2.308	103,55%	103,55%	85,91%	1.234.402	1.234.402	1.487.868
Iacobeni	Suceava	2004	2.308	70,98%	58,74%	57,92%	1.663.345	2.009.965	2.038.562

Table 4.6. Weight of financing the public authorities-related expenditures from the local government LR and the LR level per capita for the communes with a high PIT per capita in the case-study counties

Locality	County	Year	Population	Weight of local own revenues in the total budget	Weight of local revenues in the total budget	Weight of own revenues in the total budget	Weight of local own revenues in the local revenues
Păuliş	Arad	2003	4.214	20,79%	22,47%	33,94%	92,54%
Păuliş	Arad	2004	4.214	31,01%	32,70%	50,15%	94,83%
Dor Mărunt	Călăraşi	2003	6.899	18,31%	21,50%	22,82%	85,13%
Dor Mărunt	Călăraşi	2004	6.899	9,31%	12,34%	16,78%	75,49%
Vulcana-Băi	Dâmboviţa	2003	3.017	10,35%	11,31%	14,53%	91,52%
Vulcana-Băi	Dâmboviţa	2004	3.017	13,60%	15,03%	22,19%	90,48%
Bălţeşti	Prahova	2004	3.524	11,53%	15,56%	36,75%	74,09%
Niculiţel	Tulcea	2003	4.822	29,16%	32,26%	39,71%	90,38%
Niculiţel	Tulcea	2004	4.822	44,00%	49,11%	54,10%	89,58%
Vicovu de Sus	Suceava	2003	14.239	5,44%	7,31%	10,46%	74,36%

Table 4.7. Weight of local revenue categories in the total budget for the communes with an average PIT per capita in the case-study counties

Locality	County	Year	Population	Public authorities expenditures in the local own revenues	Public authorities expenditures in the local revenues	Public authorities expenditures in the own revenues	Local own revenues/ inhabitant	Local revenues/ inhabitant	Own revenues/ inhabitant
Păuliş	Arad	2003	4.214	109,68%	101,50%	67,19%	561.127	606.378	915.996
Păuliş	Arad	2004	4.214	85,90%	81,46%	53,11%	1.307.038	1.378.229	2.113.927
Dor Mărunt	Călăraşi	2003	6.899	90,22%	76,80%	72,36%	420.272	493.681	524.016
Dor Mărunt	Călăraşi	2004	6.899	246,75%	186,27%	136,99%	223.221	295.695	402.084
Vulcana-Băi	Dâmboviţa	2003	3.017	161,94%	148,21%	115,36%	639.199	698.421	897.294
Vulcana-Băi	Dâmboviţa	2004	3.017	190,79%	172,62%	116,94%	629.765	696.056	1.027.511
Bălţeşti	Prahova	2004	3.524	176,43%	130,72%	55,33%	370.034	499.432	1.179.909
Niculiţel	Tulcea	2003	4.822	105,25%	95,13%	77,28%	549.144	607.564	747.962
Niculiţel	Tulcea	2004	4.822	61,91%	55,46%	50,35%	1.372.376	1.532.061	1.687.598
Vicovu de Sus	Suceava	2003	14.239	163,79%	121,79%	85,09%	162.933	219.117	313.646
Vicovu de Sus	Suceava	2004	14.239	96,22%	13,06%	12,51%	282.113	2.079.008	2.169.534

Table 4.8. Weight of financing the public authorities-related expenditures from the local government LR and the LR level per capita for the communes

Local own revenues

The local own revenues and the local revenues per capita drop constantly from the level reached in the case of county-seat municipal cities to the rural localities which have the lowest PIT.

reflects the growing dependence of such rural communities on the transfers from the central/county budget. The same tendency towards an over-evaluation of budget revenues from local sources in 2004 as opposed to 2003 due to the above-mentioned reasons can be equally noticed.

With respect to the capacity to cover the local government-related expenditures, it is smaller than in the case of rural communities with a high PIT. Half of the localities are unable to cover these expenditures from local sources (LR), so they have very low means to provide the minimum range of public services needed in the rural areas.

4.1.5. The analysis of communes with a low PIT per capita

One can spot a higher and more significant heterogeneousness than in the case of communes with an average PIT, and similar to the one of the communes with a high PIT. For instance, if we compare for 2003 commune Sistarovat (Arad county) with commune Niculesti (Dambovita county) we see that the disparities between them are 1:5, a ratio which reflects the relatively big differences in their economic status, especially with respect to their capacity to generate revenues from local taxes and fees. The LOR weight in the LR is very high, practically speaking it exceeds 90% in all localities, which means that there are no PIT-generating economic activities. Likewise, we can see that the LOR, LR and OR weights in the local budget are very small, which reflects the utmost dependence of such rural localities on the transfers from the central/county budget. The same tendency towards the over-evaluation of budget revenues from local sources in 2004 as opposed to 2003 due to the above-mentioned reasons can be also noticed.

With respect to the capacity to cover the local government-related expenditures, it is very small. Just one community Somova (Tulcea county) is able to cover these expenditures from local sources (LR). There are cases in which such expenditures exceed more than 3 times (Sistarovat Arad) or even 5 times (Jugureni Prahova) the local revenues.

Locality	County	Year	Population	Weight of local own revenues in the total budget	Weight of local revenues in the total budget	Weight of own revenues in the total budget	Weight of local own revenues in the local revenues
Sistarovăţ	Arad	2003	304	19,50%	20,52%	53,42%	95,04%
Sistarovăţ	Arad	2004	304	27,02%	27,79%	61,81%	97,24%
Al. I. Odobescu	Călăraşi	2003	2.897	16,63%	17,61%	18,79%	94,47%
Al. I. Odobescu	Călăraşi	2004	2.897	17,44%	18,55%	24,15%	93,99%
Niculeşti	Dâmboviţa	2003	4.440	11,19%	12,38%	28,41%	90,39%
Niculeşti	Dâmboviţa	2004	4.440	12,32%	13,57%	28,66%	90,83%
Jugureni	Prahova	2004	704	5,60%	5,60%	37,97%	100,00%
Somova	Tulcea	2003	5.834	17,51%	18,70%	26,67%	93,64%
Somova	Tulcea	2004	5.834	21,69%	24,19%	29,44%	89,67%
Preuţeşti	Suceava	2003	9.250	4,69%	5,42%	7,49%	86,61%

Table 4.9. Weight of the local revenue categories in the total budget for the communes with a low PIT per capita in the case-study counties

Locality	County	Year	Population	Public authorities expenditures in the local own revenues	Public authorities expenditures in the local revenues	Public authorities expenditures in the own revenues	Local own revenues /inhab	Local revenues / inhab	Own revenues/ inhabitant
Sistarovăţ	Arad	2003	304	304,55%	289,46%	111,16%	1.254.178	1.319.566	3.435.980
Sistarovăţ	Arad	2004	304	225,49%	219,28%	98,59%	2.560.855	2.633.421	5.857.303
Al. I. Odobescu	Călăraşi	2003	2.897	135,81%	128,30%	120,22%	408.822	432.761	461.851
Al. I. Odobescu	Călăraşi	2004	2.897	150,52%	141,47%	108,67%	539.524	574.042	747.288
Niculeşti	Dâmboviţa	2003	4.440	161,73%	146,19%	63,72%	248.566	274.989	630.845
Niculeşti	Dâmboviţa	2004	4.440	177,40%	161,12%	76,28%	356.757	392.793	829.730
Jugureni	Prahova	2004	704	574,61%	574,61%	84,80%	355.114	355.114	2.406.250
Somova	Tulcea	2003	4.583	98,54%	92,28%	64,72%	465.986	497.613	709.483
Somova	Tulcea	2004	4.583	66,85%	59,94%	49,25%	946.542	1.055.640	1.284.748
Preuţeşti	Suceava	2003	9.250	217,63%	188,48%	136,46%	104.865	121.081	167.243
Preuţeşti	Suceava	2004	9.250	249,06%	220,00%	113,79%	114.595	129.730	250.811

Table 4.10. Weight of financing the public authorities-related expenditures from the local government LR and the LR level per capita for the communes with a low PIT per capita in the case-study counties

4.2. The vertical analysis

This kind of analysis enables us to draw comparisons among various types of localities. Based on the data included in the afore-mentioned Tables, we can deliver the following conclusions:

- The local own revenues (LOR) and the local revenues (LR) per capita decrease continuously from the level reached by the county-seat municipalities to the rural localities that have the lowest PIT. There are nevertheless a few exceptions, like Gaesti town or communes Blejoi and Moneasa that have levels comparable to those of county-seat municipalities.
- The level of autonomy drops as well when we talk about county-seat municipalities and rural localities. With respect to the former, the LR weight in the total budget revenues lies between 38.79% and 62.06% and with respect to very poor communes it does not exceed 20% (for 2003).
- The revenues derived from the share deducted from the PIT are very important for the urban communities (particularly in the case of county-seat municipalities) and not important at all for the poorest communes. Generally speaking, we can spot a very low weight of the share deducted from the PIT in the budget revenues, in the rural areas, which fact reflects both the lack of job-generating activities and the fact that farming activities are not taxed. The exemption from the agricultural (farming) tax can also have negative effects, depriving the local government units of additional resources to improve the infrastructure and the public services from such localities.
- The weight of the local government-related expenditures is small in the case of county-seat municipalities but it grows steadily for small towns, communes with a high, low and average PIT. In the last two categories, practically speaking, the locally-generated revenues are not enough to cover the expenditures attached to the operation of the respective local councils. This situation reflects the high level of dependence of such localities on the equalization grants (transfers) from the central/county level.

Local revenues

For the communes with an average and low PIT per capita, the locally-generated revenues are not even enough to cover the expenditures generated by the operation of their own local governments and local councils.

There was a trend which grew in 2004 (election year) - to over-estimate the locally-generated revenues, so that major budget loans could be made, even above the budgetary limit to finance of the budgets in question. This fact reveals an unhealthy financial management practice and a low capacity of efficient planning. At the same time, it discloses the much too high a power of the elected officials (mayors) in the budget and financial planning process.

5. The transparency of the budget equalization grant allocation process at local level

The development of a budget equalization system to rely upon clear criteria and adequate control institutional mechanisms to prevent the manipulation of the necessary sum allocation process is a crucially important element of a coherent policy.

A transparent equalization system is equivalent to a system where the equalization grant allocation mechanism is clear to all the interested parties. Being transparent, it enables at the same time those who wish to check the accuracy of the involved calculations and procedures and hence exercise a certain “control” over the way in which funds are distributed. Therefore, the main issue closely linked to the transparency of the budget equalization grant allocation process is that of process objectivity and of legal provision observance. The present section will examine the current model of the fiscal equalization system management and implementation, with all the involved institutions, the corresponding tasks, the inter-relationships among them, the sanction and control mechanisms, to be able to propose in the end solutions of improvement, in order to increase the transparency of the entire equalization mechanism and minimize the ways of manipulating the allocated grants.

From this perspective, fiscal decentralization must be placed in a broader reform context where a major part is played by the relationship among the local public authorities, in terms of tasks and responsibilities, so that local autonomy becomes more than wishful thinking. It is worthwhile noting here the need to revise the relation between the local government units at county and local level, especially those in rural areas, as well as the prefect's role as guardian of the law being observed.

Although in this particular field, as is also mentioned in the section on the comparative system evaluation, considerable improvements took place, there are still a few aspects left that keep raising doubts, which were reported by the interviewees.

Section 2. on The evaluation criteria for the budget equalization system describes the equalization fund allocation mechanism, together with the two tiers involved national and local. The IPP study has focused on the topic of fund allocation at local level, but the transparency and the effectiveness of the allocation criteria (presented in detail in the next section) are directly linked to both tiers of fund distribution. Therefore, we shall have

The equalization formula

The formula-based allocation enhances the transparency of the equalization system.

to consider as well the various implications of the equalization fund allocation system at central level, based on the link between the Ministry of Public Finances and the County Councils.

