

## FISCAL DECENTRALIZATION IN ROMANIA – PRESENT STATE AND PERSPECTIVES

Marius Sorin DINCĂ\*, Gheorghita DINCĂ\*\*

### Abstract

*The decentralization should transfer some attributions and services to the local level. In return, that implies that the local community should be awarded directly either a quota out of all the taxes that are collected from its fiscal territory or the entire amount of some taxes. One solution could be that the direct income taxes should be withheld at the local level whereas the indirect taxes should go to the general public Romanian budget for the overall needs of the country.*

**Keywords:** decentralization, fiscal decentralization, territorial administrative reform, local budget, direct taxes, indirect taxes

**JEL classification:** H7, H71, H72

### 1. Introduction

Romania's economy has undergone significant transformations in the last 8 years. Its GDP increased from a mere 44.8 billion Euros in 2001 to approximately 130 billion Euros in 2008. According to government's estimations in approximate 4 years the GDP per person is supposed to reach 10,000 Euros, which will ensure the conditions for catching-up with the average EU development level.

In 2005 there was made a major fiscal reform, which replaced the progressive taxation system extant to that date, both for individuals and for companies. The law introduced a flat 16% rate of taxation for all income taxpayers with the idea of encouraging the direct investment and economic activities. As a result, the GDP increased from 58.9 billion Euros in 2005 to 130 billion Euros in 2008 and the weight of direct taxes into GDP also increased from 6.3% in 2004 to 7.04% after a slight turndown in 2005.

All these evolutions laid the ground for passing toward more qualitative developments and to a real modernization of the economy and society, including the issue of decentralization.

The territorial administrative reform, together with its essential tool, the fiscal decentralization, has become widely accepted by the Romanian civil society, the academic environment and the public authorities. Also, the European experience showed that the re-

---

\* **Marius Sorin DINCĂ** ([marius.dinca@unitbv.ro](mailto:marius.dinca@unitbv.ro)), PhD, Associate Professor, "Transilvania" University of Brașov, Faculty of Economic Sciences.

\*\* **Gheorghita DINCĂ** ([gheorghita.dinca@unitbv.ro](mailto:gheorghita.dinca@unitbv.ro)), PhD, Lecturer, "Transilvania" University of Brașov, Faculty of Economic Sciences.

gional level represents the most appropriate framework for nurturing the economic initiative and development and for the best response to the needs and initiatives of its inhabitants.

*Fiscal decentralisation* has been defined as the division of public expenditure and revenue between levels of government, together with the discretion given to regional and local government to determine their budgets by levying taxes and fees and allocating resources [Davey, 2003].

In what follows we will present, in the first section of this paperwork, the main advantages and threats posed by the decentralization process. In the second section, we will analyze the current features of the fiscal decentralization process in Romania, whereas in the third final section we will propose several ways for achieving a higher degree of decentralization, taking into account the new Government program and the coming Constitutional reform initiated by the Presidency.

Our paperwork has several essential points:

- 1) The current territorial administrative framework from Romania, with 42 counties, is defined by *too many bureaucracy*, both at the central level as well as at the local level, by *limited autonomy*, both in the decisional area and in the financial and fiscal areas, by *low efficiency* in what concerns the promotion, financing and realizing investment projects at the local level and by *the growing frustration and dissatisfaction* of the local collectivities as they perceive the total predominance of the solidarity principle (of large redistribution of the public financial revenues) over the stimulative principle (which consecrates a reduced redistribution of the revenues at the national level and the promotion of local initiatives);
- 2) There is an absolute need in Romania for a serious territorial administrative reform based on a real decentralization and ensuring financial autonomy of the regional collectivities. In support of the financial autonomy, the fiscal decentralization is the most important tool. Local administrative autonomy is conditioned by the financial autonomy and offers the possibility to submit the local and national public services to the local specific demands and needs, in terms of efficiency and efficacy [Moșteanu and Lăcătuș, 2007];
- 3) There must be a clear distribution of the tasks after the decentralization between the central government and the regional government, accompanied by a clear separation of the financial resources available to each component. The fiscal decentralization should support these evolutions;
- 4) We propose a new design of the fiscal system, which should ensure the best response to the new characteristics of the regional structure after the territorial administrative reform.

