FISCAL DECENTRALIZATION AND ISSUES OF MUNICIPAL BONDS. THE CASE OF ROMANIA

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Abstract: Local governments can make an important contribution to public well-being through the execution of local government policies and the delivery of public services that are important to the local citizens. For this reason, through the local budgets are financed the public goods that are selected to be more important. But if the own revenues of the local budgets are low, the local authorities are dependent on the central ones, fact that affect the allocation of resources by the destinations. Because of the unlimited needs, the local governments search for alternative sources of financing, like bank loans, loans from the capital market, leasing, using some collaboration formulas with the private sector, like public-private partnerships and other financing forms. In a analysis on Romanian case, we shows that a greater level of decentralization give to local governments greater possibilities to cover local needs by attracting new resources, also from alternative ways. (JEL: E62, H61, G21, H72)

Keywords: local budget, municipal bond, fiscal decentralization.

The importance of financial decentralization of the local communities

Local governments can make an important contribution to public well-being through the execution of government policies and the delivery of public services that are important to the local citizens. The local budget is the main instrument of the local government authorities by which are selected the financing priorities from the socio-economic development strategies of communities. Local budgets establish the size of the expenses by the limit of the revenues and assure the substantiation of the financial resources, encourage the local initiatives, assert the local autonomy and exercise the control over the use of local funds. In this direction, the budget should be the centerpiece of a thoughtful, ongoing, decision-making process for allocating resources and setting priorities and direction.

The local budget represents the main instrument for ensuring the decisional autonomy of the local government authorities, for determining what local services will be provided and how they will be financed. In accord to this, decentralization helps to make governments more accountable, allowing a better matching of public services to local needs and enhances efficiency in public sector introducing competition across jurisdictions.

The local financial autonomy depends on certain conditions [2]:

- the local government authorities should have their own monetary resources for achieving the prerogatives stipulated by law;

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• the local government authorities should be allowed to establish their own revenues and expenses and to develop planned budgets;
• the central government authorities should have the control over the way of regulating and administrating the local public businesses.

The local financial autonomy leads to the implementation of some specific financial policies that describe the principles and objectives that guide the financial management practices of local authority. These policies influence the financial decisions, lead to the development of some strategies for reaching the objectives and, furthermore, provide the standards for assessing and monitoring the performances of the financial management system of local government.

A short history of Romanian fiscal decentralization

In 1991, Romania adopted a Constitution mandating that responsibility for local affairs management be transferred to local governments. Shortly afterwards, the first post-communist law on local public administration defined the institutional framework for local governments and it became necessary that local budgets be proclaimed in order to ensure the coherent functioning of local public administrations.

But the first steps in realizing financial decentralization were made by the adoption of local taxes law in 1994. Unfortunately, the act did not respond to the need of local financial resources according to the figures of local public expenditures.

Only starting with 1998, these financial needs started to be met in practice once the Law of the local public finance was stated. One of the most revolutionary provisions of the Local Public Finance Law is the possibility for local authorities to obtain credit in their own name from the domestic banking sector or from domestic and foreign capital market. Faced with competing demands for scarce resources, local and county councils are turning progressively to borrowing as a way of financing priority investment projects. Financing provided on commercial terms (bank lending and municipal bonds can serve investment financing for a municipality) is becoming the main complement to more traditional funding from State and local budgets.

Another important step has been added in 2004 when the legal framework of decentralization has been adopted and thus, all previous incoherent measured have been repressed. The lack of a well-established financial decentralization strategy has generated the following problems for local administrations:
• legislative instability;
• the absence of a transparent system in establishing intergovernmental financial transfers;
• the impossibility of local administrative revenues prediction;
• the lack of precision in defining competences from local administrative authorities;
• the augmentation of local administrative responsibilities without the transfer of needed/appropriate/covering resources.

In order to measure the level of local financial decentralization it is used the Hunter’s index.

\[ H = 1 - \frac{R_{nc}}{R_t} \]  

(1)

where:

- \( H \) – Hunter’s index;
- \( R_{nc} \) – revenues not controlled by local public administration;
- \( R_t \) – total revenues of the local public administration.