As a generally valid principle underlying the design of a budget equalization system, the formula-based allocation increases the equalization transparency. In strict reference to the allocation factors that make up the formula, for Romania, although the criteria are the same for all those involved in the processą, their measurement is different. The Ministry of Public Finances allocates the equalization grants to the County Councils on the basis of two criteria in indirect proportion to the fiscal capacity and in direct proportion to the county's surface. The grants thus distributed are stipulated in the annual central budget law. For 2004, the measurement of the variable on the fiscal capacity is not clearly mentioned, in the text of the Ordinance or in the text of the 2004 Central Budget Law No. 507/2003¸. The Ministry of Public Finances has used the calculation formula stipulated in Law No. 631/2002, the 2003 Central Budget Law, Annex 7, as follows:

$$SD(u)=\frac{\dfrac{(OR(j)+I(j)):P(j)}{(OR(u)+I(u)):P(u)}*\dfrac{P(u)}{P(j)}}{\sum_{u=1}^{n}\left[\dfrac{(OR(j)+I(j)):P(j)}{(OR(u)+I(u)):P(u)}*\dfrac{P(u)}{P(j)}\right]}*SD(j)$$

Where:

SD(u) =sum deducted from the income tax per local government unit
SD(j) =sum deducted from the income tax distributed across the whole county according to this criterion
OR(j) =own revenues at county level
I(j) = income tax due, under the law, at county level
P(j) =county population
OR(u) =own revenues of the local government unit
I(u) = income tax due, under the law, at LGU level
P(u) = local government unit population

Due to the Ordinance provisions, OR(j) and OR(u) are not considered in the measurement of the fiscal capacity, hence the formula is simplified, and the fiscal capacity is calculated as follows:

$$\frac{\dfrac{PIT / inh_{med}}{PIT / inh_i} * \dfrac{P_i}{P_n}}{\sum_{i=1}^{41} \left(\dfrac{PIT / inh_{med}}{PIT / inh_i} * \dfrac{P_i}{P_n} \right)}$$

Where, for the equalization from central to county level:

$PIT / inch_{med}$ = average PIT value per capita
$PIT / inch_i$ = personal income tax per capita at county level
Pi = population at county level
Pn = population at national level.

The text of the Ordinance mentions this criterion both with respect to the central level allocation and to the local level allocation. At the same time though, the following formula is applied to measure the same fiscal capacity indicator:

$$\frac{\left(\dfrac{PIT / inh_{\max}}{PIT / inh_i} - 1 \right)}{\sum_{i=1}^{n} \left(\dfrac{PIT / inh_{\max}}{PIT / inh_i} - 1 \right)}$$

Where, for the equalization from county to locality level:

$PIT/ inch_{max}$ = maximum PIT level per capita
$PIT / inch_i$ = personal income tax per capita at locality level.

So, there are several formulae for the measurement of the same criterion, at various levels of intensity: average and maximum. We do recommend a uniform method to measure the fiscal capacity, that would generate implicitly a more transparent allocation procedure.

The uniform measurement of the fiscal capacity

For 2004, different formulae have been used to measure the local level and national level fiscal capacity.

Another criterion used is based on the surface area, but here we have to consider the surface inside or outside the locality built-up area. As in the case of the fiscal capacity, to apply the law in a uniform manner, we recommend the straightforward mention in the legislation of the surface within the locality boundaries, according to the idea that this is also where the building activity takes place, and hence the local public utilities operate. Especially in the case of Suceava county, we got reports on the issue of forest land surface areas which are included in the calculation of the locality total surface but which do not incur the need for the use of public utilities.

Beyond the validity of the indicators used in this formula, the issue of observing the equalization grant allocation criteria appears at both levels of government national and local. At national level, there are many examples where the formula does not represent a fund allocation foundation, such as the cases of distribution of funds from the budget reserve available to the central government under Government Decisions (G.D.). On the 16th of December 2004 the Institute for Public Policy has submitted to the Government of Romania a request for public information, in keeping with Law No. 544/2001 on the free access to information of public interest, whereby it claimed copies of the substantiation reports for several Government Decisions by which funds from the Budget Reserve were allocated. General reasons such as, “at present, the local and county councils are faced with an acute lack of funds to make them function properly and to cover yet other current expenditures of their own and of the public institutions financed from their budgets”, or “the public authorities have asked repeatedly for the allocation of sums necessary to pay their bills to the public utilities…” (the substantiation report to the G.D. No. 1537/2004 on the allocation of sums from the Budget Reserve Fund available to the central government and provided in the 2004 central budget to cover certain local government current expenditures) cannot justify in a transparent manner the direct allocation to various local communities (see Annex 2 the substantiation report of the G.D. No. 1537/2004 on the allocation of sums from the Budget Reserve Fund available to the central government, provided in the 2004 central budget to cover certain local government current expenditures).

At local level, with respect to the relation between the county council and the local councils, the E.G.O. No. 45/2003 on local public finances mentions several stages in the allocation of equalization funds. The parties involved in this process are (in chronological order): the General Public Finance Directorate at county level, the Advisory Committee, the Budget and Finances Department advisors from each county council and of course the county council as a whole because the distribution is done through a Council Decision (Chart 5.1. draws the involved institutions). Throughout this process, a major part is played by the county council economic directors.

Firstly, the county General Public Finance Directorate (GPFD) must provide technical assistance to the county council. In operational terms, this is seen locally either as the exclusive provision of all the information necessary to substantiate (document) the allocation of the equalization grants (usually, upon the request of the county council economic director) or, apart from this information, as the design of a model for the allocation of these sums based on the criteria stipulated in the legislation. The standardized shape of such an allocation matrix is made available to each Directorate by the Ministry of Public Finances but not always is it equally used. The utilization of such a model would add more transparency to the allocation process, as all those concerned (the interested parties) could follow in a standardized manner the extent to which the legal provisions in force were observed, adding as well on their own webpage the electronic format (Excel) of the allocation model.

Secondly, the county council should consult with several representatives, brought together in a Consultative Committee, that would also include, apart from the mayors, representatives of local government associations, the prefect and the GPFD director. The examination of the Ordinance reveals the fact that this Committee played a rather contradictory part from the very beginning, as it comes out that the debates with the afore-mentioned representatives could only focus on the allocation of the 15%; the other percentages are expressed as clear indicators in the E.G.O. No. 45/2003. The case-studies showed that the role played by this Committee is rather formal, insomuch as the Ordinance provisions are little known by the political leaders. A way for such consultations to really reach the aim of meeting the local development needs would consist in including the economic and accounting directors working in local government institutions among those consulted, to the effect of having a real dialogue between the two parties involved.

Thirdly, the allocation is done in keeping with a County Council Decision, after its being also discussed in the County Council Budget Committee. Consequently, the county councilors are in a position to alter the allocation of funds, as there is no chance to apply any clear checks or sanctions, stipulated by the law. The equalization grant allocation model at local level for Romania implies the issue of “objectivity” which derives from its

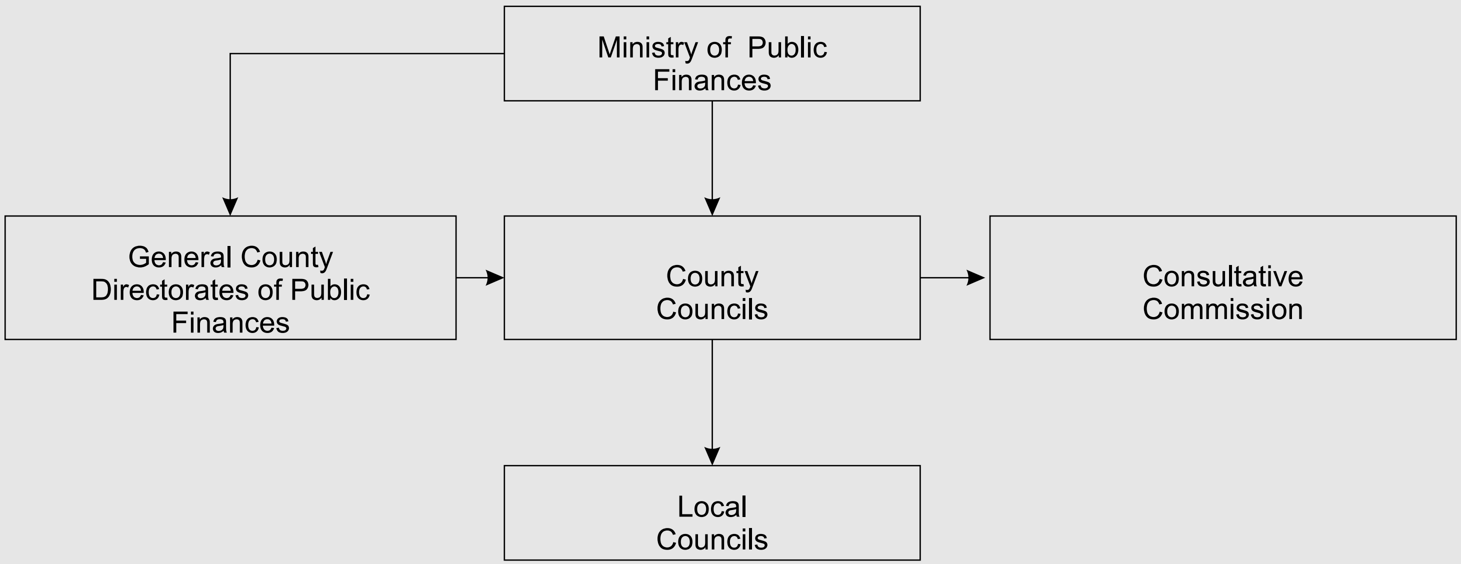


Chart 5.1. Institutions involved in the distribution of equalization grants, acc. to the E.G.O. no. 45/2003 on local public finances

very management: the involvement of a certain tier of local government in the distribution of funds for another level of local government. Although formally speaking there is no subordination between the two types of local government, practically speaking, as the final decision rests with the county council, it is somewhat unavoidable that this institution does not exercise its right of decision-making autonomy and change the distribution of funds.

Sanctions

No clear sanctions are provided in the E.G.O. No. 45/2003 in case of non-observing the equalization grant allocation criteria.

The implications of this equalization grant allocation method become ever more important as no clear sanction mechanisms are stipulated in the legislation in case of disregarding the allocation criteria mentioned in the E.G.O. No. 45/2003. A way to improve the checking of the criteria observance process is to clarify the tasks of the Court of Audit in this respect, or the provision according to which the mayors throughout a county may challenge the County Council Decision, if the latter is not in keeping with the legal distribution criteria. Another institution, the Prefect's Office, could be also involved in the control of the equalization fund distribution by the County Council. Both the Prefect's Office and the County Council do have representatives appointed on political criteria who, until the 2004 elections, belonged in their vast majority to the same political party. A crucial element is the technical “machinery”(body) needed to check the calculations made on the basis of the criteria provided by the Ordinance for 85% of the sum and the ones specified by the County Council, up to maximum 15% of the total sum to be allocated. In the absence of such experts, the control of the allocation criteria observance becomes a purely formal endeavor, which cannot be translated into practice objectively, without any political interference.

Direct allocation from the Ministry of Public Finances

IPP recommends that the equalization grant allocation be done directly by the Ministry of Public Finances

The estimation of applying the Ordinance on local public finances to the local allocation of the equalization grants has made the IPP team formulate a recommendation to provide a sound solution to this problem the equalization fund allocation to be done by the Ministry of Public Finances. According to this model, the IPP proposal is to allocate the funds directly to the local communities (see Chart 5.2.) or, as a stage of transition, to do it through the General Public Finance Directorates, by a two-stage allocation process, similar to the existing one: from national level to county level and then, by the GPFD, from county to localitył (see Chart 5.3.). According to this version, the County Council could retain, to manage specific situations, a share of 15-20% to cover the needs which are not reflected in the allocation formula.