### **1.1. The debates around decentralization**

The issue of decentralization and especially of fiscal decentralization is a very important point in the present debates around the public economy and finances domains in many European countries. In the current context, in which the people are asking for increased accountability and efficiency in the use of the public money, the fiscal decentralization has been increasingly evoked as an essential tool in this direction.

The degree of envisioned decentralization depends upon several key factors, such as the externalities generated by each way of providing the public goods, the differences in

tastes in what concerns the public spending, the knowledge and expertise of the local authorities, the social and cultural traditions and so on [Besley and Coate, 2003].

The most important arguments in favor of decentralization (and of course in favor of fiscal decentralization) could be the following:

- 1) The better identification and fulfillment of the local demand for public goods and services can be achieved only if the distance between policy makers and authorities and the people is reduced to a minimum, according to the principle closer to people [Lockwood, 2005].
- 2) It increases the accountability of the government. This refers to the extent to which rent-seeking activities of office holders, such as bribes, favoring of particular interest group and insufficient innovation and effort are controlled [Oates, 1985].
- 3) The citizens and the companies are motivated to produce and earn more, since the results of their work is shown in a direct manner even at the level of public provided goods and services, such as better infrastructure, better social services, better health care and better education. A study performed between 1984 and 1997 by Kyriacou and Roca-Sagales [Kyriacou and Roca-Sagales, 2008] for a panel of 29 developing and developed countries, revealed that fiscal decentralization has a positive effect on institutional quality. Nevertheless, they discovered, quite normally we might add, that the effect is diminished as the country gets wealthier.
- 4) It may result in greater experimentation and innovation in the production of public goods [Oates, 1972, 1999].
- 5) The increase of competition with the neighboring regions will constraint budgetary growth and will put pressure in the direction of more efficient provision of public services.
- 6) The reduction of the bureaucracy at the national level, as a lot of central government agency and structures are perceived as less useful by the regional inhabitants and the costs of maintaining such structures are very high. Recently, there was a large public debate in Romania as to the incredible salaries and work-related benefits received by the managers of such public agencies (sometimes in excess of 10,000 Euros per month, when the average salary is around 400 Euros per month).

Several studies, like the ones performed by Huther and Shah (1998) discovered that fiscal decentralization is associated with enhanced quality of government as measured by citizen participation, political and democratic accountability, social justice, improved economic management and reduced corruption. Also, Dreher (2006) finds out that law and order is more likely to advance with a higher share of sub-national revenues, especially for the developing countries.

However, there are some motivations against achieving too much decentralization:

- 1) The *competition* for attracting investing companies at regional (local) level may involve granting too many fiscal and financial incentives and hereby increasing the mobility of the economic agents and the volatility of regional budgets. As a conclusion, some regions and zones may find themselves in a position that is characterized by difficulties in raising the taxes necessary to finance their activities. Also, the reduction of the taxation levels may induce budgetary difficulties even in the settling areas of the investors. This tendency may be contained if the levels of income taxes are established unitary by the national government, even if the local authorities are allowed to establish the level of assets based taxes.

- 2) The central government will be charged with the task of using public financial resources for the development and/or for sustaining the minimum accepted standards of social services of the less developed regions.
- 3) There can be problems connected with the allocation and financing of the general interest public services and utilities and with the distribution of the positive and negative externalities generated by the economic and infrastructure activities of each region.
- 4) The rent-seeking activity will be partially transferred at the local levels, leading to the possible creation of a new class of *local barons*, which could be difficult to control and contain.

In our opinion, the disadvantages can be overcome with an overall approach and a proper planning of the decentralization process. Even democracy has disadvantages, but its prevalence over the other forms of social organization is undisputed. The economic, financial, motivational and other advantages of the real decentralization are overwhelming compared to the technical difficulties and *what ifs* of an improper implementation of the decentralization.

## 2. The current state of the fiscal decentralization in Romania

Romania is currently divided into 42 counties that contribute to the realization of the state budget. The counties also have their own budget, as well as the cities and communes that reside within the territory of the counties. The local budgets are fed from the local taxes, such as the land's tax, the buildings' tax, the tax for public advertisement, but also from transfers from the state budget.

This structure with 42 counties involves too many expenses with the local representatives of the various state authorities (public finances structures, ministry of agriculture representatives, ministry of interior representatives, ministry of labor representatives and so on). This calls for a structural reform of the public administration, which is meant to lower the public expenses but also to enhance the efficiency, accountability and operational capacities of the administrative divisions.