We have to remark that the Hunters index in Romania is oscillating year by year, with a growing tendency, which is a sign of increasing decentralization, and the best results are at the municipal level. This tendency is a result of a revenue maximizing policy. Maximizing the revenues represents a component of the local government’s financial management designed to lead towards achieving as many revenues as possible from legal and available sources, in terms of administration. This means the obligation to implement a wide range of improving the policies, the procedures, the staff and organizational structure in order to use at their full potential each of the revenues sources according to the goals and priorities of local government.

At this moment, the level of the funds that local government dispose is still low. The impossibility to raise the tax level, to obtain in this way bigger amounts of money for the local budgets, impose to find some alternative sources to finance the local projects.

**Alternative resources for financing local needs**

In order to attract additional resources, the local governments resorted to bank loans, loans from the capital market, leasing, using some collaboration formulas with the private sector, like public-private partnerships and other financing forms.

The bank credit is the obligation of a public authority towards a financing institution to repay the loaned capital, as from the bank’s point of view the loan is a direct investment and this justifies the tendency of the financing institution to be directly involved in monitoring the activities of the loaner. However, we must mention that the bank credit can be used according to the law, only by the public local authorities as well as by the trading companies with public capital.

An advantage of the bank credit is given by the fact that the creditors can structure the credit so that it responds to the needs of the borrowed, offering different forms of loans, the most frequent being the credit line which presumes that a qualified local authority has access to a certain maximum amount of credit. The local authorities have access to these commercial capitals if they demonstrate...
the capacity and will to repay the credit. Once the local authorities have a crediting relation with a bank and they show good performances concerning the repayment, the access to credits is easier and the costs can be reduced. On the other hand, the difficulties when repaying the credit, which is possible in economic crisis conditions, can lead to a rise in the price of the future loans, but also the creditors can request the situation of default by the respective authority. Even so, the main disadvantage that the bank credits have is the granting term as the granting period is usually of 5 years, which, if these loans are for financing the investments, can lead to the impossibility of exactly foreseeing the investment’s financing.

As the bank credits, the municipal bonds are forms of loan. The main difference refers to the market’s conditions, as well as to creditors’ categories that can be interested to invest in the respective instrument. Therefore, a state or municipal bond is the obligation of a public administration to repay the loaned capital, having the advantage to attract a larger group of institutional investors, individual or legal persons. Besides the classical credit institutions these investors are passive, not getting involved in activities of inspecting the loner. Another advantage is that of establishing the loan’s technical conditions by the loaner, an essential aspect when there are large resources volumes.

The debentures or municipal bonds are debt instruments issued by metropolis, municipality, cities through which these assume the obligation to repay the loaned sum plus the due interests after a period of time which is exactly specified.

The municipal bonds have many advantages, from which we can mention:

- Accelerating the local development. By accessing this type of financing, the projects from the investments priority list will be finalized in advance and the local community will benefit from these projects. Once finalized, the investment will produce earlier benefits for the local community and will also allow a better spacing out of the capital expenses. As a rule, «the administration’s investments attract private investments», the infrastructure investments carried out by the public local authority attract other investments from the private sector.

- Reduced costs. The total costs due to the financing through obligatory loan are more reduced then the costs implied by a bank loan.

- Ending the projects already started. The possibility of ending some large projects whose direct financing would involve special efforts that will significantly influence the balance of the local budget or whose spacing out in time would involve high maintenance costs. Besides, by reducing the project’s execution time the maintenance costs are saved.

- Equity between generations. The principle of public finances equity can be achieved by increasing the maturity of the loan -“Those who benefit of a project must pay for it”.

[73]
• Reducing the financing costs. The positive evolution of the local financial market, mirrored through the decrease of interest rates and the increase of loan’s maturity, now allows the procurement of some credits whose financing costs are more reduced then in the previous years.

• They are financial instruments that, from the natural person’s point of view are free of tax regarding the incomes from possessing the state securities and/or bonds issued by the territorial-administrative units. The incomes obtained from dealing the state securities (capital gain) are taxed.

Therefore, the municipal bonds have a number of potential advantages for attracting the capital, but they also have disadvantages i.e. they cannot be used by the municipalities with a poor financial management, and in the countries in which the local administrations are relatively weak or face poor management.

There are a series of essential conditions for the municipal bonds market to work:

• the existence of an active and functional capital market which can be accessed by the local authorities;
• The existence of some institutional mechanisms for evaluating the credit’s rating;
• In order to issue bonds, public local authorities must have a sufficient capacity and credibility.