As to the application of the Ordinance provisions, evaluated in the case-studies

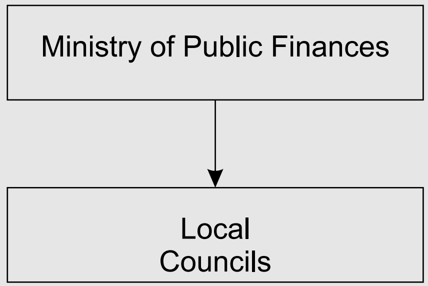


Chart 5.2. The IPP recommendation for the allocation of equalization grants

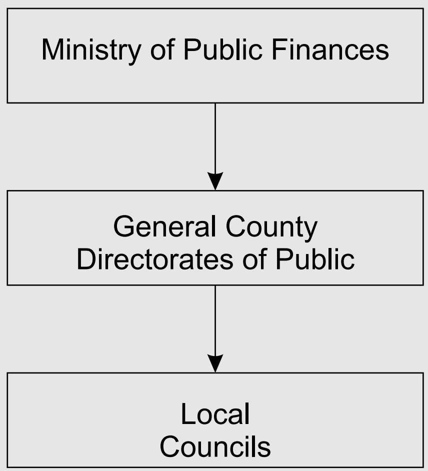


Chart 5.3. The IPP recommendation for the allocation of equalization grants (as a transitory stage)

undertaken, we could notice very diverse situations in the counties we visited. For instance, in Arad county, the County Council has applied a very transparent method for the implementation of the E.G.O. No. 45/2003, not only with respect to the 85% share of the equalization funds, distributed according to Article 29, but also by rigorously substantiating the criteria for the distribution of the remaining 15%. Thus, the following elements were considered in the distribution of sums based on specific criteria: the concrete status of each locality revenues, its expenditure needs, the criteria also mentioned in the text of the Ordinance. All the criteria and the indicators are adopted by a County Council Decision (in the Annex both the CC Decision and its substantiation report see Annex 3 the Economic Dept., Arad County Council Report on the proposed criteria for the distribution to the local budgets of the sums deducted from the income tax and the 17% share available to the County Council in 2004). All this information was put into a special format by means of an allocation model (in Excel) and the results plus all the steps of the process were published on the webpage of the institution long before the allocation decision was adopted, so that we have full transparency, while the elected officials are correctly informed, know exactly how the distribution was made and are in a position to submit potential claims. We must note the existence of a high-quality database within the Arad County Council, which facilitates the distribution of the equalization grants. (4)

In Tulcea county we ran into a similar process, even if less complete. Here we also found the same detailed criteria, and indicators that quantify the specific situations in the county, all being given shape as an allocation model (also Excel, but unpublished on the webpage). The Tulcea County Council equally has a very good database, which represents the foundation of the allocation model, similar to the one used in Arad.

Unfortunately, there are opposite examples as well, where not only is the allocation of the 15% from the equalization grants done in an un-transparent manner, but the provisions of Article 29 from the E.G.O. No 45/2003 are not observed.

The Institute for Public Policy has equally monitored the allocation of the equalization grants from the county councils to the local councils, for 2005. IPP has organized group discussions with the mayors from counties Prahova and Dambovita in December 2004, and collected the information included in the County Council Decisions which made possible the distribution of grants for six other counties, selected so that they represented various levels of fiscal capacity Constanta, Giurgiu, Harghita, Olt, Timis, Vaslui (some of

Public calculations

The calculations resulted from the equalization grant distribution formula must be made public in order to be followed/checked by all the interested parties.

the county councils published their Decisions on the webpage, the other Decisions being requested in accordance with Law 544/2001 on the free access to information of public interest). The way of publishing this kind of information is extremely relevant for the provision of a transparent mechanism of equalization grant allocation in keeping with Law No. 52/2003 on the decision-making transparency in local government, they must be published in various ways as early as in the stage of draft decision. The example of Arad county - where next to the draft decision the corresponding Annex is equally published, which includes the substantiation report as well as the electronic version (in Excel) - is indeed the one that allows us to check and see whether the legal provisions are applied correctly or not. The publication of the total sums allocated to each community, without the mention of the sums deducted according to the criteria provided by the Ordinance, as well as the reasons and the data at county level needed for the allocation of the 15% share available to the County Council, makes more difficult the control over the amount allocated to each locality.

Closely linked to the transparency of the equalization grant allocation process, we can mention the example of the Timis County Council that has published on its website the minutes transcript of the meeting when the County Council Decisions on the distribution of the shares deducted from the VAT, the income tax and the income tax share for local budget equalization for 2005 were adopted. During the same meeting, other issues specific to budget matters were also discussed Constantin Ostaficiuc, the County Council President, said: “In keeping with the legislation in force, we must consult with the Prefect, with the director of the Finance Directorate, within the Advisory Committee, as regards the budget distribution at county level. During such talks we held diverging views to the ones conveyed by the Finance Directorate and the Ministry of Public Finances… We have interpreted the income tax of local government units as being the tax levied per local government unit. The 36% which stays with a particular locality, plus what is distributed throughout the year added to yet other sources attracted to the locality in question. The Finance Directorate did not voice the same opinion. They argued that the income tax is the one due to the 36% share which stays with the local council” (source: www.cjtimis.ro, date of access: January 28, 2005). Ultimately, the solution adopted by the Timis CC was the one suggested by the Ministry of Public Finances and the General Public Finance Directorate representatives.

From the field visits made, the need to build a locality-level database became once more apparent, to substantiate correctly the equalization grant allocation process and to also check the process accuracy. The experience underlying this study shows once more the problem derived from the lack of county-level complete databases, covering all the local government units included in a county. Moreover, the same indicators record different values, over the same time span, derived from two different sources for instance, on the one hand, the local level, local council level or county council level, and, on the other, the data collected by the National Statistics Institute. At the same time, apart from the data source, in order to build a database fit for the design of an efficient fiscal decentralization model, the data must reflect the needs as well as possible and they must not become subject to local government manipulation techniques for instance, a useful indicator in the equalization formula must not include the number of schools in a locality but the number of students or school-age population (see Box 1.1. General principles applied in the equalization grant allocation process (5)).

To conclude, the research (documentation) trips revealed problems related to the actual development of consultation work and the provision of technical assistance in keeping with the law, to the uniform measurement of the criteria provided in the law, to the availability of databases at locality level with relevant indicators for the budget equalization process and last but not least to the firm application of the allocation criteria stipulated in the E.G.O. No.45/2003 as well as the application of controls and sanctions in case of non-observance.

Databases

Databases must be built at locality level, with relevant indicators for the process of budget equalization.

Notes :

[1] we put all specific criteria in a separate category, common to al county councils.

[2] Law No. 511/2001 on the central budget for 2005 mentions explicitly the fiscal capacity calculation formula. IPP has drawn the attention on this particular issue at the public debate meeting organized in Bucharest on October 4, 2004.

[3] the IPP study has also included questions on the following assumption: the management of the equalization grants not by the county council, but by the GPFD. In relation to this question, most respondents agreed that this would be a more “objective” allocation method. In each of the case-study counties, the IPP team planned to also collect specific data on local government responsibilities, such as the ones related to social protection (the average number of the Child Protection Directorate beneficiaries in 2003, the average number of the minimum income guarantee beneficiaries, the average number of the disabled' personal

next ➲

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assistants, the average number of disability allowances/benefits in 2003, etc.), public services, transportation, education, etc. Only in counties Arad and Tulcea are there locality-level databases for the requested data and also for yet other relevant information to substantiate the equalization grant distribution process.

6. Allocation criteria for the budget equalization grants and simulation models

The IPP study focused on the county council - local council relationship issue with regard to the matter of budget equalization. Nevertheless, apart from the aspects of the equalization grant allocation process within the county, another major issue is the amount of these grants, hence the allocation from national level to county level.

For the county level to the local level equalization, the IPP study has benefited from several suggestions derived from the interviewees. Some of them can be made operational in quantitative terms and fed into a simulated model, like the ones presented in the following paragraphs, while others can be regarded as recommendations in qualitative terms.

A frequently mentioned issue is the inclusion of the support for residential care facilities among the allocation criteria. As a matter of fact, one of the specific criteria used for the six case-study county councils relate to the support of general-interest facilities (i.e. homes for the elderly). The problem of institutions that include beneficiaries coming not only from the local government unit in question refers also to the homes for the elderly and to high-schools, particularly in towns. During our field research trips we visited hospitals for the mentally sick, which fall under the jurisdiction of rural (commune) local governments. At this point we have identified a major problem, that was reported during the previous studies as well namely, a devolution of responsibilities done indistinctly and with no regard to the various levels of local government, according to its beneficiaries. The afore-mentioned example is only one from a whole range of cases which illustrate this problem.

Throughout the research process, the General Public Finance Directorate representatives have reported the matter of encouraging (finding incentives to) the collection of local taxes and fees, so that no special transfers be given to cover the primary deficits of local budgets. In keeping with the theoretical framework, the evaluation criterion for the nondistorsion of the local fiscal effort, that includes here the development of incentives for the local authorities to increase their own financial resources, is an essential element for the improvement of the current model.

Likewise, it is an element that cannot be quantified, as an accurate assessment should

Incentives for the local fiscal effort

Incentives must be found to generate more local government financial resources instead of using the equalization grants to cover the primary deficits of local budgets.

take into account both the tax base and the local tax level; but there is no such database at national or county level. A fiscal effort approximation could be made from the level of collections over the last 5 years, but during these past years three major legislative changes have occurred (see Box 3.2.3. Main pieces of legislation on the regulation of local taxes and fees between 1999-2003). Hence, a variation in the collection process over this time span does not reflect the decisions made locally, but mainly the legislative changes.

In the allocation of specific criteria made available to the County Council, the Ordinance stipulates the prevailing support lent to externally-funded programs, which need co-financing (article 29, paragraph 3, letter d). Although problems were reported with respect to the identification of priority programs in need of co-financing, there is an aspect which is often neglected in the current list of allocation criteria. Local government responsibilities also include the maintenance of facilities like the ones built through external-financing programs, which incur significant current costs, especially in the field of social protection.

Another specific issue mentioned during our field visit talks refers to the fiscal capacity measurement in the particular case of some communes where the inhabitants perform farming activities that generate nontaxable incomes. Consequently, they are not reflected in the fiscal capacity formula of that particular local government unit. The opinions voiced in such cases have underscored the fact that the current budget equalization model is not favorable to such localities.

During the same field trips made in the case-study counties we were reported the situation related to the existence of a criterion which in fact supports those local government units that are unable to cover their operational expenditures from their own revenuesą. This criterion was called primary deficit cover and it represents the difference between the own revenues and the minimum operational expenditures˛.

If we consider the recommendations made by the LG representatives we have interviewed, to the effect of improving the allocation formula provided in the E.G.O. No. 45/2003, we have to start from the evaluation criteria system described in Section 2. Evaluation criteria for the budget equalization system, especially from those criteria which are directly linked to the method of equalization grant determination. Of the 11 criteria displayed, we found two of them to be directly linked to the allocation formula:

equity (fairness) and concentration. The former refers to the ability of the formula to allocate the equalization grants so that the poorer communities get more than the wealthier ones, all of them being in fact able to provide public services at a minimum qualitative level. Concentration refers to the ability of the formula to channel the funds prevailingly to the local governments in the most difficult situation, if we consider the limited equalization resources available to them and the need to increase the efficiency of their allocation.