### 2.1. The pseudo-reform with the development regions

As a requirement of joining the EU, the 42 counties were formally grouped into 8 **development regions**, in order to ensure a better access and use of the pre-accession funds allocated for the economic and social development.

However, the 8 regions showed a questionable efficiency, proven by the failures of the regional economic policies, such as the incapacity to achieve the objectives of reducing the development imbalances, of stimulating economic development, of encouraging the partnerships and the regional spirit [Ghinea and Moraru, 2002].

Another problem connected with the functioning of the 8 regions was that they were mainly given responsibilities related to the use of the EU funds and the development achievable by the mean of those funds. The other development issues that were identified at the level of each member county were rarely articulated into a coherent development strategy at the region's level, as the relations between the management of each county and the management of the region were not properly defined.

The 8 regions are not allowed to raise taxes and they do not have real decisional impact upon the including counties.

## 2.2. The current characteristics of Romanian fiscal activity

The state budget is raised from the territory of each county, collecting direct taxes, such as individuals' income tax and company income tax and indirect taxes, such as VAT and excise taxes. Out of the overall taxes collected, the state budget finances the general public interest services, such as the national police, the national defense system, the judiciary system, the education system, the sanitary system, social assistance, etc. and also makes transfers toward the local communities in order to balance their budgets.

In the current period, the local budgets received certain responsibilities (the primary and secondary education, social assistance services, the decentralized cultural institutions, public health services, etc.) but they did not receive fully financial autonomy for these assigned responsibilities. In fact, the state budget allocates amounts as quotas from the state budget revenues – mainly from VAT and the income tax- toward the local budgets. These amounts become revenues for the local budgets and consequently expenses of these budgets.

Hence, the financial autonomy of the local communities is limited, as parts of their budgets (the transfers and the allocated quotas) have to be approved by the Ministry of Finance and validated in the Parliament. Of course, the other part of the local budgets is approved at the local level, by the Local councils or County councils.

The necessity of changing the current administrative system is greatly due to the failure of the existing solidarity principle as compared to the more modern stimulative principle. The solidarity principle was used as a reference in the reallocation and internal transfers' processes at the level of the Central State budget, but it actually deepened the development imbalances between and inside the 8 development regions. The solidarity principle failed to motivate the less developed regions in their efforts to attract more revenues and in the same time it accentuated the frustration of the people from the more developed regions, as their own development projects were delayed or lacked funding (as it is the case with the Braşov airport project).

The creation of really functional and autonomous regions will also involve creating regional budgets which are meant to encourage the local development strategies that will become complementary rather than competitive, as it is the case with the current 8 development regions.

The further decentralization was made a priority by the Presidency and the new Government instated after the elections from December 2008.

From the principles of government related with the decentralization presented by the newly installed Govern after the 2008 elections in Romania we can mention:

- 1) The principle of subsidiarity for the confinement of the decisional outreach of the Government to the fields and problems that cannot be addressed more efficiently at the local level.
- 2) The principle of contribution and of solidarity for promoting social progress.

In what concerns **the administrative decentralization**, the same program stipulates establishing a rigorous calendar regarding the decentralization of the public services and enforcing regulations meant to allow the transparent and stable management of the decentralization.

**The main stipulations regarding the financial decentralization are:**

- The modification of the Public Finances Law as to ensure both the financing of the operating expenses for the public services from the responsibility of the local authorities, according to standards such as cost per beneficiary or unit measure, as well as the financing of the development expenses, including the ones keeping to investment projects or programs at the local, regional and county level.
- The inclusion in the annual budgetary law of distinct annexes to contain estimations for the next four years of the amounts that will be allotted to the local budgets, such as the local authorities to able to promote multiannual projects and programs and to have the guarantee of their implementation.
- The unitary coordination of the local public infrastructure investments and of other priority projects. At the level of State budget will be created a National development Fund. The resources of this fund will be used inclusively for the supplementation of the funds required for the co-financing of the programs/projects benefitting from European funds' financing.
- Increasing the financial autonomy of the territorial-administrative units through augmenting and ensuring the stability of their own financial resources through:
  - Granting local authorities the right to modify the level of the local taxes and contributions according to the local necessities and the degree of supportability of the population;
  - Calculating the fiscal value of the lands and buildings using their market values, where these latter values are significantly greater than the values used for the current taxation system.
- The allotment of the 47% quota from the tax income to the local budget, according to the fiscal domicile of the taxpayer instead of the fiscal domicile of the employer.
- The review of the quota allotted from the income tax according to the new competencies transferred to the local authorities during the decentralization process;
- Leaving the entire amount of the fines applied to companies at the disposal of local budgets, the same as for the amounts coming from fines applied to individuals.
  - The sizing of the amounts allotted for financing the decentralized services according to standards such as cost per beneficiary/measure unit, especially in education, social services, health care and public roads maintenance;
  - The annulment of the regulations that centralized the real-estate transactions' tax and the judicial stamp' taxes.