A method which leads to increasing the municipalities’ credibility is the possibility to contract insurances for bonds, through which the insurers guarantee the payment of the interest and the main if needed.

The secondary market for municipal bonds is administrated by the Bucharest Stock Market where you can transaction securities on medium and long term using the services of authorized agents.

The financial leasing represents another financing source for the public sector. This is useful when the institution or the economic public agent can guarantee with an active for a bank credit and can immediately benefit of it. The municipality does not have the ownership on the guarantee until the credit is paid and all the other conditions are fulfilled. The financial leasing can be used especially for purchasing the means for public transportation, the computerized infrastructure, the vehicles fleet etc., both by the public administrations and the public trading companies.

Another possibility to develop the tasks which the public sector assumed in the conditions of some limited financing resources is represented by the public-private partnerships which suggests a cooperation between the public authority and the private sector, respectively non-governmental organizations, associations of the businessmen or companies in order to deliver some quality public services. Fundamentally the public-private partnership assures totally or partially the public service depending on the private funds and it calls for the know-how of the private sector.
The cooperation between the public and the private sectors can take different shapes, from the simple relation between the buyer and the seller of a good to mixed companies with a complex structure. Nevertheless there can be pointed out certain characteristics common to the public-private partnership projects:

- The contract between the public and the private parts for the infrastructure’s development and management;
- Dividing the risks between the two partners – the risk is assigned to the part which has the capacity administrate it better thus minimizing the costs;
- The need to use the management and experience of the private sector;
- PPP is an umbrella notion which covers a variety of economic activities and is in a continuously evolution;
- PPP is a partnership between the public and private sectors in order to deliver a project or a service assured traditionally by the public sector. „PPP” best illustrates the way in which both the public and the private sector has certain advantages in relation to the other in the performance of fulfilling certain tasks/objectives, allowing each sector to act as efficiently as possible, thus the public services and infrastructure being assured in the most efficient and economic way;
- „PPP” is a generic term for the relations created between the public and the private sectors often used to include the resources of the private sector and/or the expertise in order to help the insurance of public sector’s goods and services. „PPP” term is used for describing a wide variety of arrangements from a strategic, broad, informal partnership to contracts for DBFO services and joint-venture companies;
- PPP bring together, for the mutual benefit, a public organism and a private company in a long-term joint venture for delivering some high quality public services. Attracting the best from the public and private sectors, the PPPs assure additional resources for the reorientation of the investments in different branches of the public sector and the efficient management of the investment.

The advantages of public-private partnerships are multiple: different solutions for private financing the public projects, reducing the costs for the central or local administrations, using the know-how and the private managements within public projects, high efficiency in developing the project, a smaller implementation period, technical innovation and a higher quality of the delivered services. Additionally, a part from the project’s risks is transferred to the private partner: besides the construction risk, the private partnership can assume the exploitation risk, or the risk of availability.

The main distinction between the PPPs and the alternative privatization schemes is that the public sector plays an important role as services buyer. As for the privatization (the public utilities) the clients of the private operator
are private users, if building the infrastructure through a PPP the govern pays for the delivered services and has a major influence in specifying the results and controlling the quality of the services delivered by the private partner. On the other hand, the difference between PPPs and the model of traditional public acquisition is represented by the transfer of the construction, operating and financing risks towards the private sector.

In some states there were created a series of other financing mechanisms of the local development, those being reunited under the generic name of municipal developing funds. Thus, there are four large institutional models for municipal developing funds:

- Municipal lending and developing funds which function like revolving credits and are financed by governmental funds or by internal or external donators;
- Development banks specialized in municipal loans;
- Grants and loans for the municipal infrastructure given by investment funds controlled by the pensions, insurances or economies companies;
- Autonomous institutions which provide loans and technical assistance.

Most country from Western Europe created institutions which give credits for investments to the local authorities [7]. Other institutions give credits to different public or private economic agents, including the local authorities. In the Western Europe the municipal funds were highly financed by the financial markets. The market’s financing mechanisms were different. For example in Austria, Belgium, Germany, Italy, Portugal the most important was the direct deposits of private economies. In other countries, the financial institutions – pensions funds, insurance companies, commercial banks – were the most important sources (by contrast, the newest municipal development funds from the developed countries were highly financed with public funds).

