ROMANIA:
MUNICIPAL CREDITWORTHINESS AND LOCAL GOVERNMENT DECENTRALIZATION

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TABLE OF CONTENTS

CHAPTER III: THE LEGAL AND INSTITUTIONAL FRAMEWORK FOR LOCAL PUBLIC ADMINISTRATION AND FINANCE IN ROMANIA

CHAPTER IV: FINANCIAL ANALYSIS OF EIGHT GENERAL PURPOSE LOCAL GOVERNMENTS

ABBREVIATIONS USED IN THIS REPORT

DGPF	Directorate General for Public Finance and State Financial Control (Ministry of Finance local office established in each *judet*)
DTFB	Department for Taxes, Fees and Budget, in MOF DGPF offices.
EBRD	European Bank for Reconstruction and Development
FY	Fiscal Year
IC	Interministerial Committee for Public Works
IEO	Investment Evaluation Office—Technical Office of MOF
MOF	Ministry of Finance
MPW	Ministry for Public Works and Territorial Planning
MUDP	Municipal Urban Development Program
RA	*Regia autonome/Regii autonomes*
SLGA	Subsidiary Loan and Guarantee Agreement

ROMANIA

MUNICIPAL CREDITWORTHINESS AND LOCAL GOVERNMENT DECENTRALIZATION

CHAPTER I. SUMMARY OF FINDINGS AND RECOMMENDATIONS

PURPOSE AND ORGANIZATION OF STUDY

This report examines the creditworthiness and capacity to borrow of municipalities in Romania. It was originally designed to complement other technical assistance being offered to the Government of Romania through the European Bank for Reconstruction and Development (EBRD), which would recommend the structure of a Municipal Credit Facility for lending to local governments. However, the analysis applies equally well to other forms of local government borrowing, such as the issuance of municipal bonds.

At the heart of municipal capacity to borrow lies municipal financial strength. Financial strength, in turn, is a product of the intergovernmental financing system and of the legal framework within which municipalities operate. The report therefore tackles these broader issues, which are critical to assessing municipalities' capacity to participate in decentralization, as well as their ability to participate in the credit market.

Warning: This report incorporates the results of field work through the first week of February 1997. The fiscal and budgetary picture in Romania is changing rapidly. The Report discusses legislative and budgetary proposals as of early February. However, some of these proposals are likely to change before legislation becomes final. Fiscal data generally are presented as actual data through 1995; estimated data for 1996; and projected data thereafter. Extrapolating from past trends is often inappropriate, since the 1996 elections brought a shift in national priorities. One of the top priorities is to reduce the central government budget deficit. This process is likely to tighten intergovernmental flows in 1997 for the local sector.

In the Terms of Reference for the project, the consultants were asked to examine the finances of local general purpose governments—municipalities and *judets*—only. The report therefore focuses on these entities. The finances of general local governments are closely tied to the finances of *regii autonomes*, however, and these connections are also explored.

This chapter summarizes the principal findings and recommendations of the study. Chapter two examines the intergovernmental financing system and aggregate local government finances in Romania. Chapter three addresses the legal framework and the principal legal issues affecting local governments' financial condition and creditworthiness. Chapter four summarizes the local-level analyses that were carried out for four larger municipalities and their corresponding *regii autonomes* and *judets*.

PRINCIPAL FINDINGS

Local Government Investment

Local government investment in Romania is carried out by a combination of general purpose governments (municipalities and judets) and *regii autonomes.* The division of local capital spending between these two groups of institutions has fluctuated considerably. In 1994, *regii autonomes* were responsible for 63 percent of local government capital investment; in 1995, their share was only 35 percent. This reflects the fact that either kind of institution may invest in certain types of works, such as water supply.

More than 80 percent of local capital spending is financed directly by central government capital subsidies. This ratio has remained essentially constant since 1993. Although investment is implemented locally, the investment approval and financing process remains highly centralized. All investment projects in excess of 100 million lei (approximately $16,000) must be approved first by the Investment Evaluation Office of the Ministry of Finance; then must be reviewed and approved by the Interministerial Committee for Public Works, headed by the Minister of Public Works. This review confirms that approved projects are technically feasible, in line with national priorities, and have received all necessary permits. Investment subsidies are allocated to *judets* by the Ministry of Finance; the judets, in turn, allocate the investment subsidies to local authorities based upon local budget applications. Local authorities can match the cpital subsidies they receive with specific investment projectsat their discretion.

The entire finance allocation process is repeated annually, with the result that there is no guaranteed multi-year financing of capital projects, and many investment projects remain unfinished.

Municipal Creditworthiness and Capacity to Borrow

One way to accelerate local investment would be for local governments to borrow to finance part of their capital spending. Before MUDP I there was no long-term borrowing by Romanian local governments. There still has been no borrowing to finance investment by municipalities or judets, as opposed to *regii autonomes*. All investment has been financed on a pay-as-you-go basis, through a combination of central government capital subsidies (constituting 80 to 84 percent of capital financing) and local governments' own resources (constituting 16 to 20 percent of the total).

What are the factors affecting municipalities' capacity to borrow and repay long-term debt?

■ **Operating savings.** In a decentralized fiscal system, local governments' first source of revenue for debt servicing is their operating surplus—i.e., the excess of regular, recurring revenues over recurring expenditures. Savings from the operating budget can be carried over to the capital budget, either to finance new investment directly or to pay off debt.

At present, municipalities in Romania have very modest margins of operating savings. These savings constituted 3 to 4 percent of municipal budgets in 1994-95, much less than local governments in Poland (24 percent in 1995) or France (15-18 percent), for example. The low rate of operating savings is the principal limitation on municipal borrowing capacity.