The Government program was made having in mind the following forecast of the main macroeconomic measures, presented in table no. 1.

*Table no. 1. The forecast of the main macroeconomic measures*

Measures Year	2008	2009	2010	2011	2012
GDP – Billion Lei, current prices	505.0	582.7	660.7	745.9	838.1
GDP – real growth - %	8.5	3.5	4.5	5.5	6.0
Average inflation rate – %	7.9	5.0	4.0	3.5	3.0
Gross average monthly income – Lei/month	1700	1870	2122	2410	2722

Gross average monthly wage – Lei/month	1580	1740	1975	2240	2532
The average monthly social insurance pension – Lei/month	593	760	862	978	1105
The average number of employees – ‘000’s of persons	5055	5100	5220	5350	5485
Budgetary revenues – as % of GDP	32.0	32.6	34.0	35.1	35.9
Budgetary expenditures – as % of GDP	35.5	35.1	35.6	36.2	36.8
The deficit of the general consolidated budget as % of GDP	3.5	2.5	1.6	1.1	0.9
The current account deficit – as % of GDP	13.3	11.1	9.7	9.3	8.8

*Source: The new Romanian Government economic program*

The forecasted values of the macroeconomic measures present a certain degree of relativity due to current uncertainties coming from the economic and financial crisis.

We can notice that there is a certain orientation at the Government level toward increasing the financial and administrative autonomy, with the direct goal of improving the quality, availability, financing techniques and the efficiency of the public services. Nevertheless, in the current context, those steps can be seen more like a delegation of central attributes, together with the corresponding allotment of the funds that are still firstly raised through the state budget. This happens because the current territorial administrative framework has definite limitations and has reached its maximum functional and developmental capacities, calling for a new territorial-administrative and fiscal reform.

### 3. The perspectives of the fiscal decentralization in Romania

The decentralization process in Romania (including fiscal decentralization) has to respond to several requirements:

- 1) To ensure an increased efficiency in the use of public money and to offer better public services and utilities to the inhabitants of each region;
- 2) To enable the regional public authorities to exercise full initiative and autonomy in approaching the needs of their citizens, together with the proper financial and fiscal tools;
- 3) To rationalize the circuits of the public funds, starting with their collection thru the tax system and onto their final use, fulfilling the individual and collective requirements of the region’s inhabitants. It serves no purpose to nobody if the region firstly collects hundreds of million Euros in taxes that go to the central state budget, they get lost in the complexity of the execution of the state budget system, and only after six or nine months the Public Finance Ministry authorities decide to allocate the same amount of money as transfers to balance the regional budget or as subsidies. The result is that the region awaits for the money and may lose important investment opportunities;
- 4) To stimulate the development of the local economy and infrastructure, promoting the public-private partnership in solving the needs of the local communities;

- 5) To motivate the management of each region to have an active attitude toward creating, financing and implementing development projects and to increase the local public revenues.

The decentralization process in Romania should, in our opinion, pass through the following steps:

- 1) In Romania there is a stringent need for the territorial administrative reform, which is intended to replace the current organization with 42 counties and to implement a system with 9 to 12 regions, which will increase the functionality and efficiency in providing the public services and utilities, together with the capacity of designing and attracting EU funds for regional development. The referendum on this matter will be held most likely in 2010;
- 2) A privatization of the markets for the provision of public utilities (garbage collection and disposal, public transportation, water services, central heating system) and other public services. This will lead to increased competition, better services, lower costs and a reduced budgetary pressure, together with ensuring a steadier flow of public financial revenues at the local budgets. This privatization has to be performed with maximum attention, in order to avoid the trap of creating private monopolies instead of the public monopolies.
- 3) After the privatization, the remaining public services and utilities have to be properly shared between the central government and the local government. This has to be realized through clear legislation in order to avoid the overlapping of the competencies and to ensure the proper covering of each field of public activity. In the Romanian current situation the most important issue of this point to be solved is the assignment of the higher education. There will be serious debates about the financing issues connected with the higher education, which currently is done by the state budget. In the current territorial administrative system any given county would not be able to finance a medium or large state university, even if it would be left with overall direct taxes generated by that county. The regions that will appear after the territorial administrative reform could probably afford to finance one or two regional state universities.
- 4) The evaluation of the financial requirement for each component of the system (central government, regional government, local government), according to the previously established competencies. After determining the financial requirement, the public revenues can be divided according to the best financial scheme in order to assure the proper financing of the publicly provided services. In this way, we sustain the opinion of authors such as Martinez-Vazquez [Martinez-Vazquez, 2001], which argue that the first fundamental step in designing the intergovernmental fiscal relations should be the clear assignment of functional responsibilities among different levels of government.

In table no.2 from below we are presenting the structure of the public financial revenues, as percentage of GDP.

*Table no. 2. The structure of financial public revenues, as % of GDP*

	2001	2002	2003	2004	2005	2006	2007
Central government	16.7	12.2	12.4	12.4	12.3	11.5	12.10
Local government	0.7	5.6	5.9	5.8	6.0	7.3	9.09

*Source: Commission Services EU*

We can notice the clear tendency of increasing the weight of the local government revenues in the GDP, from a mere 0.7% in 2001 to 9.09% in 2007, respectively a 12 fold



increase and reflecting an obvious tendency of local public revenues of matching the weight of the central government revenues. Those numbers reflect a tendency for financial decentralization, although the current systems will not allow for much longer the actual trends.

In what follows we are investigating several methods of achieving the real fiscal decentralization together with their implications, advantages and disadvantages.

### 3.1. The direct-indirect method

This method is the most radical method and implies that the regional/local authorities should retain and use at the local level, all the direct taxes raised from their fiscal territory, respectively the *income based taxes* (the individuals' income tax and the company income tax), as well as the so called *local taxes*, represented mainly by the asset based taxes – the taxes on buildings, lands and transportation means, paid both by the individuals and by the companies.

There are varying definitions of local taxes. For example, Kenneth Davey attributes to local taxes the following features [Davey, 2003]:

- they accrue to the budgets of the local government in whose area they are collected, and
- they are subject to some degree of variation by the recipient local government; i.e. the local government has some discretion in deciding how much each person pays, by setting the rate, determining the basis of assessment, granting exemptions etc.

The main difference to the existing system should be the fact that the local authorities should retain and use for their own development and public servicing purposes *the overall direct taxes* raised in their fiscal territory and not only the *local taxes*. In the current system the local authorities are entitled to retain and use in the first instance only the *local taxes* and only afterwards will receive back transfers and allotments from the state budget to ensure the fulfillment of the public functions at the local level.

In our proposed system, the state budget will use the VAT and excises mainly for the remaining central offered public services, such as justice, national defense, national police, fundamental research and infrastructure. Part of the indirect taxes collected at the national level can be used for balancing the underdeveloped regions' budget.

In order to demonstrate the applicability of our method we will have the following approach:

- 1) We will show that the direct taxes have had a positive trend as weight in Romania's GDP and hence they could support the task of representing the core of the financial autonomy of the regions in the new administrative framework.
- 2) We will proof that both at the Brasov county level as well as at the level of the Romanian state budget the proposed separation of the taxes (direct at the local level and indirect to the state budget) will respond to the envisioned criteria of rationalizing the financial circuits, providing enough financing and motivating the actors to have an active approach in achieving their operational, development and budgetary objectives.

In table no.3 we are presenting the structure of revenues in Romania (indirect taxes, direct taxes and social contributions) from 2001 to 2007.