An analysis of the Romanian municipal bonds market

Local public authorities launched bonds for the first time in 2001, and in order to have the guarantee of a success they practiced an attractive output. The local administrations generally used a coupon in three months (like the BUBOR+BUBID/2 inter-banking rates), to which they added a risk bonus of 2-3%. This is the reason for which, although the risk degree of the municipal bonds is considered a little low, the outputs of the corporative bonds are superior, a somewhat atypical situation. The attracted resources were used for financing different investments of local interest.

The first municipal bonds, listed at BVB at the end of 2001, were issued by the local administrations from Mangalia and Predeal.
From the dates in the table we can see the fact that at the beginning (2001-2004) the bond emissions had a reduced date of payment (1.5 – 6 years), with a risk bonus attached to the basis interest of 2 – 3%, and starting with 2005, once the municipal bonds’ market and the ascendant evolution of the Romanian economy matured, their term gradually increased, reaching 21 years (2007 – municipal bonds issued in Iaşi, of 200.000.000 RON), and the risk bonus dropped.

Table 1. Issue of municipal bonds (2001-2009)

<table>
<thead>
<tr>
<th>The issue’s year</th>
<th>The number of issues</th>
<th>Total value (RON)</th>
<th>Maturity (min-max)</th>
<th>Risk bonus attached to the new bonds</th>
<th>Number of BVB transaction issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>2</td>
<td>1.500.000</td>
<td>1.5 – 2 years</td>
<td>2%-3%</td>
<td>2</td>
</tr>
<tr>
<td>2002</td>
<td>8</td>
<td>12.650.000</td>
<td>1 – 3.5 years</td>
<td>0% - 2%</td>
<td>4</td>
</tr>
<tr>
<td>2003</td>
<td>12</td>
<td>46.004.600</td>
<td>2 – 5 years</td>
<td>0% - 2%</td>
<td>9</td>
</tr>
<tr>
<td>2004</td>
<td>8</td>
<td>22.216.000</td>
<td>2.5 – 4 years</td>
<td>2%</td>
<td>18</td>
</tr>
<tr>
<td>2005</td>
<td>6</td>
<td>38.750.000</td>
<td>6 - 20 years</td>
<td>0%-2%</td>
<td>15</td>
</tr>
<tr>
<td>2006</td>
<td>5</td>
<td>42.500.000</td>
<td>8 - 20 years</td>
<td>0.1%-1.65%</td>
<td>11</td>
</tr>
<tr>
<td>2007</td>
<td>8</td>
<td>168.008.500</td>
<td>18 - 21 years</td>
<td>0.75%-1.43%</td>
<td>16</td>
</tr>
<tr>
<td>2008</td>
<td>5</td>
<td>198.000.000</td>
<td>17.5 - 20 years</td>
<td>0.65%-1.3%</td>
<td>20</td>
</tr>
<tr>
<td>2009</td>
<td>5</td>
<td>95.550.000</td>
<td>16,5 – 20 years</td>
<td>0.7%-1.15%</td>
<td>26</td>
</tr>
</tbody>
</table>

Note: the different portions were considered different emissions.
Source: authors’ calculus after the dates provided by www.kmarket.ro.

It has to be said, based on Mosteanu and Lacatus, that the revenues and expenditures of the Romanian municipalities who issued municipal bonds reveal a decentralization level superior to the average level. In accord with this finding, we can say that a greater level of decentralization give to local governments greater possibilities to cover local needs by attracting new resources, also from alternative ways.

Summary

The local financial autonomy leads to an increased responsibility of the local government towards the citizens of their own jurisdiction, which is reflected in a faster and greater adjustment of the resources to the local needs. Confronted with some great needs and limitation of the financial resources, local governments have the possibility to use alternative financing sources. Among these sources we find the issue of municipal bonds which leads to obtaining some quantitative resources for relatively long periods of time. The analyse of the municipal bonds in Romania shows the fact that the access to this financing source is easier for large municipalities that have a greater financial autonomy, but their efficient use requires the adoption by the local governments of some integrated development strategies that guide their own financial policies.
References


DECENTRALIZAJCA PODatkOWA I KWESTIE OBLIGACJI KOMUNALNYCH NA PRZYKLADZIE RUMUNII