Moreover, municipalities have little flexibility on their own to generate additional recurring savings. With one significant exception—the tax on self-employed income—municipalities are not able to raise additional revenues on their own, either by increasing local tax rates or imposing new taxes. For most local revenue sources, the central government determines what taxes municipalities can impose, how the tax base is determined, and what the rate of taxation will be. The central government restrictions not only limit local revenue-raising flexibility but make it difficult for “own-source” revenues to keep pace with inflation. Local property taxes, for example, are levied on the basis of historical costs minus depreciation. This makes it impossible for the property tax to become a significant source of income.

The budgetary rules imposed by central government further limit local savings capacity. Municipalities cannot accumulate cash surpluses to carry forward to finance next year’s capital budget, either for investment outlays or debt service. Instead, all unexpended surpluses go into a *judet*-level treasury fund, which is used to finance short-term lending to local authorities..

The municipal financing system in Romania in effect has been constructed so as to exert central government control over local spending and local revenue decisions. It focuses exclusively on *annual* budgetary management. Multi-year financing of local capital projects, using local resources, has not been contemplated in either the intergovernmental financing system or in the budget rules. As a consequence, a significant use of local debt to finance municipal investment will require an overhaul of existing legislation and regulation.

■ **Real property collateral.** During a transition period, the introduction of municipal borrowing can be accelerated by the use of collateral—especially real property collateral—to guarantee loan repayments. In the Czech Republic, Hungary, and Poland the municipal capital market initially was built around collateralized municipal lending. Municipalities used income-generating real property that they owned as collateral for bank loans or municipal bonds. Later, as municipal budgets became regularized, and the municipal credit market became more familiar with assessing municipal credit risk, collateral requirements were relaxed or eliminated altogether for creditworthy municipalities.

Unfortunately, a similar path for developing the municipal credit market is not possible in Romania. Municipalities possess clear title to very little property. The lack of clear property rights holds back development of the entire economy. In the municipal sector, it is unclear which property in local public use belongs to the national government and which property belongs to the municipal government or to other local authorities. Without clear title, the property cannot be offered as collateral on municipal loans. Further, no party has an incentive to optimize the economic use of such property, because it is legally unclear who can receive the income from earnings or property sales.

■ **Central government guarantees.** The first choice of both local governments and their lenders would be to have central government provide guarantees for local government loans. Although this arrangement would substantially increase the flow of lending to municipalities, the policy has several fundamental drawbacks.

First, central government guarantees expose central authorities to debt obligations that are beyond their management control. At a time when central government is seeking to reduce its own budget deficit and borrowing, it is counter-productive for it to become the guarantor of local public sector borrowing.

Second, the presence of central government guarantees removes the incentive that lenders otherwise have to scrutinize local ability to pay and the feasibility of local investment projects. Lenders see “through the veil” of local repayment capacity, and look only to the quality of the central government guarantee in making their lending decisions. This removes the major discipline that should accompany the use of borrowing to finance local investment--the obligation that borrowing imposes on both sides of the credit transaction to make sure that debt can be repaid from local resources.

The Government of Romania has refused to guarantee most of the municipal bonds and municipal loans that have been proposed to it. The MUDP I and MUDP II programs are an important exception. The external borrower in this case is the Ministry of Finance, which in effect guarantees repayment of the subsidiary local loans.

Whether central government provides an *implicit guarantee* when the Ministry of Finance authorizes long-term borrowing is a question as yet unanswered in Romania. It is an important issue to resolve. Lenders to local government, especially international lenders, are likely to speculate that the central government (as in Turkey, for example) will not allow local authority debts to remain unpaid, for fear of destroying the central government’s access to the international credit market.

Implicit guarantees almost always end in misunderstandings. The central government may refuse to make payment on a local loan that the lender thought was implicitly guaranteed, or local authorities may abuse the guarantee by borrowing excessively. Either course threatens to undermine development of a sound municipal credit market.

■ **Government revenue-sharing and capital subsidies.** Most municipal and *judet* income consists of transfers from the central government. In the case of municipalities, the principal revenue sources are the shared wage tax and capital subsidies. Neither of these major revenue sources currently provides a good source of loan repayment.

Wage tax transfers are needed to help cover municipalities' operating costs. Transfer amounts are likely to come under additional pressure in 1997, as central government begins cutting back on the operating subsidy for district heating, and local governments have to use their wage tax allocations for social protection. Over the longer term, however, shared tax revenues may provide a more stable revenue source, which can be collateralized to provide security for local authority borrowing.

As presently structured, capital subsidies can be used only for authorized capital spending. Modifying budget rules so that part of the capital subsidy could be set aside for debt service would be one way to strengthen municipal borrowing and municipal investment in the short run. To have a substantial impact on borrowing and investment levels, however, municipal entitlements to future capital subsidies would have to be spelled out in the law, so that there could be certainty about the future income stream securing debt repayment. No law presently defines how the aggregate amounts available for wage-tax distribution or capital subsidies are determined, or how these amounts are to be allocated among municipalities. Central government retains sole discretion. In other countries in the region, such as Hungary and Slovakia, drastic reductions in local governments' share of joint revenues, occasioned by central government's need to reduce its own fiscal deficit, have destabilized the local credit market.

Other Limitations on Local Borrowing

The modest capacity of municipalities to repay debt is the fundamental constraint on borrowing by Romanian municipalities. However, a variety of other requirements—current or proposed—further impede market development and betray the often contradictory attitudes toward local government debt that central authorities maintain.