Table no. 3 The structure of revenues in Romania (in % of GDP)

Structure of revenues	2001	2002	2003	2004	2005	2006	2007
<b>Indirect taxes</b>	<b>11.4</b>	<b>11.7</b>	<b>12.3</b>	<b>11.8</b>	<b>12.9</b>	<b>12.7</b>	<b>10.84</b>
VAT	6.3	7.1	7.2	6.7	8.1	7.9	7.72
Excise duties and consumption taxes	2.3	2.4	3.5	3.6	3.3	3.2	2.77
Other taxes on products (incl. Import duties)	2.3	1.5	1.0	1.0	1.0	1.1	0.04
Other taxes on products	0.5	0.6	0.6	0.5	0.5	0.6	0.3
<b>Direct taxes</b>	<b>6.1</b>	<b>5.7</b>	<b>5.9</b>	<b>6.3</b>	<b>5.3</b>	<b>6.1</b>	<b>7.04</b>
Personal income	3.3	2.7	3.1	2.8	2.3	2.8	3.43
Corporate income	2.5	2.5	2.7	3.1	2.7	2.8	3.61
Other	0.3	0.5	0.1	0.3	0.3	0.4	0
<b>Social contributions</b>	<b>10.3</b>	<b>10.8</b>	<b>9.5</b>	<b>9.3</b>	<b>9.7</b>	<b>9.8</b>	<b>6.0</b>
Employers'	6.4	6.5	6.2	5.9	6.4	6.3	4.08
Employees'	3.8	4.2	3.1	3.1	2.9	-	1.9
Self and non-employed	0.1	0.1	0.2	0.2	0.4	-	0.02

Source: Eurostat Commission Services and the Romania's Ministry of Finance

The overall tax-to-GDP ratio of Romania was, at 28.6 % in 2006, 8.5 percentage points lower than the EU-27 average. The level of taxation in Romania is the lowest in the EU.

We can notice that the weight of direct taxes into GDP has increased from 6.1% in 2001 to 7.04% in 2007. Even if this increase as weight in GDP is only of about 1% in percentage point terms (16.6% in relative terms), the per se increase of direct taxes it is much more significant, from 2.7328 billion Euros in 2001 to 8.5184 billion Euros in 2007 in absolute terms (a 211.7% increase in relative terms). This is due to the vigorous economic growth and also to the instatement of the flat tax rate in 2005, which brought up an important part of the underground economy. These evolutions proof that the assignment of the overall direct taxes to the regional budgets will allow a good base for local development and for the fulfillment of the local public needs.

The weight of indirect taxes into GDP, which in our model are meant to fuel the state budget, has known a certain decrease in relative terms, from 11.4% in 2001 to 10.84% in 2007, as the custom duty taxes had a significant drop as a result of joining the EU. Nevertheless, in absolute terms, the indirect taxes grew from 5.1072 billion Euros in 2001 to 13.1164 billion Euros in 2007 (an increase of 156.82%).

In order to prove the feasibility of the direct-indirect method we will analyze the situation at the level of Braşov county and for the Romanian state budget.

For example, in the Braşov county the total of direct taxes collected thru 10.31.2008 was of 677,674,865 LEI (data obtained from the Local State Treasury), whereas the total of the Central Budget allotted amounts as quotas from direct income taxes were of 351,774,281 LEI and from VAT 295,158,037 LEI, or a grand total of 646,932,318 LEI.

The same question for 2007 shows:

- Total direct taxes collected were of **688,239,128 LEI**;
- The total money allotted from direct taxes quotas were of 359,510,459 LEI;
- The total money allotted from indirect taxes quotas (VAT mostly) was of 358,709,943 LEI.
- Total allotted money from central budget: **718,220,402 LEI**.
- For 2006 we get the following data:
- Total direct taxes collected were of **476,948,599 LEI**;
- The total of allotted quotas from direct taxes were of 235,419,883 LEI;
- The total of allotted quotas from indirect taxes (VAT mostly) were 373,214,934 LEI.
- Total allotted money from central budget: **608,634,817 LEI**.
- The data for 2005:
- Total direct taxes collected were of **383,785,031 LEI**;
- The total of allotted quotas from direct taxes were of 159,871,681 LEI;
- The total of allotted quotas from indirect taxes (VAT mostly) were 245,348,359 LEI.
- Total money allotted from central budget: **405,220,040 LEI**.

From this collection of data we can deduct the following conclusions:

For 2005, 2006 and 2007 the total amount of money allotted from the central state budget was somewhat higher than the amount of the direct taxes collected from the area of the Braşov County. That means that for these 3 years the principle of financing the local needs through direct taxes had to be slightly corrected with allotments from VAT or other state budget tax, but it worked essentially if we have in mind the need for rationalizing the money circuits.

For 2008 the situation is substantially better, since the Braşov county could finance itself, without any transfers from the state budget, should it had kept for its own use the overall direct taxes collected, of 677,674,865 LEI. We can notice that the overall allocations from the state budget were of 646,932,318 LEI, less than the collections from direct taxes.