An improvement of the allocation formula in terms of the equity criterion implies first of all the design of a formula measurement method, which is a highly sensitive issue. The present study recommends the following indicator to measure the growth of the national level allocation formula degree of equity: decreasing the gaps among the counties in terms of the sums received per capita from the Personal Income Tax in all its shapes plus the general-purpose ones (equalization sums and shares deducted). In such circumstances, one does not take into account the volume of revenues derived from the local taxes and fees; hence the preservation of the spirit in the E.G.O. No. 45/2003 which determines the fiscal capacity only on the PIT basis; another reason is the fact that the gap among the county levels per capita with respect to this revenue source is not so big. This is also due to the fact that the average per inhabitant established at county level “makes homogeneous” the discrepancies among the localities in the respective county.

To evaluate the equity criterion in terms of the equalization from county level to local level, the study recommends a similar indicator: downsizing the discrepancies among localities with respect to the general-purpose financial resources per inhabitant available to them. They are made up of revenues derived from local taxes and fees, the shares deducted from the PIT and the sums deducted from the PIT for equalization purposes. A difference arises at this point between this particular indicator and the one used nationally the introduction of the revenues derived from local taxes and fees. We undertook distinct procedures because within counties there are huge differences among localities in terms of the revenues per inhabitant, generated from local taxes and fees.

In both circumstances, the measurement of downsizing these gaps is done by determining the minimum and the maximum levels in the county series of general - purpose revenues (PIT-derived only) per capita (the national/county level equalization) and in the local series of general-purpose revenues (including the PIT and the local taxes and fees) per capita (the county/local level equalization). The diminution of the ratio

Equalization equity (fairness)

The equity of the equalization process at local level was measured by reducing the discrepancies among localities in terms of their financial resources per capita.

Concentration of equalization grants

The study has tried to improve the equalization system by concentrating the funds through the use of an equalization exclusion criterion

between the minimum and the maximum values of these series illustrates a smaller gap among the general-purpose financial resources available to various types of local government.

All the simulations mentioned below were done using as starting point the budget execution data for 2003 from the Ministry of Public Finances and the assumption that the national-level equalization fund volume has remained the same in 2004. Similarly, at county level, we have allocated, according to the new formula, the same equalization funds as in 2004.

6.1. Allocation from national level to county level

The principle we relied on in the allocation from central level to county level was the concentration principle. The allocation formula, which includes the exclusion criterion, is explained below. The first version of the central to county allocation formula starts from the indicators used at present: the county fiscal capacity and the weight of their surface area in the total country area. As there are two methods of determining the fiscal capacity and two ways of building the allocation formula (multiplying the fiscal capacity index by the index which reflects the weight of the county surface area in the national surface area or adding the two indices weighted by certain coefficients the latter is being currently used by the Ministry of Public Finances), we have come up with four options (for a detailed version of the formulas, see Annex 4):

Formula 6.1.

This formula is based on calculating the fiscal capacity according to the average PIT per capita at national level, weighted by a pre-determined coefficient A.The fiscal capacity formula is being multiplied by the weight of the county surface area in the country's

$$FC_{med} * A_{i/n} \qquad (6.1.)$$

FC_{med}= county fiscal capacity, based on the medium level of PIT per inhabitant

$A_{i/n}$= weight of the county surface area in the country's surface area

The final allocation coefficient for each county is being determined by relating its coefficient, calculated according to formula 6.1., to the sum total of all the county coefficients, for the counties involved in the equalization process. According to this version, A is an over-unit coefficient depending on which the exclusion of certain counties from the equalization process takes place, so that the concentration of the entire process grows. Hence, the counties with a PIT per inhabitant higher than A*PIT/inh will no longer get equalization grants from the national level.

Formula 6.2.

This formula calculates the fiscal capacity starting from the maximum PIT value per inhabitant at county level. As for the rest, the same rules apply as in the case of Formula 6.1.

$$FC_{\max} * A_{i/n} \qquad (6.2.)$$

Fc_{max}= county fiscal capacity, based on the maximum level of PIT per inhabitant

Formula 6.3.

This formula is similar to 6.1., the only difference being that the fiscal capacity and the surface area indices are added according to specific weights (e.g. 70% for the fiscal capacity and 30% for the surface area):

$$\alpha * FC_{med} + \beta * A_{i/n} \qquad (6.3.)$$

α şi β are the weights specific to the fiscal capacity index and the surface area index, and á + â = 1 (or 100%, if expressed in percentage terms).

Formula 6.4.

This option uses, as in case 6.2., the maximum PIT value per capita, at county level: Where α and β are the weights specific to the fiscal capacity and the surface area, and $\alpha + \beta = 1$ (or 100%, if expressed as a percentage)

$$\alpha * FC_{\max} + \beta * A_{i/n} \qquad (6.4.)$$

The second version of the allocation formula from national level to county level adds one more indicator to the ones used so far: the weight of the local government units (LGU) number from each county in the total LGU number at country level. This new indicator was suggested by Mr. Liviu Dragnea, the Teleorman County Council President and the President of the National County Council Union in Romania. Here as well you will find the four options used to build the allocation formula, which are described below:

Formula 6.5.

This formula is based on calculating the fiscal capacity according to the average PIT per capita at national level, weighted by a pre-determined coefficient A. The fiscal capacity formula is multiplied by the county surface area in the national surface area weight and by the county LGU number in the total LGU number weight, which results in the following county-level coefficient:

Version I	Independent parameters			Results		
fiscal capacity and county surface	Weight of fiscal capacity α	Weight of county surface β	Exclusion coefficient A	Maximum of revenues with general destination/ inhabitant	Minimum of revenues with general destination/ inhabitant	Ratio Maximum/ Minimum
Scenarium 1	**70%**	**30%**	**1,25**			
Current situation				5,028361	1,261627	3,985615
Formula 6.1.				4,854504	1,38021	3,517222
Formula 6.2.				4,854504	1,293364	3,753393
Formula 6.3.				4,854504	1,314373	3,693398
Formula 6.4.				4,854504	1,232795	3,937803
Scenarium 2	**80%**	**20%**	**1,20**			
Current situation				5,028361	1,261627	3,985615
Formula 6.1.				4,854504	1,380155	3,517362
Formula 6.2.				4,854504	1,293364	3,753393
Formula 6.3.				4,854504	1,333421	3,640638
Formula 6.4.				4,854504	1,223612	3,967357
Scenarium 3	**100%**	**0%**	**1,20**			
Current situation				5,028361	1,261627	3,985615
Formula 6.1.				4,854504	1,380155	3,517362
Formula 6.2.				4,854504	1,293364	3,753393
Formula 6.3.				4,854504	1,337633	3,629174
Formula 6.4.				4,854504	1,206469	4,02373

Table 6.1. Results of simulated equalization models for the allocation from national level to county level, based on version I (fiscal capacity and county surface area)

$$FC_{med} * A_{i/n} * U_{i/n} \tag{6.5.}$$

$U_{i\text{-}n}$= weight of the county LGU number in the total LGU of the country

The final allocation coefficient for each county is determined by relating its coefficient, calculated according to formula 6.1., to the sum total of all county-level coefficients of the counties included in the equalization process. According to this version, A is an above one(1) coefficient according to which the exclusion of certain counties from the equalization process takes place, so that the concentration of the entire process grows. Thus, the counties with a PIT per capita higher than A*PIT/inh will no longer get equalization grants from the national level.

Formula 6.6.

This formula calculates the fiscal capacity starting from the maximum PIT value per capita at county level. As far as the rest is concerned, the same rules apply as in Formula 6.5.

$$FC_{\max} * A_{i/n} * U_{i/n} \tag{6.6.}$$

Formula 6.7.

This formula is similar to 6.1., the only difference being that the fiscal capacity and surface area indices are added according to specific weights (i.e. 70% for the fiscal capacity, 20% for the surface area and 10% for the LGU number).

$$\alpha * FC_{med} + \beta * A_{i/n} + \lambda * U_{i/n} \qquad (6.7.)$$

α and β are the weights specific to the fiscal capacity, the surface area and the LGU number indices, where $\alpha + \beta + \lambda = 1$ (or 100% if expressed as a percentage).

Formula 6.8.

This option uses, like in case 6.2., the maximum PIT value per capita at county level

$$\alpha * FC \max + \beta * A_{i/n} + \lambda * U_{i/n} \qquad (6.8.)$$

α, β and λ are the weights specific to the fiscal capacity, the surface area and the LGU number indices, where $\alpha + \beta + \lambda = 1$ (or 100% if expressed as a percentage).

The simulation results for these options, within the second version, are detailed below. As you can see, the independent parameters that have varied in the three scenarios were A,α, β and λ.

Version II	Independent parameters						Results
fiscal capacity, county surface area and number of LGU	Weight of fiscal capacity α	Weight of county surface β	Weight of fiscal capacity α	Weight of county surface β	Weight of fiscal capacity α	Weight of county surface β	Weight of fiscal capacity α
Scenarium 1	**70%**	**20%**	**10%**	**1,25**			
Current situation					5,028361	1,261627	3,985615
Formula 6.5.					4,854504	1,35534	3,58176
Formula 6.6.					4,854504	1,216301	3,991202
Formula 6.7.					4,854504	1,31209	3,699825
Formula 6.8.					4,854504	1,230613	3,944785
Scenarium 2	**60%**	**20%**	**20%**	**1,20**			
Current situation					5,028361	1,261627	3,985615
Formula 6.5.					4,854504	1,364876	3,556737
Formula 6.6.					4,854504	1,216301	3,991202
Formula 6.7.					4,854504	1,309384	3,707472
Formula 6.8.					4,854504	1,237937	3,921446
Scenarium 3	**80%**	**10%**	**10%**	**1,20**			
Current situation					5,028361	1,261627	3,985615
Formula 6.5.					4,854504	1,364876	3,556737
Formula 6.6.					4,854504	1,216301	3,991202
Formula 6.7.					4,854504	1,312446	3,698821
Formula 6.8.					4,854504	1,221491	3,974243

Table 6.2. Results of simulated equalization models for the allocation from national level to county level, based on version II (fiscal capacity, county surface area and number of LGU)

The analysis of national-to-county (level) allocation results

What interests us most in our evaluation is which of the allocation formula versions is most efficient, on the one hand and whose independent parameters' variation has the most powerful positive impact, on the other. From the very onset we must admit that the number of scenarios and the value of the independent parameters were decided on a somewhat random basis as we tried to develop the best options. It goes without saying that yet other independent parameter combinations can arise, meant to improve the results displayed in the 3 scenarios attached to the 2 versions of the allocation formula.

Based on the simulation results presented in Tables 6.1. and 6.2. the following conclusions can be drawn:

- ✍ The exclusion criterion is introduced in order to generate a better concentration of equalization funds in the poorer counties but its effectiveness is only moderate. Both for the 1.2 and for the 1.25 value of parameter A, the number of excluded counties is 9, and the total amount thus made available represents approximately 16% of the entire equalization fund. A decline of the exclusion parameter value towards 1.15 results in the elimination of several counties from the equalization process, but it also depreciates the final outcomes: the gaps among the counties are deeper.
- ✍ The best results are attached to version 1 of the equalization formula (formula 6.1.) which makes use of the values and indicators belonging to the independent parameters, identical to the ones used by the Ministry of Public Finances; the only difference consists in the mathematical shape of the fiscal capacity formula and in the index aggregation method (multiplication instead of weighted addition).
- ✍ The variations in the fiscal capacity and surface area parameters do not yield more spectacular results. One has to note though that in the circumstances in which all the other parameters remain the same, the fiscal capacity weight increase close to 100% does improve the results a little.
- ✍ The introduction of the local government unit number indicator does not improve the results at all. Other tests performed on the same model and which are not included in the tables reveal that the variation of this indicator's parameter improves less the fund allocation than the variatiothat then of the surface area parameter, which leads us to the conclusion surface area

Intra-county discrepancies

The introduction of the exclusion criterion in order to get a better concentration of the equalization grants to the poorer counties is moderately efficient. It is equally debatable due to the much higher intra-county discrepancies compared to the inter-county ones.