Municipalities in Romania have the legal authority to borrow, with the approval of a two-thirds majority of the local council, as long as there is assurance that they can repay the loan. Long-term loans--those that commit the municipality beyond the current fiscal year--must be approved by the general population through referendum. (This referendum requirement applies only to municipalities and *judets*, not *regii autonomes*.) Interpreted literally, however, the law requires that municipalities submit for voter approval each tranche of a multi-year loan. This further reflects the focus on annual budgeting and annual budget control built into the Romanian legal structure.

According to the Law on Public Finance, local and *judet* councils can finance "expenditures for well-justified actions" through the issuance of bonds. However, they must be authorized to do so in the central government's Annual Budget Law. At the end of January 1997, twelve local and *judet* councils had received authorization from central authorities for bond issuance.

Approval of local bond issues would seem to imply approval of a significant level of local borrowing. Yet, the State Budget Law now under preparation proposes to limit the annual borrowing of all municipalities and *judets* to 20 percent of the sum of own revenues plus shared wage tax receipts. This would severely restrict the amount of borrowing that is possible in any one year, and force municipalities into the position of having to take out several different loans, over several years, to finance a single capital project. Each loan presumably would be subject to voter approval.

One consequence of these different and conflicting rules is a wildly different set of expectations about the level of bond issuance that is legally permissible and financially feasible.

For example, the town of Sinaia (population 20,000) proposed a ten-year, 200 billion lei ($33 million) bond issue at a variable rate of interest initially set at 60 percent per annum. This debt level vastly exceeds both the municipality's repayment capacity and the proposed local borrowing ceiling. The bond issue was abandoned after the Ministry of Finance refused to guarantee it. The Municipality of Constanţa reportedly is developing with international financing partners a $100 million bond issue. Again, this amount vastly exceeds the borrowing ceiling that is being proposed for incorporation in the State Budget Law.

Until a clear and consistent set of rules are developed governing municipal borrowing and debt repayment, conflicts of this kind will persist. The chances are high that an unfortunate precedent will be set, when a municipality borrows more than it is capable of repaying or more than another part of the complex legal framework allows.

THE MUNICIPAL ROLE IN DECENTRALIZATION

Romania has endorsed the principle of decentralization. The Constitution of 1991 grants local governments the legal autonomy to perform functions of local interest. In practice, however, the legal structure continues to give central government control over most local government spending and the intergovernmental financing system continues to assign to central government the final word about most local government revenues.

In particular, the Romanian legal and administrative structure is inconsistent with the European Charter of Local Self-Government to which Romania has been a signatory since 1993 but which the Romanian Parliament has not ratified. Concerning local autonomy, Article 9 of the Charter provides that:

— Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, which they may dispose freely within the framework of their own powers;
— At least part of local government resources shall be derived from local taxes and fees and, within limits established by law, local governments will have the power to establish tax rates and fee amounts;
— Financial resources of local governments shall be commensurate with the responsibilities reserved to them by the constitution and the law;

— Local authorities will be consulted on how redistributed tax revenues are allocated to them; and,
— Local governments have access to national capital markets to finance capital improvement projects.

The new Government has made practical decentralization and harmonization of the Romanian legal framework with the minimum standards of the Charter a public policy priority.

LOCAL LEVEL FINANCIAL ANALYSIS

As part of the overall study, on-site analyses were conducted of four municipalities and their corresponding *judets*. The four municipalities were Baia Mare, Constanţa, Oradea, and Târgovişte. The four *judets* were Bihor, Constanţa, Dâmboviţe, and Maramureş.

As would be expected, these localities displayed considerable differences in financial condition and the administrative division of service responsibilities. However, several general patterns emerged of relevance to both future decentralization policy and local government creditworthiness.

■ **Municipalities appear to be in significantly weaker financial condition than *judets*.** Although the sample of local governments was selected by USAID and EBRD largely on programmatic criteria, and thus does not constitute a representative sample, the difference between municipal and *judet* finances was striking. The growth of both revenues and expenditures has been considerably faster at the municipal level than at the *judet* level, as local service delivery has been focused on municipal governments. For all of the municipalities examined, there was significant real growth in both revenues and expenditures over the period 1993-1996.

Although growing faster in their total budgets, municipalities also were far more likely to be incurring operating deficits. The municipalities in the sample had operating deficits in 13 of the 15 years for which operating budget data were available. In contrast, the *judets* in the sample incurred operating deficits in only one of the 13 years for which financial results were available.

Municipalities have been going through a period of very rapid fiscal change, much of it beyond their administrative control. The operating deficits of the municipalities in the sample reflect their inability to fully keep up with this change, despite real growth in revenues. The instability of financial conditions clearly has implications for municipal capacity to borrow. Until municipal budgets are further stabilized through national legislation, the recent record of individual operating deficits implies that municipalities will have a difficult time clearing the way for debt service.

■ **National rules and practices regarding local finances create obstacles to sound financial management at the local level.** Local governments in Romania are buffeted by a great deal of intergovernmental uncertainty. They must prepare their initial budgets each year without having a clear picture of either their revenues or expenditures for the next year. They must manage their finances for several months of the fiscal year without knowing their actual intergovernmental revenues or their full expenditure responsibilities.

On the revenue side, the transfer of funds from the state budget follows practices that have lacked consistency or transparency from year to year. The rules governing local taxes and fees as well as the distribution of central revenues between *judets* and municipalities changed in each year between 1993 and 1996. Only now is the Government beginning to move toward clearly defined formulas that will establish local entitlements to revenue transfers.