The degree of coverage, calculated as the ratio between the direct taxes collected at the county level and the total allocations from the state budget, evolved as follows (see table no. 4 below):

*Table no. 4. The evolution of the coverage degree at the Braşov county level*

Measures	2005	2006	2007	2008*
Direct taxes collected from the Braşov county territory	383,785,031	476,948,599	688,239,128	677,674,865
Transfers from the state budget as quotas from income tax and VAT	405,220,040	608,634,817	718,220,402	646,932,318
The coverage degree (Total direct taxes/Transfers from state budget)	94.71%	78.36%	95.82%	104.75%

*\* the data for 2008 cover only the first 10 months. All data collected from Local Treasury of Public Finances*

The hypothesis can be verified even for the overall Romanian state budget. For 2008, for example, the state budget had overall transfers and amounts (allotted as quotas of VAT and income tax) toward the local budgets of 41,086 mil. LEI, whereas the total direct taxes were in amount of 32,020 mil. LEI. That proves that everybody would have been better off if the 32,020 mil. LEI would have remained at the disposal of local public authorities in the

first place and the state budget would have contributed with 9,000 mil. LEI to balance the budgets of the less favored counties. For this purpose, the allotments from VAT alone would have sufficed.

The enforcement of the proposed system in Romania is conditioned by the new expected regional-administrative reform (which will imply the reduction in the number of the territorial administrative units – from 42 counties in present to something like 10-12 regions after the reform will be completed).

The theoretical foundation for this system is quite logical, having in mind that is normal that the region should benefit, in the first place, from the results of the economic activity that is carried out in that region (by the mean of income taxes). Of course, it can be argued that even the central state contributes to a certain extent to the realization of the revenues in any given region, but the territoriality principle can be easily defended in this case.

This will have serious consequences upon the number and structure of public services financed from the state budget, respectively from the local budget. The regional/local authorities will have to assume some of the tasks and functions that are currently performed by the central authorities. Some of those may involve health and education services (including maybe the higher education), local police forces, regional infrastructure and others.

The main disadvantages posed by this approach could be:

- Temporary disfunctionalities and blockages in the public services that are currently offered by the state authorities as a result of reorganizing, relocating and changing financing procedures;
- Some workforce problems at the Bucharest city level due to downsizing the centralized authorities and services;
- There can be budget execution problems at the level of less developed regions as a result of the insufficient level of direct taxes raised from that territory. In this case, the solution could be represented by transfers from the central state budget and accessing EU regional development funds;
- The need to increase the level of real assets taxes in order to ensure the balancing of the local budgets may determine also social and economic problems;
- The local authorities will have to develop control and auditing services that will ensure the proper and legal use of the funds, involving some organizing, staffing, functioning and financing issues. All these can be overcome but will imply initial investments at the local level.

The main advantages lie in the fields of increased accountability of the local authorities toward the taxpayers, increased efficiency of the public money spend (shorter money circuits and reduced bureaucracy), better preference matching (a better correlation between the needs of the residents and taxpayers and the directions of spending the public funds in that region). Also, there can be a significant emulation due to the awareness that the fiscal decentralization will mean visible improvements for the taxpayers at the local level.

### **3.2. The allotted quotas method**

The allotted quotas method represents practically an extension of the current system, in which local administrations receive transfers to balance their budgets, as parts from the central collected taxes, mainly from VAT and income taxes.

The new government program foresaw the allotment of the 47% quota from the tax income to the local budget, according to the fiscal domicile of the taxpayer instead of the fiscal domicile of the employer and also the review of the quota allotted from the income tax according to the new competencies transferred to the local authorities during the decentralization process.

The main problem is that the effective allocations and transfers are always influenced by the political interferences, electoral interests and votes buying. Also the great fragmentation of the territorial administrative system, with 42 counties, involves a serious limitation in creating urban development areas based on cultural, economic and regional traditions and affinities and hinders the accession of EU funds.

Other authors (Davey, 2003) propose similar solutions, respective intergovernmental transfers as *shares of national taxes*, distributed by some formula (e.g. per capita) or by origin and as *grants/subventions*, targeted or untargeted.

#### 4. Conclusions

The decentralization process is definitely on the front page agenda for the leading authorities of Romania, like the Presidency and the Government, being subject of an imminent referendum, scheduled for 2010 or 2011.