New allocation criteria

The IPP study introduces new allocation criteria at locality level: the population under 18, the population of 65 and over, plus a fixed allowance to each rural community.

indicator is more sensitive than the number of local government units, as far as the equalization grant allocation is concerned, so that the discrepancies among the counties be reduced.

- An essential matter is whether the utilization of the exclusion criteria is effective insomuch as the equalization grant allocation from national level to county level is concerned. Due to the existence of huge gaps between the urban localities (especially the county-seat municipal cities) and the rural localities in all of Romania's counties, which gaps are much deeper than those among counties, the utilization of the exclusion principle at this particular level as a means to improve the concentration of funds is debatable and it yields quite modest results.

6.2. Allocation from county level to local level

All the afore-mentioned formulae are versions meant to improve the equalization process from national level to county level. For the local level equalization, due to the intra-county discrepancies which are larger than the inter-county ones, we recommend the following set of indicators, to be used in adequate proportions:

1. fiscal capacity weighting parameter
2. surface area (A) weighting parameter
3. population under 18 (Y) weighting parameter
4. elderly population aged 65 and over (O) weighting parameter
5. fixed allocation for each rural community (R) (the equalization sums are divided equally to the communes) weighting parameter ,

where $\alpha+\beta+\delta+\varepsilon+\mu= 1$ (or 100% if the parameters are expressed as percentages).

This model completes the current set of indicators, having in mind the local needs. According to indicator 5, the equalization sums are divided equally to the communes, starting from the idea that an increased number of inhabitants in a certain locality does not trigger directly and straightforwardly increased operational costs for that particular local government.

To create models for the allocation process from county level to local level we have used 3 formula options in order to establish the fiscal capacity of each locality (for a detailed version of the formulas, see Annex 4).

Formula 6.9.

For this case, the fiscal capacity calculation formula is one of the versions used for the national level allocation as well:

$$FC_{locmed} = \frac{1 - \dfrac{PIT / inh_i}{A * PIT_n / loc_{med}}}{\sum \left(1 - \dfrac{PIT / inh_i}{A * PIT_n / inh_{med}} \right)}$$

In this case, PIT/inch is the personal income tax per inhabitant per locality, and PI/linh is the average personal income tax per inhabitant at national level. If we also add the above-mentioned indicators, we get a coefficient specific to each locality

$$\alpha * FC_{locmed} + \beta * A_{i/j} + \delta * Y_{i/j} + \varepsilon * O_{i/j} + \mu * \frac{1}{R} \qquad (6.9.)$$

Where i represents the locality index and j represents the county index and.

$A_{i/j}$ =weight of the locality surface area in the county's surface area

$Y_{i/j}$ =weight of population under 18 of the locality in the total county's population under 18

$O_{i/j}$ =weight of locality's population aged 65 and over in the total county's population aged 65 and over

R =fixed allocation for each rural community

The final allocation coefficient for each locality is determined by relating its coefficient, calculated according to formula 6.9., to the sum total of all the coefficients of the localities in the county which is included in the equalization process. In this situation, the exclusion is done for all the cases where $PIT / inh_i > A * PIT_n / inh_{med}$

Formula 6.10.

In this situation, the fiscal capacity of a locality is determined according to the personal income tax (PIT=IVG) and to the revenues derived from local taxes and fees (LTF) per capita, related to the county average per capita both with respect to the PIT and to the local taxes and fees (LTF). The coefficient specific to each locality is as follows

$$\alpha * FC_{LTF\,locmed} + \beta * A_{i/j} + \delta * Y_{i/j} + \varepsilon * O_{i/j} + \mu * \frac{1}{R} \quad \text{where} \qquad (6.10.)$$

$$FC_{LTF\,locmed} = \frac{1 - \dfrac{PIT/inh_i + LTF_i}{A*(PIT_j/inh_{med} + LTF_j/inh_{med})}}{\sum 1 - \dfrac{PIT/inh_i + LTF_i}{A*(PIT_j/inh_{med} + LTF_j/inh_{med})}}$$

In this case we have used in order to determine the fiscal capacity a mathematical formula somewhat similar to the current formula used by the MPF, without weighting once again by the population number. As to the rest, the same indicators are used as in formula 6.10. In this situation, the coefficient specific to each locality is as follows:

The final allocation coefficient for each locality is determined by relating its coefficient, calculated according to formula 6.10., to the sum total of all the coefficients of the localities in the county which is included in the equalization process. In this situation, the exclusion is done for all the cases where:

$$PIT/inh_i + LTF_i > A*(PIT_j/inh_{med} + LTF_j/inh_{med})$$

Formula 6.11.

$$\alpha * FC_{LTF\,locmed\,2} + \beta * A_{i/j} + \delta * Y_{i/j} + \varepsilon * O_{i/j} + \mu * \frac{1}{R} \quad \text{where} \qquad (6.11.)$$

$$FC_{LTF\,locmed\,2} = \frac{\dfrac{PIT/inh_i + LTF_i}{A*(PIT_j/inh_{med} + LTF_j/loc_{med})}}{\sum\left(\dfrac{PIT/inh_i + LTF_i}{A*(PIT_j/inh_{med} + LTF_j/loc_{med})}\right)}$$

The final allocation coefficient for each locality is determined by relating its coefficient, calculated according to formula 6.11., to the sum total of all the coefficients of the localities in the county which is included in the equalization process. In this situation, the exclusion is done for all the cases where:

$$PIT/inh_i + LTF_i > A*\ PIT_j/inh_{med} + LTF_j/inh_{med}$$

The results of the simulations based on these formulae and some specific scenarios are presented in the tables below for each of the six counties examined in our study. The independent parameters which have varied within the scenarios were: A, α, β, δ, ε şi μ.

The analysis of county-to-local (level) allocation results

As in the case of the national-to-county level allocation, what interests us most in this evaluation is which of the allocation formula versions is more effective and the variation of which independent parameters has the strongest positive impact. Likewise, the number of scenarios and the value of the independent parameters were determined on a somewhat random basis, as we tried to obtain the best and the closest to the optimum level options. We have to note that in all three scenarios we did not change the values of the fiscal capacity, surface area, population under 18, elderly population and fixed allowance for rural localities parameters, whereas we did change from county to county the value of the exclusion parameter, in order to get the best results in a particular county.

On the basis of these simulations, we can draw the following conclusions:

- as shown in yet other studies, the inter-county discrepancies are smaller than the intra-county ones. In our study, it is only Calarasi county that displays inter-locality discrepancy values close to the national-level inter-county values. For the rest, the intra-county discrepancy values exceed several times the inter-county ones (first ranks here Suceava county).
- The counties considered to be the wealthiest (Arad and Prahova) display inter-locality discrepancy values much bigger than the poorer counties (Calarasi). One can easily notice that the minimal values are very close among all the counties, while the maximal ones are the ones that really make the difference between a relatively rich and a relatively poor county. This shows that rural underdevelopment is distributed quite evenly throughout the country and that wealthy counties are differentiated from the others by a few islands of prosperity, located mainly in the county-seat municipal cities, localities that include in their territory large industrial facilities (for instance, Brazi and Floresti in Prahova county) or other exceptional cases (Sadova commune in Suceava county where the local taxes and fees-derived revenues are unusually high). Therefore, we can say that, unlike rural underdevelopment, prosperity be it rural or urban is very much unevenly

Arad county	Independent parameters						Results		
	Fiscal capacity α	Locality Surface Area β	School-aged population	Elderly population	Fixed allocation for each LG unit	Exclusion coefficient A	Maximum of revenues with general destination/ inhabitant	Minimum of revenues with general destination/ inhabitant	Maximum/ Minimum ratio
Scenarium 1	30%	25%	15%	15%	15%	2,00			
Current situation							8,20538	0,77325	10,61155
Formula 6.9.							12,99242	1,07366	12,10106
Formula 6.10.							12,94065	1,08288	11,95022
Formula 6.11							14,97951	0,77325	19,37214
Scenarium 2	30%	25%	15%	15%	15%	0,60			
Current situation							8,20538	0,77325	10,61155
Formula 6.9.							14,09297	1,12447	12,53299
Formula 6.10.							12,30762	1,164553	10,56853
Formula 6.11.							18,10643	1,100956	16,4461
Scenarium 3	40%	15%	15%	15%	15%	0,55			
Current situation							8,20538	0,77325	10,61155
Formula 6.9.							13,95081	1,148026	12,152
Formula 6.10.							11,1327	1,213194	9,176357
Formula 6.11.							20,81113	1,157413	17,98074

Table 6.3. Results of the simulation model from county level to local level, for Arad county

Calarasi county	Independent parameters						**Results**		
	Fiscal capacity α	Locality Surface Area β	School-aged population	Elderly population	Fixed allocation for each LG unit	Exclusion coefficient A	Maximum of revenues with general destination/ inhabitant	Minimum of revenues with general destination/ inhabitant	Maximum/ Minimum ratio
Scenarium 1	30%	25%	15%	15%	15%	2,00			
Current situation							3,353809	0,795798	4,214396
Formula 6.9.							3,241816	0,813468	3,985179
Formula 6.10.							3,061983	0,869633	3,521008
Formula 6.11							3,810266	0,751562	5,069797
Scenarium 2	30%	25%	15%	15%	15%	0,80			
Current situation							3,353809	0,795798	4,214396
Formula 6.9.							3,061983	0,870703	3,51668
Formula 6.10.							3,061983	0,962528	3,181189
Formula 6.11.							3,172583	0,814452	3,89536
Scenarium 3	40%	15%	15%	15%	15%	0,80			
Current situation							3,353809	0,795798	4,214396
Formula 6.9.							3,061983	0,883963	3,463926
Formula 6.10.							3,061983	0,991954	3,086819
Formula 6.11.							3,376912	0,794679	4,249405

Table 6.4. Results of the simulation model from county level to local level, for Calarasi county

Dambovita county	Independent parameters						Results		
	Fiscal capacity α	Locality Surface Area β	School-aged population	Elderly population	Fixed allocation for each LG unit	Exclusion coefficient A	Maximum of revenues with general destination/ inhabitant	Minimum of revenues with general destination/ inhabitant	Maximum/ Minimum ratio
Scenarium 1	30%	25%	15%	15%	15%	2,00			
Current situation							3,858093	0,623397	6,188819
Formula 6.9.							3,711732	0,709746	5,229661
Formula 6.10.							3,711732	0,734325	5,054615
Formula 6.11							4,763855	0,579958	8,214141
Scenarium 2	30%	25%	15%	15%	15%	0,60			
Current situation							3,858093	0,623397	6,188819
Formula 6.9.							3,711732	0,807576	4,596137
Formula 6.10.							3,711732	0,867475	4,278779
Formula 6.11.							4,854809	0,65852	7,372306
Scenarium 3	40%	15%	15%	15%	15%	0,60			
Current situation							3,858093	0,623397	6,188819
Formula 6.9.							3,711732	0,854128	4,345637
Formula 6.10.							3,711732	0,932576	3,980083
Formula 6.11.							5,343371	0,64664	8,263286

Table 6.5. Results of the simulation model from county level to local level, for Dambovita county

Prahova county	Independent parameters						**Results**		
	Fiscal capacity α	Locality Surface Area β	School-aged population	Elderly population	Fixed allocation for each LG unit	Exclusion coefficient A	Maximum of revenues with general destination/ inhabitant	Minimum of revenues with general destination/ inhabitant	Maximum/ Minimum ratio
Scenarium 1	30%	25%	15%	15%	15%	2,00			
Current situation							9,72506	0,880937	11,03945
Formula 6.9.							9,72506	1,341905	7,247205
Formula 6.10.							9,72506	1,247425	7,796105
Formula 6.11							9,72506	1,032676	9,417335
Scenarium 2	30%	25%	15%	15%	15%	0,90			
Current situation							9,72506	0,880937	11,03945
Formula 6.9.							9,72506	1,436812	6,768498
Formula 6.10.							9,72506	1,448279	6,714906
Formula 6.11.							9,72506	1,230438	7,903741
Scenarium 3	40%	15%	15%	15%	15%	0,95			
Current situation							9,72506	0,880937	11,03945
Formula 6.9.							9,72506	1,448834	6,712335
Formula 6.10.							9,72506	1,473258	6,601056
Formula 6.11.							9,72506	1,189171	8,178019