On the expenditure side, both *judets* and municipalities were subject to numerous changes in functional responsibilities over the period. There was no consistent direction of change. Responsibility for spending on certain functions was shifted back and forth between the national and local governments and between *judets* and municipalities. Local governments also moved certain expenditures off budget by shifting them to local entities under their control.

Actual revenue distributions and expenditure responsibilities for local governments for any given year are included in the state budget, which is approved several months into the fiscal year.

Faced with growing pressures to balance revenues and expenditures, some of the local governments are turning to solutions that may not be sustainable in the long run. There is evidence of a growing propensity to carry forward from one fiscal year to the next some part of expenditures as accounts payable. This has the effect of reducing expenditures as recorded in the annual income and expense statement in the first fiscal year. On the opposite side, some local governments are carrying forward from one fiscal year to the next a substantial unpaid balance of funds borrowed for short-term cash management. This has the effect of increasing the revenues as recorded in the annual income and expense statement in the first fiscal year. These practices distort the picture of the financial condition of the local government. They also may be masking an underlying imbalance between revenues and expenditures.

■ **Many of the *regii autonomes* that provide basic infrastructure services at the local level face serious financial difficulties.** In general, the *regii* are having problems passing on increased operating costs to their clients. They face growing arrearages. To compensate and conserve scarce cash, many of the *regii* are delaying payment of bills to their creditors.

The *regii* that provide heating, hot water and public transportation services face the greatest difficulties. Several of them may run out of case as early as 1997. The problems are serious but less severe for *regii* that provide water and collect waste water. The *regii* that handle road maintenance and repairs and those providing solid waste collection are generally in acceptable financial condition.

■ **Poorer households face significant difficulties in paying for local services.** Payment of all local taxes, fees and service charges would require between 36 percent and 52 percent of the income of households in the bottom twentieth percentile of the income distribution in Constanţa, Oradea, and Târgovişte. Households in the bottom 40th percentile would have to pay from 18 percent to 26 percent of household income to cover all taxes and fees for their current consumption levels.

The weight of fees, service charges, and local taxes in household income obviously constrains the extent to which new local debt can be incurred and repaid through user fees. It argues for a national policy of income-targeted household subsidies for basic services, such as is now found in many countries.

PRIORITIES FOR REFORM AND OPPORTUNITIES FOR USAID TECHNICAL ASSISTANCE

Fortunately, the priorities for building a reliable municipal credit market and strengthening municipal creditworthiness coincide with the priorities for strengthening local government autonomy. Therefore, municipal creditworthiness can and should be addressed within the general framework of effective decentralization.

Among the principal priorities are:

- Clearly define property ownership rights as between the national and local levels of government and as between the state and the citizenry. This will require a new Law on Patrimony or Property Rights. Clarifying municipal property ownership is critical both in development of the municipal credit market and to municipalities' more general legal and financial autonomy.

- Establish a transparent, stable basis in law for wage-tax sharing and capital subsidies to local government. This process would spell out how the aggregate amounts of both transfers are to be determined and how the aggregate amount is to be allocated among municipalities. The proposed State Budget Law for 1997 takes the first step in this direction by identifying for the first time the exact criteria that will be used in making local government allocations, though it does not specify how the total amount to be allocated is determined.

A transparent, well-defined basis for intergovernmental transfers will help support local financial autonomy, and provide secure income streams that can be used to repay long-term borrowing.

- Reform the current set of budget rules that discourage and prevent local officials from adopting a multi-year perspective on budgeting and financial planning at the local level. These rules are spelled out in the body of this report. They range from rules prohibiting the accumulation and carry forward of local budget surpluses to rules requiring that all capital subsidies be calculated on an annual basis without future commitments to ensure project completion. In this context, there also will be a need to improve project planning and feasibility analysis practices among the local governments and *regii*.

- Modify the accounting and financial reporting standards and practices that apply both to the local governments and to the *regii* so that they provide a more accurate picture of the financial condition of these entities.

- Establish a basic set of local revenue sources for which municipal governments can set their own tax rates and adjust tax bases in line with inflation. As the European charter emphasizes, local revenue-raising flexibility is necessary for local fiscal autonomy, as well as for municipal capacity to take on and repay debt.

  Converting the property tax to a tax based on the market value of property, for which local authorities have the flexibility to set tax rates within an approved range, would be one important step towards creating local financial autonomy. Implementation of this change, however, will be institutionally demanding, in terms of modernizing cadastre and property ownership records and establishing market value assessments. Full conversion of the property tax system would require several years to implement and would be worthwhile only if the property tax were to become significant source of local revenues. In the meantime, local authority for establishing other local tax rates should be enhanced.

- Simplify the present array of “local” taxes and fees. At present, the law defines 105 different classes of local taxes and fees, most of which raise insignificant levels of revenues. This system should be drastically simplified, so that the revenue system is more comprehensible and can be administered more efficiently.

  All these measures taken together will eliminate the current obstacles to sound financial management at the local level. They will provide the authority and the tools which local officials need to address the financial challenge of meeting the demand for local services in their communities. They also will make those officials clearly accountable for the financial condition of the local governments.

- Specify and coordinate all the different laws and regulations affecting the issuance of municipal debt. At present, these rules are internally inconsistent and unclear. They threaten to lead to damaging precedents for the local credit market. The rules, regulations, and laws cover such items as voter approval of debt, central government authorization of debt, debt and borrowing ceilings, implicit and explicit government guarantees, the pledging of collateral, etc.