The idea is appreciated by the Romanian society, the academic environment and the public authorities, but still has to be the object of a vast information campaign before it can be brought up to the attention of Romanian voters by referendum. The outcome of the referendum will depend on the quality of the information campaign, as the inhabitants of the less developed areas will be inclined to vote against the proposal.

The decentralization will address the territorial administrative reform, proposing the creation of 9 to 12 administrative regions instead of the 42 counties extant in present. The regions will get financial autonomy by the mean of their own budget, yet the fiscal arrangement that will render operational their administrative autonomy is not yet clearly defined.

The current fiscal system, which offers limited autonomy in obtaining the public financial resources and in the setting of the local budget, will not work in the new proposed territorial administrative framework.

We are proposing two main fiscal methods which eventual will offer the much needed financial autonomy to the upcoming regions.

The first one, which we called the *direct-indirect method*, is the most innovative one and proposes the allocation of the overall direct taxes to the regional budget, whereas the indirect taxes should still fuel the Romanian state budget for the national offered public services. In the current framework the local budgets only retain part of the direct taxes, respective the asset-based taxes, whereas the income taxes go to the Romanian state budget.

We verified this hypothesis both for the Braşov county and for the Romanian state budget and we discovered that the result would be a drastic reduction of the financial circuits and a much better opportunity for budget planning at the local level. Also, it will lead to increased incentive toward securing local public financial revenues, as the deficit would have to be secured through demands to the Romanian state budget, which means waiting time and insecurity.

## References

- Besley, T. and Coate, S. (2003) – “Centralized versus decentralized provision of local public goods: a political economy approach”, *Journal of Public Economics* 87(2003), [www.elsevier.com/locate/econbase](http://www.elsevier.com/locate/econbase)
- Davey, K. (2003) – “Fiscal Decentralization”, [unpan1.un.org/intradoc/groups/public/documents/ UNTC/UNPAN017650.pdf](http://unpan1.un.org/intradoc/groups/public/documents/UNTC/UNPAN017650.pdf)
- Dreher, A. (2006) – “Power to the People? The impact of decentralization on Governance”, Mimeo: Swiss Federal Institute of Technology: Department of Management, Technology and Economics
- Ghinea, A. and Moraru, A. (2002) – “Aspects regarding decentralization process in Romania. The administrative-territorial reform”, Institute for Public Policy Bucharest, Open Society Foundation;
- Huther, J. and Shah, A. (1998) – “Applying a simple measure of good governance and its application to the debate on the appropriate level of fiscal decentralization”, World Bank Working Paper Series, no. 1894, Washington D.C.
- Moșteanu, T. and Lăcătuș, C.M. (2007) – “The Municipal Bonds – the Cause and the Effect of the Local Financial Decentralisation Growth. Romanian Case”, *Theoretical and Applied Economics*, Academy of Economic Studies, Bucharest;
- Lockwood, B. (2005) – “Fiscal decentralization: A Political Economy Perspective”, Warwick Economic Research Papers, The University of Warwick, January 2005;
- Kyriacou, A. P. and Roca-Sagales, O. (2008) – “Fiscal decentralization and the quality of government: Evidence from panel data”, Instituto de Estudio Ficales, Universitat Autònoma de Barcelona;
- Martinez-Vazquez, J. (2001) – “Intergovernmental Fiscal Relations and the Assignment of Expenditure Responsibilities”, Fiscal Policy Resource Center, <http://isp-aysps.gsu.edu/fprc/>
- Oates, Wallace E. (1972) – *Fiscal Federalism*, New York, Harcourt Brace Jovanovich;
- Oates, Wallace E. (1985) – “Searching for Leviathan: An empirical study”, *American Economic Review*, no. 79;
- Oates, Wallace E. (1999) – “An Essay on Fiscal Federalism”, *Journal of Economic Literature*, no. 37
- Eurostat, Statistical Books, 2008, [www.europa.eu](http://www.europa.eu), last accessed January 20, 2009
- Romanian Government data, [www.guv.ro](http://www.guv.ro), last accessed January 25, 2009
- Romanian Ministry of Public Finance data – [www.mfin.ro](http://www.mfin.ro), last accessed January 20, 2009
- Brașov Public Finance Treasury data – The accounts of budgetary execution for 2005, 2006, 2007 and 2008