Table 6.6. Results of the simulation model from county level to local level, for Prahova county

Suceava county	Independent parameters						**Results**		
	Fiscal capacity α	Locality Surface Area β	School-aged population	Elderly population	Fixed allocation for each LG unit	Exclusion coefficient A	Maximum of revenues with general destination/ inhabitant	Minimum of revenues with general destination/ inhabitant	Maximum/ Minimum ratio
Scenarium 1	30%	25%	15%	15%	15%	2,00			
Current situation							23,62257	0,794561	29,73036
Formula 6.9.							24,6133	0,744039	33,08065
Formula 6.10.							23,36671	0,778853	30,00143
Formula 6.11							23,36671	0,019859	1176,602
Scenarium 2	30%	25%	15%	15%	15%	1,10			
Current situation							23,62257	0,794561	29,73036
Formula 6.9.							24,67203	0,770606	32,0164
Formula 6.10.							23,36671	0,821717	28,43643
Formula 6.11.							23,36671	0,019859	1176,602
Scenarium 3	40%	15%	15%	15%	15%	1,10			
Current situation							23,62257	0,794561	29,73036
Formula 6.9.							24,69027	0,777277	31,76507
Formula 6.10.							23,36671	0,834774	27,99166
Formula 6.11.							23,36671	0,019859	1176,602

Table 6.7. Results of the simulation model from county to local level, for Suceava county

Tulcea county	Independent parameters						**Results**		
	Fiscal capacity α	Locality Surface Area β	School-aged population	Elderly population	Fixed allocation for each LG unit	Exclusion coefficient A	Maximum of revenues with general destination/ inhabitant	Minimum of revenues with general destination/ inhabitant	Maximum/ Minimum ratio
Scenarium 1	30%	25%	15%	15%	15%	2,00			
Current situation							7,484472	0,870703	8,595895
Formula 6.9.							7,742268	0,959326	8,070528
Formula 6.10.							8,282011	1,040834	7,957094
Formula 6.11							9,837682	0,86955	11,31353
Scenarium 2	30%	25%	15%	15%	15%	0,55			
Current situation							7,484472	0,870703	8,595895
Formula 6.9.							8,769559	1,100865	7,96606
Formula 6.10.							8,606469	1,256524	6,849425
Formula 6.11.							11,72619	1,031053	11,37302
Scenarium 3	40%	15%	15%	15%	15%	0,55			
Current situation							7,484472	0,870703	8,595895
Formula 6.9.							8,06786	1,151778	7,004703
Formula 6.10.							7,459202	1,325038	5,629427
Formula 6.11.							11,56084	1,029373	11,23096

Results of the simulation model from county level to local level, for Tulcea county

Local level exclusion criterion

We must notice that, unlike the national level equalization process, the county level one is significantly improved by the recommended formulae and that the utilization of the exclusion criterion is highly efficient.

distributed throughout Romania.

- The results thus obtained must be examined with caution, as the evaluation of financial needs at locality level is a highly difficult process. Even if, in keeping with the law, all local councils, irrespective of the type of locality, have the same responsibilities, in fact there are huge differences between the public services provided in the urban areas and the ones provided in the rural areas. This situation generates different financial resources-based needs.
- We must also notice that, unlike the national-level equalization process, the county-level one is considerably improved by the proposed formulae and the utilization of the exclusion criterion is highly effective. This situation is in keeping with the previous analysis which reported a much bigger scope of the intra-county discrepancies as opposed to the inter-county ones.
- The best results were achieved in all three scenarios by applying Formula 6.10., with only one exception Prahova county where the best result was achieved by applying Formula 6.9. If we also compare the scenarios among themselves, we notice that the best results are achieved by using Formula 6.10.; in many instances, this is accompanied by an increased fiscal capacity parameter (from 30% to 40%) and a decreased surface area parameter (from 25% to 15%), the only exception being here Tulcea county.
- One can see that the best results are achieved in each county, for all scenarios, at different values of the exclusion parameter. Nevertheless, we do have three counties (Arad, Dambovita and Tulcea) where the value of this coefficient is very narrow: 0.55-0.60. This shows us one the one hand that we have fairly different situations (realities) among counties and on the other it questions the effectiveness of the local budget equalization in its two stages: from national to county level and from county to local level. Perhaps in a uniform one-stage approach from national to local level by using both the personal income tax and the revenues derived from local taxes and fees, calculated as national averages per capita, better results could be obtained.

Revenues derived from local taxes and fees

The introduction of the revenues derived from local taxes and fees in the fiscal capacity formula does improve the results.

- The fiscal capacity is the most sensitive of all the indicators used for the county level equalization, considering the purposes of our study. One must also note that the introduction of the revenues derived from local taxes and fees in the fiscal capacity calculation formula does improve the results. This aspect raises again the issue of the balance which must exist between equity and efficiency, between the equalization process of the resources available to localities and the encouragement of their own efforts towards a better collection of local taxes and the stimulation of their economic development. In the attempt to reach both goals, the current budget equalization system must undertake major changes. The introduction of the revenues derived from local taxes and fees in the fiscal capacity calculation formula, as it stands today, and which was preserved in broad lines in the present study, has the role to discourage the local government effort to develop the local economy and to improve the collection rate. Changing the equalization method so as to avoid the risks mentioned above implies a different methodological framework and especially more numerous and more detailed information about all the localities in Romania .

To conclude, the main reason based on which the IPP study recommends the improvement of the current system is concentration accomplished by means of an exclusion criterion in different ways at national and local level. Similarly, with respect to the local level equalization, the formula recommended by this study takes into consideration several indicators to reflect as adequately as possible the needs of a locality.

Last but not least, we would like once again to draw the attention on the issue of stimulating the collection of taxes and fees at local level instead of using the equalization grants to cover the primary deficits.

Equity and efficiency

The current system of budget equalization must suffer major changes in order to reach the equity- and efficiency-oriented goals

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Notes :

[1] a substantiation example of an equalization grant allocation criterion within the limits of percentages available to the County Council is again the one of Arad County Council, formulated as the provision of the proper operation of local councils and their subordinates. The distribution of funds according to this criterion is based upon the following elements for the 2004 fiscal year: an estimate of the local budget potential resources in 2004, defining the scope of the criterion, providing the necessary subsidies for 2004 (excluding the price and charge differences) and providing the needs for 2004 in terms of the transfers (grants) from the commune, town, city budget to support the child protection system. You will find details about these criteria in Annex 3.

[2] an original criterion for the distribution of the equalization grants belongs to the Suceava

next ➲

next ➲

County Council, that has determined, with respect to the specific criteria for the distribution of the shares deducted from the PIT available to the County Council to equalize the local budgets in 2004, a proportion of 15%, next to the number of school-age and pre-school-age children (also included in the simulation models described in the present Section), prizes for the winners of the competition “The best managed locality” in the amounts settled by the Suceava County Council Decision no. 30/2003. The whole competition evaluation methodology was put in place by the Suceava County Council; the members of the committee were exclusively Suceava County Council representatives.

7. Main conclusions and recommendations

At a stage where many research studies have already been conducted on the topic of fiscal decentralization in Romania, the risk of taking certain measures without professional and updated assessments as to the impact of the public policies developed in this respect is quite high. The study undertaken by the Institute for Public Policy (IPP) has tried to identify, through the quantitative and qualitative analyses made in 2004 in various parts of Romania,
several crucial aspects meant to contribute to an improvement of the existing budget equalization system.

1.
The first aspect refers to the **principle of concentrating the allocated sums by the development of an exclusion criterion** mainly for the county to - local level equalization. The application of an exclusion criterion for the national to county level equalization may raise problems due to the very existence of large gaps between the rural and the urban areas in each county: the inter-county discrepancies are much smaller than the intra-county ones. This problem could be simplified if the equalization process took place from national level straight to local level, the exclusion criterion being thus applied in a unitary manner throughout the country and affecting those local councils (irrespective of their type) that have enough own revenues to finance the responsibilities assigned to them. Accordingly, the allocation formula that has improved considerably improved the model is the one which relates the fiscal capacity to the average value of the personal income tax per inhabitant. To the recommended versions which include an exclusion criterion (see Section 5. Allocation criteria for the budget equalization grants and simulation models) we have to add that, in case they are used, a period of transition must be allowed for those counties/localities which are going to be excluded. This period is meant to enable their adjustment to the newly-created fiscal situation.

2.
The second principle which aims at the increased efficiency of the budget equalization model consists in the **nondistorsion of the own fiscal effort**, in other words, encouraging the growth of the own resources. Therefore, the equalization amounts

received by a locality must be affected (diminution-wise) by the non-collection of local taxes and fees or by the decrease of the standard or average levels of the local taxes and fees. This implies the existence of a national database including all the local taxes and fees, their levels, the collected amounts, the collection rate, to be made available to the Ministry of Public Finances. The development of a genuine fiscal policy with regard to the local budgets implies the mandatory creation of the afore-mentioned database, the interoperability of the local databases where they exist as well as the generation of new ones where they do not exist.

3.
At the same time though, with respect to improving the current indicator system, the IPP study adds **new fund allocation criteria** to the ones stipulated in the E.G.O. No. 45/2003 (such as, the weight of the population under 18, of 65 and over, as well as the equal distribution of the equalization grants, amounting to 15%, at commune level). Thus, the premises are set for the application of an equalization system to meet more efficiently and more transparently certain local development needs. Although such criteria can perfect the current budget equalization model, their incorrect application and the insufficient transparency of the allocation process may render the whole system ineffective. Due to all these reasons, we recommend that the management of the allocation process be undertaken by the General Public Finance Directorates at county level, based on clear and uniformly measured criteria. The manipulation of the fiscal capacity formula in various calculation versions is a crucial element highlighted by the IPP study, which must be amended through adequate legislation.

As a matter of fact, the existing criteria stipulated in the Ordinance need additional assessment. The current allocation criteria provided by the E.G.O. No. 45/2003 do not include the allocation of equalization grants to cover the costs incurred by the running of institutions whose beneficiaries come from more than one local government unit (such as, psychiatric hospitals, homes for the elderly, etc.). The same situation also applies to the maintenance of facilities built within projects that needed co-financing, mostly those in the field of social protection. Although the construction costs represent one of the priorities mentioned by the E.G.O. No. 45/2003 with respect to the allocation of the 15% available to the County Council, no consideration is attached to their urgent maintenance needs.

4.
In the absence of a **complex locality-level database**, for all the counties, the adequate budget equalization models cannot be developed nor can the accuracy of observing the allocation criteria by those concerned be monitored. The technical assistance provided by the General Public Finance Directorates at county level should follow the pattern of the Ministry of Public Finances, thus avoiding that one and the same indicator, for instance the fiscal capacity, be measured in different ways. We would like to draw the attention onto the differences between fiscal capacity measurements at local (county) level and those made at central level; IPP suggests a better articulation of the two systems.

5.
We recommend that the budget equalization process be performed **directly by the Ministry of Public Finances**, without the intercession currently undertaken by the county councils. This process can take place either in one stage (as it would in a normal situation), by applying the equalization process directly from national level to locality level, or in two stages, as it happens at present, except for the fact that the county-to-local level equalization would be performed by the General Public Finance Directorates at county level. This latter alternative could be used as a period of transition until the former is implemented. Likewise, the county councils could keep the smaller funds (within the limits of the 15% - or even more, up to 20%-25% of the share deducted from the PIT, for equalization purposes, and which at present is allocated according to specific criteria set at county level).