- Establish a practical precedent for responsible local government borrowing. The MUDP program promises to help establish precedents for responsible borrowing by *regii autonomes*. It is critical to complement this experience with responsible borrowing by municipalities from the private market. This would involve ensuring that the first long-term municipal bond or municipal loan in Romania, outside the MUDP program, conforms to all laws and regulations; is financially responsible; is explicit as to whether it does or does not have a central government guarantee; spells out what collateral, if any, is provided and how the lender will access the collateral in the event of non-payment, etc.

  The practical impact that the first market borrowing will have on the future development of the municipal credit market cannot be overstated.

- Integrate the legal framework supporting local government finances so that different pieces of legislation reinforce a consistent set of principles. The legislation in question includes:

  — Law on Local Public Administration
  — Law on Annual State Budget
  — Law on Local Taxes and Fees
  — Law on Property Rights and Patrimony
  — Law on Public Finance
  — New Law on Local Finance
  — Law on Public Debt.

- Form a continuing consultative body, consisting of representatives of different central ministries and local governments, to consider proposed reforms of the local government legal framework and changes on intergovernmental financing practice.

CHAPTER II.
ASSESSMENT AND OPTIONS
REGARDING THE INTERGOVERNMENTAL FINANCING SYSTEM

INTRODUCTION

The creation of Romanian municipal[1] and judet (county) governments, based on the principles of local autonomy and the decentralization of public services was established under the Law on Local Public Administration (hereafter referred to as Law 69/1991).[2] The first local elections, based on the Law on Local Elections,[3] took place in early 1992, with the newly elected municipal and judet councils taking office in March-April 1992. As procedures for budget preparation are lengthy and must be initiated in the summer of the preceding fiscal year,[4] the first budget year for which elected local governments (municipalities and judets) in Romania were fully responsible was 1993.

Although the principle of administrative autonomy for local governments is clearly stated in the relevant texts, the financial means of achieving this autonomy have not followed. The financial terms under which local governments have operated since their creation have been based on a mix of well-defined and not so well-defined laws and decisions, many partly based on practices inherited from the previous regime. In particular, several significant laws, such as a law on local finances and a law on patrimony (for the definition of the ownership of local assets) have not yet been passed. This lag in ensuring a sound basis for local government financial autonomy has a number of practical implications in terms of local creditworthiness and debt carrying capacity.

The change of government after recent presidential and parliamentary elections will open the way to a considerable legislative reform effort to reinforce local autonomy and decentralization. According to "Romania's Macro-Stabilization and Development: Basic Program until the Year 2000," objectives are defined for both the reform of the local public administration and a radical reform of the local public finance system. Among the objectives of the former are:

- To ensure sufficient financial resources corresponding to the competence and responsibilities of local and county councils; and
- To define the public patrimony of local communities that has to be under either local or county administration.

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1 The term municipalities includes cities (municipii), towns (oraşele) and villages (comunele).

2 No. 69, November 26, 1991, as amended by Law No.24, April 12, 1996.

3 No. 70, November 26, 1991, as amended by Law No. 25, April 12, 1996.

4 In Romania, the fiscal year follows the calendar year.

In order to achieve some of these objectives, as concerns specifically the finance system, the Government's program indicates that: "the Romanian local finance system must provide:

— The stimulation of the local public administration in trying to collect its own resources;
— A transparent system of budget transfers, relying on objective, stable and mandatory criteria;
— The compensation of effects whenever income disparities occur among various local administrations, ensuring a minimum access level to basic services; and
— Support mechanisms for infrastructure development and its financing."

This chapter will examine the basis of local government revenues, particularly as concerns the intergovernmental finance system, and assess the implications of the current situation for municipal creditworthiness. Following analysis of the framework for local government finances and budget preparation, as well as aggregate trends in local government finances since 1993, specific revenues will be examined in detail. These include shared wage tax, non-investment subsidies, and own revenues. A specific section is devoted to investment preparation and financing. The final sections will discuss borrowing by local governments, and policy issues as concerns creditworthiness in the context of the Government's stated objectives.

FRAMEWORK FOR LOCAL GOVERNMENT FINANCES

The framework for local government finances, including types of revenues, preparation of the budget and execution of revenues and expenditures is defined through several different laws and regulations. The organization for local government budgets is defined by an order of the Ministry of Finance (MOF), with an approved budget code and classification for each line item[5]. Annex No. 8 of the State Budget Law[6] details the categories of own revenues and expenditures projected in judet and municipal budgets.

Law 69/1991 states the general principle that "...the local public administration shall have the right to own sufficient sources, in proportion to the competencies they have according to the law and of which they may freely dispose".[7] A separate Law on Local Taxes and Fees[8] defines most direct taxes and fees, their taxable base and maximum tax rates.

5 Order 1394/1995 Official Gazette No. 300, March 23, 1995.

6 For example, 1996 State Budget Law, No. 91 May 6, 1996.

7 Article 91(2), No. 69, November 26, 1991, as amended by Law No.24, April 12, 1996.

8 Law No. 27, May 27, 1994.

Some of the principal direct taxes paid by legal and physical persons are : tax on self-employed professionals, craftsmen and individual or family associations; building tax; land tax (on built-up plots); vehicle fees (means of transportation); fees for use of public places (market fees). Other legislation also set the base for local government revenues from the tax on agricultural income,[9] inheritance taxes, stamp duties, other direct and indirect taxes and nonfiscal revenues. Specific county and municipal government revenue sources are listed each year in the annual budget law, with the reference to the Law, Decree or Ordinance which defines the own revenue sources in question (Annex No. 4, the list of taxes, fees and revenues for 1996[10]).

Municipal and judet councils can set local tax rates, and may establish special taxes and fees.[11] For the setting of local rates, however, the margin of influence of municipal councils is quite limited (see Section 7). New taxes and fees are limited to special, specific services, which are listed in Annex 3 of the Law on Local Taxes and Fees. Among approved services are: operation and maintenance of potable water and wastewater systems, solid waste collection, public bathhouses, night security services, municipal slaughterhouses, and municipal weigh stations.[12]

Local governments also receive as income a share of taxes collected by the State and subsidies for specific purposes from the State Budget. These transfers are distributed among municipalities by the judet council, after consultation with the Department for Taxes, Fees and Budget (DTFB) of the Directorate General for Public Finance and State Financial Control of the MOF established in each judet (hereafter referred to as DGPF).[13] Municipal mayors and councilors are also consulted during this process. Actual amounts of transfers from the State Budget to local governments (through the judets) are included annually in the State Budget Law; the amount of the shared wage tax is in Annex No. 5, and the subsidies for investment and social protection, in Annex No. 6.

Municipal budget preparation and execution is organized in conjunction with two departments of the deconcentrated DGPF: the DTFB and the MOF local treasury office. The DTFB provides a consultative and informational role to local governments during budget preparation. As the local Treasury office is responsible for the cash execution of the budget, municipalities also consult this office for budget preparation, as a source of up-to-date real-time information on the payment of expenditures and receipt of revenues.

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9 A law on the amendment and completion of the agricultural tax is to be forwarded to Parliament before the end of 1997. In anticipation of major changes in this tax, many taxpayers are withholding payments.

10 1996 State Budget Law, op. cit.

11 Articles 95 and 96, No. 69, November 26, 1991, as amended by Law No.24, op. cit..

12 Annex 3, Law No. 27, May 27, 1994.

13 Article 93, No. 69, November 26, 1991, as amended by Law No.24, op. cit..

The MOF local treasury office serves as the treasury for local government revenues and payments. According to the Ordinance No. 66/1994,[14] "...the local and judet councils, as well as public institutions subordinated to the Central and local ones, ...are under the obligation of performing collection and payment operations through the round of the general State Treasury...." MOF local treasury offices also perform tax assessment and collection roles for certain local government taxes, such as the building tax, the land tax, and vehicle fees.

TRENDS IN LOCAL GOVERNMENT FINANCES (1993-1996)

This section first analyzes the overall weight of local governments in the national economy and compared to the state budget. Overall budget results for all local governments, and their financial situation are examined from the 1993 budget year, as this was the first year of autonomous budget preparation.

Local Government Finances in the Macroeconomic Context

Local government aggregated budget expenditures are compared to Romania's GDP, general government expenditures[15] and central administration expenditures (Table 1). In the overall economy, local governments account for slightly less than 5 percent of GDP, although the local government share has risen by one percentage point since 1993. Over this period, they also account for an increasing share of general government (from 11 to 14 percent) and central administration (from 16 to 21 percent) expenditures.

The portion of central administration expenditures which consist of transfers to local governments has increased slightly, from 13 to 15 percent.

Table 2 on the next page compares the weight of Romanian local governments with some countries of Western Europe as well as with other formerly centralized countries. The apparent lesser role of Romanian local governments is not necessarily due to a smaller overall role for local authorities, but may reflect the fact that many essential public services are carried out by *regii autonomes*, whose accounts are not reflected in local government budget accounts.

Financial Situation of Local Governments

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[14] Articles 1 and 3, Government Ordinance on the setting up and usage of funds monitored by the state treasury, No. 66/1994.

[15] General Government Expenditures consist of State central administration + local government + social insurance fund.

Aggregate data of all municipal and judet councils for actual 1993 to 1995 results and the 1996 budget project was provided by the Ministry of Finance. The local government budget classification does not separate the budget into an operating account and a capital account, per se, but presents total revenues (including capital revenues and transfers for investments) and total expenditures (including investment expenditures and debt service), in one consolidated document. For the purposes of this analysis, the operating and capital portions of the aggregate local government budget have been separated, in order to calculate their net savings capacity (see Table 3 on page 18).

Table 1
Macroeconomic Context for Local Governments

	1993	1994	1995	1996
Macroeconomic indicators (billions of current lei)				
GDP	20,036	49,795	72,249	n/a
General government expenditure[a]	5,987	15,425	23,222	n/a
Central state expenditure	4,129	10,930	15,858	n/a
Local government (LG) expenditure	696	1,735	3,265	5,109
LG revenues transferred from state budget[b]	560	1,431	2,403	3,886
Ratios (percent)				
LG expenditure/GDP	3.5	3.5	4.5	n/a
LG expenditure/general government	11.6	11.2	14.1	n/a
LG expenditure/central state expenditure	16.9	15.9	20.6	n/a
Transfers to LG/central state expenditure	13.6	13.1	15.2	n/a

Notes
a Including local government revenues.
b Shared wage-tax, investment and social protection transfers.
Sources: *Romania: Country Profile 1996-97*, The Economist Intelligence Unit,
Ministry of Finance Budget Department.

Table 2
Comparison of Romanian Local Governments with Other European Countries

	Local Government Expenditure (percent of GDP)	Local Government Expenditure (percent of central government)
Romania (1995)	4.5	20.6
Poland (1995)	7.0	14.0
Belgium (1989)	6.1	11.8
France (1989)	8.9	17.2
Germany	6.2	13.3
Italy	14.7	29.5

Within operating revenues, a distinction has been made between recurring and non-recurring revenues. Recurring revenues, which provide a stable portion of local income year after year include own fiscal revenues, shared wage tax and non-investment subsidies from the State Budget. Non-recurring revenues are not stable or certain from one year to the next, and include entertainment fees, nonfiscal revenues, and short-term loans for cash flow needs. Net recurring savings is equal to recurring revenues minus operating expenditures plus debt service. The net savings capacity is an indication of the means which local governments dispose of to finance investment and eventual further debt payments from own revenue sources.