6.
IPP would like to underscore the need to attach **transparency** to any type of equalization system. This refers to the following: a clear-cut allocation formula, not to allow the discretionary allocation of funds; all calculations must be made public and thus subject to any criticism; these calculations must not be influenced by the doings of the beneficiary local governments (to the effect that an indicator such as the fiscal capacity implies a uniform level of local taxes and fees; otherwise, its measurement is impaired); the calculations must be based on the equalization needs (they must be related not to the number of local schools but to the number of public service beneficiaries); these formulae must be clearly formulated in the actual legislation and not in the annual budget laws, in order to provide predictability.

7.
Any change in **the PIT determination and collection methodology** applied by the Ministry of Public Finances must rely on the evaluation of its impact on the local government. This kind of changes must be implemented only after consulting with the local government, if we consider the crucial role played by this tax in local government financing.

8.
The local government **responsibilities** must be made **clear** by distinguishing among various levels of local government, types of localities and different fields.

First of all, the local government responsibilities must be made clear, both with respect to separating them between the two levels of local government and to defining them as exclusive, shared and delegated responsibilities. This process must rely on the observance of the subsidiarity principle, the range of beneficiaries and the economies of scale. At the same time, these responsibilities must be financed through differentiated transfers: the delegated responsibilities - through the conditional grants in the first place (and to a lesser extent through the unconditional ones). The shared responsibilities must be financed by means of the general-purpose grants (acc. to the analysis in Section 1. Principles of fiscal decentralization) which must be as a rule unconditional grants (or conditional grants only in the first 1-2 years after the transfer of that particular function to the local government). The exclusive responsibilities must be financed first through the own revenues (local taxes and fees and the share deducted from the PIT) to which the equalization grants determined starting from the fiscal capacity should be added.

The responsibilities to be transferred to the local government and which are now the task of the local authorities must be **full and exclusive**, to the largest extent possible. This means that the local government must have full decision-making power in those respects it provides financing for. At the same time, one must avoid the local government financing/managing only one part of a certain activity the responsibilities assigned to the local authorities must be exclusive to the largest extent.

The responsibilities of the two local government levels must be clearly **differentiated**, as well as the ones attached to localities of various sizes. It is not normal that a commune with 2,000 inhabitants and a municipality with 200,000 inhabitants have equal public services-related responsibilities.

The local government **responsibilities** in the field of **social protection**, which imply cash benefits must be insured 100% through (conditional or unconditional) grants from the central budget, to safeguard the universal protection of the citizens' rights. In the medium and long run, once the institutional strengthening and expansion of the de-concentrated services provided by the Ministry of Labor, Social Solidarity and Family take place, such responsibilities should be taken over entirely by these structures.

9.
A greater **flexibility** must be attached to the local government capacity to determine the level of local taxes and fees. Thus, one should revert to the situation in 1999 when the local government could alter by +/- 50% the level of local taxes and fees stipulated in the legislation, unlike the current situation when the local authorities can raise them only by 20%. Likewise, it is important that the calculation of the property tax be modified so that it relies on the market value of land and buildings. In this context, one can also imagine the introduction of a progressive system for the calculation of this tax, based not on the number of properties, as today (which is very hard to monitor), but on the property value (or size). In the rural areas, one has to expand the local budget resources, which makes the introduction of the land property tax a must; this would have a positive impact on the phenomenon of agricultural property concentration and the reduction of non-arable land as well.

10.
The reorganization and modernization of the IT system at county level must be also performed, to enable the use of more sophisticated tools in the field of public finance, of budgetary planning, of resource allocation and at the same time to pave the way for increased transparency and civil society involvement in the local budget substantiation process. The IT system must include complex data about the economic status of each locality, about the level and performance of local finances, about the consolidated financial situation of each local authority, about the quality of the public services provided locally.

11.
Within the counties, **the distribution** of the share (35% - 36%) deducted from the PIT must join together the derived-basis allocation (the collection area is the locality) and the per capita allocation. This “recipe” yields best results as it combines the benefits of fiscal

decentralization promoted by the system of derived-basis shared taxes and the need to downsize the horizontal inter-county and intra-county discrepancies generated by the huge differences in terms of fiscal capacity caused by the personal income tax.

12.
The formulae for the allocation of the conditional and unconditional grants should rely on **minimum standards** of expenditures specific to the local government responsibilities, so that a minimum level of quality can be attached to the public services provided by any type of locality. This means for the years to come a sustained activity of standardizing the costs of various public services, which fall under the direct local government responsibility.

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List of abbreviations

Ai	county/ locality surface area
An	country/county surface area
$A_{i/n}$	weight of the county surface area in the country's surface area
$A_{i/j}$	weight of the locality surface area in the county's surface area
CC	County Council
Cei	estimated level of expenditures for locality i
Ci	expenditures of locality i
Csi	standardized expenditures for locality i
E.G.O	Emergency Government Ordinance
$FC_{LTF\ locmed}$	fiscal capacity of the locality, calculated based on the medium level of PIT/inh
FC_{locmed}	fiscal capacity of the locality, calculated based on the medium level of PIT/inh and on the revenues collected from local taxes and fees
G.D.	Government Decision
G.O.	Government Ordinance
GDP	Gross Domestic Product
Gi	grant volume for locality i
GPFD	General Public Finance Directorate
I(j)	income tax due, under the law, at county level
I(u)	income tax due, under the law, at LGU level
IMF	International Monetary Fund
LG	local government
LGU	local government unit
LOR	local own revenues derived from local taxes and fees
LR	local revenues
MIG	minimum income guarantee
NAD	National Agency for the Disabled
NGO	non governmental organization
OECD	Organization for Economic Cooperation and Development
$O_{i/j}$	weight of locality's population aged 65 and over in the total county's population aged 65 and over

OR	own revenues
OR(j)	own revenues at county level
OR(u)	own revenues of the local government unit
P_n	population at national level
P(j)	county population
P(u)	local government unit population
PIT	personal income tax
$PIT / inch_{med}$	average value per capita
$PIT / inch_{max}$	maximum PIT level per capita
$PIT / inch_{i}$	personal income tax per capita at county level
ROL	Romanian Leu
SD(j)	sum deducted from the income tax distributed across the whole county according to this criterion
SD(u)	sum deducted from the income tax per local government unit
VAT	value added tax
Vlmi	own revenues produced in the context of an average fiscal burden for locality i
Vpi	own revenues in locality i
Vppi	planned own revenues for locality i
Ui	county local government units
Un	total local government units of the country
$U_{i/n}$	county local government units number (LGU) units in the total LGU number
$Y_{i/}$	weight of population under 18 of the locality in the total county's population under 18
α,β,λ	weights specific to the fiscal capacity index, surface area and number pf local government units (α+β+λ = 100%

2004 Expenditures Second quarter (millions ROL in constant values)	Total expenditures	Staffing expenditures	Material and services expenditures	Transfers and subsidies	Capital expenditures	Other expenditures
Total value for Local Government	28.141.501	11.611.472	7.378.966	6.438.371	2.331.669	381.023
County Councils	6.367.796	1.114.026	1.860.984	2.906.624	390.796	95.366
Municipalities	13.107.540	5.358.187	3.783.425	2.455.701	1.293.310	216.916
Towns	2.129.503	1.180.535	489.184	260.061	186.325	13.399
Communes	6.536.663	3.958.725	1.245.373	815.986	461.238	55.343

2004 Expenditures Second quarter (millions ROL in constant values)	Public authorities	Education	Culture	Social protection	Public services, development and housing expenditures	Transport and communications	Other expenditures
Total value for Local Government	2.438.053	10.339.568	1.188.238	3.711.486	5.973.463	3.382.271	1.108.422
County Councils	343.344	710.153	658.280	1.438.292	1.310.729	1.606.295	300.702
Municipalities	756.887	5.626.184	290.224	939.132	3.693.322	1.273.968	527.824
Towns	239.311	1.000.128	69.826	250.614	364.211	141.343	64.069
Communes	1.098.511	3.003.103	169.907	1.083.448	605.200	360.665	215.827

next ➲

Annex 1. Local government revenues and expenditures for 2004 (2^{nd} quarter)

next ➲

2004 Expenditures Second quarter (millions ROL in constant values)	Total revenues	Own revenues	Shares deducted from PIT	Sums deducted from PIT and allocated by the CC for equalization	Sums deducted from VAT for education, nursery school and agricultural consultancy	Sums deducted from VATto subsidize heating	Sums deducted from PIT for equalization	Other revenues
Total value for Local Government	30.350.024	13.526.388	6.142.167	1.645.108	8.930.297	1.778.421	4.419.554	1.695.365
County Councils	6.898.380	3.372.202	2.409.849	492.343	712.331	392.709	1.357.330	1.063.808
Municipalities	14.086.144	7.169.183	3.006.269	362.330	4.553.174	1.332.068	706.762	324.958
Towns	2.274.895	940.073	344.478	93.570	890.123	48.455	343.088	53.156
Communes	7.090.604	2.044.929	381.571	696.865	2.774.669	5.189	2.012.373	253.443

Annex 2.
Substantiation report for the Government Decision No. 1537/2004 on the allocation of certain amounts from the Budget Reserve Fund available to the central government and provided in the state budget for 2004, to cover certain current expenditures of local government authorities, was published in the Official Journal No. 893/30-09-2004.

Source: www.guv.ro (data of access: 16th of December 2004)

At present, the local and county councils are faced with an acute shortage of funds needed for their adequate operation as well as for the coverage of other current expenditures of their own and of the public institutions financed from their budgets.

The local government authorities in question have requested repeatedly the allocation of certain funds strictly needed for the payment of the public utility bills and for undertaking certain current repair works to their own buildings and to the buildings belonging to the public institutions financed from their budgets.

Similarly, the recently set-up communes are in need of additional funds to provide for their adequate operation throughout the entire financial year.

In the current context, the present Government Decision on the allocation of certain sums from the Budget Reserve Fund available to the central government and stipulated in the state budget for 2004, to cover certain current expenditures of local government authorities, was advanced..

Annex 3. The Economic Department of the Arad County Council Report on the recommended criteria for the distribution of the sums deducted from the personal income tax and from the 17% share available to the County Council for 2004

In keeping with the State Budget Law for 2004, the distribution of the local budget equalization grants is done according to the provisions of the Emergency Government Ordinance No. 45/2003 on local public finances.

In keeping with Article 29, item 3 of the E.G.O. No. 45/2003, “a 25% share of the sums deducted from certain state budget revenues for local budget equalization purposes, approved annually by the State Budget Law, and of the 17% share available to the county council, is allocated to the county budget, and the difference is distributed to the communes, towns and municipalities according to a County Council Decision, after consulting with commune, town and municipal local governments and benefiting from the technical assistance provided by the General Public Finance Directorate, based on the following criteria:

a) the fiscal capacity determined on the basis of the income tax collected per inhabitant, in the amount of 30%
b) the local government unit surface area, in the amount of 30%
c) the local government unit population, in the amount of 25%
d) other activities determined by a County Council Decision, in the amount of 15%.