Table 3
Local Government Net Savings (1993-1996, millions of current lei)

	1993 (actual)	1994 (actual)	1995 (actual)	1996 (program)
Total Operating Revenues	**493,189**	**1,202,720**	**2,497,846**	**3,853,862**
Own Recurring Fiscal Revenues	*92,118*	*237,421*	*732,211*	*930,030*
Direct taxes	82,855	206,814	688,674	*88,392*
Taxes on profits of *regii*	3,314	6,376	19,906	41,658
Taxes/fees on individuals	36,321	90,846	219,657	271,274
Building tax (legal persons)	28,713	39,613	266,049	321,513
All other direct taxes	14,507	69,979	183,062	249,479
Indirect Taxes - Other Indirect Taxes	9,263	30,607	43,537	46,106
Own Non-recurring Revenues	*17,838*	*45,963*	*141,936*	*224,589*
Indirect Taxes - Entertainment Fees	589	1,418	2,153	2,775
Nonfiscal Revenues	17,249	44,454	139,783	221,814
Shared Wage Taxes	*231,770*	*668,109*	*1,203,024*	*1,987,098*
Non-investment Subsidies from State Budget	*151,463*	*249,731*	*410,587*	*711,000*
Social protection (district heat/urban transport)	151,463	249,731	410,587	711,000
Short-term Loans (reserve fund, revolving fund)	*0*	*1,496*	*10,088*	*0*
Other Operating Revenues	*0*	*0*	*0*	*1,145*
Total Operating Expenditures	**478,190**	**1,111,004**	**2,277,855**	**3,687,051**
Personnel	83,833	193,568	225,288	310,097
Materials and Services	227,607	619,475	1,303,570	2,079,583
Subsidies	166,750	297,961	539,943	888,105
Other operating expenditures	0	0	209,054	409,266
Net Recurring Savings	**-2,839**	**44,257**	**65,809**	**-68,380**
Gross recurring savings	-2,839	44,257	67,967	-58,923
Debt and interest payments	0	0	2,158	9,457
Total Net Savings	**14,999**	**91,716**	**217,833**	**157,354**
Capital Budget				
Capital Expenditures	*217,779*	*624,062*	*985,278*	*1,412,375*
By public institutions	123,045	228,438	641,489	731,414
By *regii*	94,734	395,624	343,665	668,461
Investment partly funded from external loans	0	0	124	12,500

	1993 (actual)	1994 (actual)	1995 (actual)	1996 (program)
Capital Revenues	*219,359*	*564,430*	*838,612*	*1,255,790*
Revenue from sale of state property/assets	42,582	51,615	49,312	67,829
Investment subsidies	176,777	512,815	789,176	1,175,461
Investment subsidies partly funded from external loans	0	0	124	12,500
To Finance Investment	*-1,580*	*59,632*	*146,666*	*156,585*
Result	**16,579**	**32,084**	**71,167**	**769**

Table 4
Local Government Budget Ratios (1993-1996)

	1993 (actual)	1994 (actual)	1995 (actual)	1996 (program)
Budget Evolution (1995 lei, percent change from previous year)				
Total operating revenues		*50.1*	*62.3*	*6.5*
Own recurring fiscal revenues		58.6	140.9	-12.4
Own non-recurring fiscal revenues		58.6	141.3	9.2
Nonfiscal revenues		58.9	145.2	9.5
Shared wage taxes		77.4	40.7	14.0
Subsidies from State budget (social protection)		1.5	28.4	19.5
Operating expenditures		43.0	60.2	11.7
Capital expenditures		76.3	23.3	-1.1
Capital revenues		58.3	16.1	3.3
Savings Capacity				
Net recurring savings (percent of recurring revenues)	-0.6	4.0	3.2	-1.9
Debt Burden				
Debt service (percent of recurring revenues)	0.0	0.0	0.09	0.26
Debt Coverage Ratio				
Net recurring savings/debt service (percent)			35.17	-7.23
Structure of Total Revenues (percent)				
Operating revenues	69.2	68.1	74.9	75.4
Capital revenues	30.8	31.9	25.1	24.6
Structure of Operating Revenues (percent)				
Own revenues	*22.3*	*23.6*	*35.0*	*30.0*
Of which: Direct taxes	16.8	17.2	27.6	22.9
Of which: Indirect taxes	2.0	2.7	1.8	1.3
Of which: Nonfiscal revenues	3.5	3.7	5.6	5.8

	1993 (actual)	1994 (actual)	1995 (actual)	1996 (program)
Shared wage taxes	47.0	55.6	48.2	51.6
Subsidies from State budget (social protection)	30.7	20.8	16.4	18.4
Short-term loans	0.0	0.1	0.4	0.0
Investment Effort				
Recurring savings/Investment (percent)	-1.3	7.3	7.7	-4.8
Capital expenditure (percent of operating revenues)	44.2	51.9	39.4	36.6
Investment Subsidies (percent of capital expenditure)	81.2	82.2	80.1	84.1
Budget Balance				
Surplus / (-) deficit (percent of operating revenues)	3.4	2.7	2.8	0.0

The share of operating revenues in total revenues increased from 69 percent in 1993, to 75 percent in 1995-1996 (see Table 4 on previous page). Operating revenues comprise direct taxes, indirect taxes, nonfiscal revenues, shared wage taxes and subsidies from the State Budget for social protection (subsidies to the *regii autonomes* for district heat and urban transport). The largest source of operating income is the shared wage tax (47-55 percent) followed by own revenues (over 30 percent since 1995). Among own revenues, direct taxes are most important, now accounting for over 25 percent of operating revenues, an increase of 10 percentage points since 1993. This is due to the implementation of the Law on Local Taxes and Fees, passed in 1994, and came into effect the following year. The share of district heat/urban transport subsidies has fallen from over 30 percent of operating revenues (1993) to under 20 percent.