The application of the provisions in the E.G.O. No. 45/2003 to Arad county based on the sums distributed to Arad county by the State Budget Law for 2004 looks as follows:

	UM = thousand ROL
1. sums deducted from the PIT for equalization purposes	190.547.000
2. the 17% share from the PIT for equalization purposes	190.600.000
TOTAL (1+2)	**381.147.000**

of which:	
A. Arad County Council (25%)	95.286.750
B. local councils (in communes, towns, municipalities)	285.860.250
of which:	
a). Ordinance-based criteria (85%)	242.981.220
of which:	
- fiscal capacity (30%)	85.758.080
- local government unit surface area (30%)	85.758.080
- local government unit population (25%)	71.465.060
b). specific criteria approved by the County Council (15%)	42.879.030

With regard to the above-mentioned situation, the following criteria are suggested for the distribution of the 15% from the sums deducted from the income tax and from the 17% share available to the County Council:

Priority 1:
Criterion: “The proper operation of local councils and of their subordinate institutions”.
The distribution process according to this criterion involves the following steps:

1. an estimate of the potential local budget resources in 2004, made up of the following:

a) the own revenues excluding the special-purpose revenues. The estimate was done according to the own revenues produced over a period of 10 months in each local council, to which a 136.8% increase was applied. The 136.8% was calculated as follows:

- the basis	10
- the estimate for 2003	12
- 114% increase in 2004 (inflation rate + economic growth)	136,8

b) the 36% share available to the local councils. The estimated level for 2004 was also calculated on the basis of the 10-month revenues, the estimated level for 2003 and a 10% increase (above the level of inflation) for all the local councils

c) a) the 17% share from the income tax (85%) distributed to the local councils according to the criteria stipulated in Ordinance No. 45/2003.

The estimate of the above-mentioned indicators was done on the basis of the data supplied by the General Public Finance Directorate in Arad County and by its involvement in the completion of this step.

2. the definition of the scope of this criterion.

The expected functionality:

a)covering the staffing expenditure needs in 2004 for each local government unit, with respect to the number of payroll staff in October, given a 109% increase (the inflation rate) as well as covering all the salary payments provided by the legislation in force.

The 2004 substantiation was done for all the items of expenditure excluding item 57.02. “education” which is financed from the sums deducted from the VAT.

b)covering the material expenditures (costs) relative to the operation of local councils and their subordinate institutions.

The estimate of the material expenditure needs associated to their operation was done for all the items of expenditure including “education”, by covering the needs of the following items of expenditure:

Article 21 “Social expenditures”

Article 24 “Operation and maintenance expenditures” with the following paragraphs:

- 01 “Heating”
- 02 “Lighting”
- 03 “Water, sewage, sanitation”
- 04 “Postal, telephone, telex, radio, telefax services”
- 05 “Office supplies”
- 06 “Cleaning supplies”
- 07 “Other materials/supplies and services”

Article 25 “Materials/supplies and services for functional purposes”

Identifying the needs attached to the above-mentioned functionality was done by using as baseline the 9-month revenues, the estimate for 2003 and the provision of a 120% increase in 2004 as against the estimated level.

a)covering the subsidy needs in 2004 for all the public institutions (excluding the price- and charge-related differences).
b)covering the needs for 2004 consisting in transfers from the local (commune, town, municipality) budget, to support the child protection system. Given that the strict needs associated only to the functionality of local councils and their subordinate institutions do not cover yet other titles and items of expenditure, the total expenditure needs attached to the functionality for 2004, determined according to the above, were discounted by a 120% increase. If we consider that the resources allocated to the local councils for the 2004 budget are bigger than the ones allocated in 2003, we can estimate that the level of the sums to be allocated according to this criterion will not exceed 8 billion ROL as against the over 23 billion ROL allocated this year.

Priority 2
Criterion: "Town and commune local council participation to the co-financing of internationally-funded programs and projects, as well as to the financing of the engagements assumed according to the documents which prepare Romania's accession to the European Union."

This criterion is also stipulated in the State Budget Law for 2004 and it is meant to generate incentives for the local councils whereby the latter can attract foreign funds provided they get county council support.

Priority 3
Criterion: "Health care and social protection institutions"
This criterion implies the provision of financial resources to cover the expenditures stipulated in the legislation, in relation to social and medical institutions, homes for the elderly and hospitals.

Priority 4
Criterion: "Education"
Resources shall be provided for the resolution of specific problems which exist in the public pre-university education system and also for the specialized training of the

teaching staff. Together with the School Inspectorate, the distribution needs shall be identified and the priorities shall be determined

Priority 5
Criterion: “Rural road maintenance and repair”
The maintenance of rural (commune) roads entails the provision of adequate resources, according to the works in progress, the condition and length of the roads.

Priority 6
Criterion: “Special situations”
This refers to special circumstances which cannot be included in any of the above-mentioned cases. Since according to criteria 2 6 the local councils get resources (funds) based on well-defined targets even if some of them have enough financing as it is, this criterion motivates the utilization of the allocated resources in accordance with the pre-defined targets.

Annex 4.
Formulas for allocation from national level to county level (simulated models)

Formula 6.1.

$$FC_{med} * A_{i/n} \qquad \frac{1-\dfrac{PIT/inh_i}{A*PIT/inh_{med}}}{\sum\left(1-\dfrac{PIT/inh_i}{A*PIT/inh_{med}}\right)} * \frac{A_i}{A_n}$$

Formula 6.2.

$$FC_{\max} * A_{i/n} \qquad \frac{1-\dfrac{PIT/inh_i}{PIT/inh_{\max}}}{\sum\left(1-\dfrac{PIT/inh_i}{PIT/inh_{\max}}\right)} * \frac{A_i}{An}$$

Formula 6.3.

$$\alpha * FC_{med} + \beta * A_{i/n} \qquad \alpha * \frac{1-\dfrac{PIT/inh_i}{A*PIT/inh_{med}}}{\sum\left(1-\dfrac{PIT/inh_i}{A*PIT/inh_{med}}\right)} + \beta * \frac{A_i}{An}$$

Formula 6.4.

$$\alpha * FC\max + \beta * A_{i/n} \qquad \alpha * \frac{1-\dfrac{PIT/inh_i}{A*PIT/inh_{\max}}}{\sum\left(1-\dfrac{PIT/inh_i}{A*PIT/inh_{\max}}\right)} + \beta * \frac{A_i}{An}$$

Formula 6.5.

$$FC_{med} * A_{i/n} * U_{i/n} \qquad \frac{1-\frac{PIT/inh_i}{A*PIT/inh_{med}}}{\sum\left(1-\frac{PIT/inh_i}{A*PIT/inh_{med}}\right)} * \frac{A_i}{A_n} * \frac{U_i}{U_n}$$

Formula 6.6.

$$FC_{\max} * A_{i/n} * U_{i/n} \qquad \frac{1-\frac{PIT/inh_i}{PIT/inh_{\max}}}{\sum\left(1-\frac{PIT/inh_i}{PIT/inh_{\max}}\right)} * \frac{A_i}{A_n} * \frac{U_i}{U_n}$$

Formula 6.7.

$$\alpha * FC_{med} + \beta * A_{i/n} + \lambda * U_{i/n} \qquad \alpha * \frac{1-\frac{PIT/inh_i}{A*PIT/inh_{med}}}{\sum\left(1-\frac{PIT/inh_i}{A*PIT/inh_{med}}\right)} + \beta * \frac{A_i}{An} + \lambda * \frac{U_i}{Un}$$

Formula 6.8.

$$\alpha * FC\max + \beta * A_{i/n} + \lambda * U_{i/n} \qquad \alpha * \frac{1-\frac{PIT/inh_i}{A*PIT/inh_{\max}}}{\sum\left(1-\frac{PIT/inh_i}{A*PIT/inh_{\max}}\right)} + \beta * \frac{A_i}{An} + \lambda * \frac{U_i}{Un}$$

Where:

FC_{med} county fiscal capacity, based on the medium level of PIT per inhabitant =

$$\frac{1-\dfrac{PIT/inh_i}{A*PIT/inh_{med}}}{\sum\left(1-\dfrac{PIT/inh_i}{A*PIT/inh_{med}}\right)}$$

$A_{i/n}$ weight of the county surface area in the country's surface area = $\dfrac{A_i}{A_n}$

$FC_{\max}$ county fiscal capacity, based on the maximum level of PIT per inhabitant =

$$\frac{1-\dfrac{PIT/inh_i}{PIT/inh_{\max}}}{\sum\left(1-\dfrac{PIT/inh_i}{PIT/inh_{\max}}\right)}$$

$U_{i/n}$ county local government units number (LGU) units in the total LGU number = $\dfrac{U_i}{Un}$

α,β,λ coefficients for, correspondingly, fiscal capacity, surface area and number pf local government units (α+ β+ λ = 100%)

Formulas for allocation from county level to local level (simulated models)

Formula 6.9.

$$\alpha * FC_{locmed} + \beta * A_{i/j} + \delta * Y_{i/j} + \varepsilon * O_{i/j} + \mu * \frac{1}{R} =$$

$$= \alpha * \frac{1 - \dfrac{PIT / inh_i}{A * PIT_n / inh_{med}}}{\sum\left(1 - \dfrac{PIT / inh_i}{A * PIT_n / inh_{med}}\right)} + \beta * \frac{A_i}{A_j} + \delta * \frac{Y_i}{Y_j} + \varepsilon * \frac{O_i}{O_j} + \mu * \frac{1}{R}$$

Formula 6.10.

$$\alpha * FC_{LTF\,locmed} + \beta * A_{i/j} + \delta * Y_{i/j} + \varepsilon * O_{i/j} + \mu * \frac{1}{R} =$$

$$= \alpha * \frac{1 - \dfrac{PIT / inh_i + LTF_i}{A * (PIT_j / inh_{med} + LTF_j / inh_{med})}}{\sum 1 - \dfrac{PIT / inh_i + LTF_i}{A * (PIT_j / inh_{med} + LTF_j / inh_{med})}} + \beta * \frac{A_i}{A_j} + \delta * \frac{Y_i}{Y_j} + \varepsilon * \frac{O_i}{O_j} + \mu * \frac{1}{R}$$

Formula 6.11.

$$\alpha * FC_{LTF\,locmed\,2} + \beta * A_{i/j} + \delta * Y_{i/j} + \varepsilon * O_{i/j} + \mu * \frac{1}{R} =$$

$$= \alpha * \frac{\dfrac{PIT / inh_i + LTF_i}{A * (PIT_j / inh_{med} + LTF_j / loc_{med})}}{\sum\left(\dfrac{PIT / inh_i + LTF_i}{A * (PIT_j / inh_{med} + LTF_j / loc_{med})}\right)} + \beta * \frac{A_i}{A_j} + \delta * \frac{Y_i}{Y_j} + \varepsilon * \frac{Oi}{O_j} + \mu * \frac{1}{R}$$

Where:

FC_{locmed} fiscal capacity of the locality, calculated based on the medium level of PIT/inh = $\dfrac{1-\dfrac{PIT/inh_i}{A*PIT_n/inh_{med}}}{\sum\left(1-\dfrac{PIT/inh_i}{A*PIT_n/inh_{med}}\right)}$

$A_{i/j}$ weight of the locality surface area in the county's surface area = $\dfrac{A_i}{A_j}$

$Y_{i/j}$ weight of population under 18 of the locality in the total county's population under 18 = $\dfrac{Y_i}{Y_j}$

$O_{i/j}$ weight of locality's population aged 65 and over in the total county's population aged 65 and over = $\dfrac{O_i}{O_j}$

R fixed allocation for each rural community (R) (the equalization sums are divided equally to the communes)

$FC_{LTF\ locmed}$ fiscal capacity of the locality, calculated based on the medium level of PIT/inh and on the revenues collected from local taxes and fees (1st variant)=

$$\frac{1-\dfrac{PIT/inh_i+LTF_i}{A*(PIT_j/inh_{med}+LTF_j/inh_{med})}}{\sum 1-\dfrac{PIT/inh_i+LTF_i}{A*(PIT_j/inh_{med}+LTF_j/inh_{med})}}$$

$FC_{LTF\ locmed\ 2}$ fiscal capacity of the locality, calculated based on the medium level of PIT/inh and on the revenues collected from local taxes and fees (2nd variant) =

$$\frac{\dfrac{PIT/inh_i + LTF_i}{A*(PIT_j/inh_{med} + LTF_j/loc_{med})}}{\sum\left(\dfrac{PIT/inh_i + LTF_i}{A*(PIT_j/inh_{med} + LTF_j/loc_{med})}\right)}$$