The debt burden of local governments is currently insignificant at less than 1 percent of current revenues, with the first debt service payment appearing in 1995 (representing the interest and 10 percent reserve fund for EBRD's MUDP I loan to five local *regii*). However the recurring savings capacity of local governments is quite low, at 3-4 percent in 1994-1995, much less than for local governments in say Poland (24 percent in 1995) or France (15-18 percent). The level of current savings for aggregate budgets indicates that in the current situation of municipal finances, local governments do not generate a sufficient level of revenues which would allow them to self-finance a significant portion of investment. Indeed, although capital expenditures account for 30 percent of total expenditures, they are financed for over 80 percent by investment subsidies transferred from the State Budget. Net recurrent savings was sufficient to finance only 7-8 percent of investment in 1994-1995.

Table 5
Expenditures by Sector (percentage shares, 1995 lei)

	1993 (actual)	1994 (actual)	1995 (actual)	1996 (projected)

Public authorities	7.92	8.49	7.26	7.20
Education	0.00	0.00	10.36	11.80
Health	14.58	15.17	12.50	12.30
Culture	3.97	4.33	4.30	3.18
Social assistance	4.39	4.54	6.00	7.43
of which: Social help	0.00	0.00	2.07	2.78
Urban services and housing	45.70	42.64	38.91	37.30
Transport and communications	22.85	24.19	19.87	18.57
Other activities	0.59	0.64	0.74	1.69
Guarantee fund for loans	0.00	0.00	0.00	0.00
Interest payments	0.00	0.00	0.00	0.01
Debt and interest repayments	0.00	0.00	0.06	0.17
Reserve fund	0.00	0.00	0.00	0.33
Total expenditures	100.00	100.00	100.00	100.00

Source: Ministry of Finance Budget Department

Of the main sector tasks for which local governments are responsible, urban services (water, sewerage, solid waste) and housing account for the largest share of total expenditures, at close to 40 percent (Table 5—Local Government Expenditures by Sector). This is followed by transport and communications (20 percent), health (12-13 percent) and education (11-12 percent). Responsibility for pre-university education, health and for social assistance was only transferred to local governments in 1995.

Regulation on Use of the Local Government Budget Surplus

The end of year result for local governments has shown a small surplus each year since 1993, equal to about 2.5 to 3.5 percent of operating revenues (see Table 4—Local Government Budget Ratios). It is not possible, however, for local governments to carry over these funds to the following fiscal year. Nor may they establish a small set-aside fund for investments. According to Article 63 of the Public Finance Law[16], the annual surplus of the local budget must be utilized for up to three purposes, in the following order. First, the available surplus must be used to reimburse any overdue debt payments, including interest. Second, a national operating revolving fund is established ("*fondul de rulment*"), financed with this surplus, for up to 5 percent of revenues. Third, and if there is still any remaining budget surplus, it is allocated to the respective county treasury fund ("*fond tezaur*") or Bucharest Municipality Treasury Fund.

The revolving fund is opened in a special account with the local treasury offices and is open to each administrative unit. The fund may be used for short term loans to cover any

[16] Law on Public Finance, No. 10/91, as amended by Law No. 72/96.

temporary deficits during the fiscal year. Use of the revolving fund has been minimal, with 66 million lei of loans in 1994 and 481 million lei in 1995.

The *judet* treasury funds may also be used to provide short-term loans to finance cash shortfalls and liquidity problems. If they are reimbursed before the end of the fiscal year in which they were given, the loans are interest-free. If reimbursement is not made by the end of the FY, the loan is rolled over for 18 months, with an interest rate of about 15-18 percent. The amounts allotted so far by the treasury funds are less than 0.3 percent of total revenues, with 1.4 billion lei in 1994 and 9.6 billion lei in 1995. Interest payments for these loans amounted to 58 million in 1995 and an estimated 435 million in 1996. Despite the small amounts, the rapid increase in their use over a one-year period may indicate greater cash flow and liquidity management problems at the local government level.

In the draft of the 1997 Budget Law, there is a proposed Article 29 which would authorize the *judet*-level treasury funds to use up to 50 percent of the funds for the financing of investments.[17] According to Ministry of Finance officials, the *judet* would be responsible for establishing the priority list, and determining how the reserve funds would be used for investment.

Financial Relations Between Local Governments and Their **Regii Autonomes**

The organization of local *regii autonomes* is regulated by an Ordinance from 1994[18]. Local RA can be organized in several sectors of local public utility, network and other services, such as (1) water supply, sewerage and wastewater treatment; (2) production, transport and distribution of district heat; (3) urban public transportation; (4) administration and maintenance of housing, markets, fairs, municipal roads, parks; and, (5) construction, maintenance and rehabilitation of county roads and bridges. One *regia* covering these public services can be organized in cities with more than 30,000 inhabitants; in the largest cities (more than 300,000 inhabitants), up to 3 RAs may be created. These limits do not apply to Bucharest, which is a special case.

In accounting terms, RAs follow the rules for commercial accounting based on the 1992 Plan of Accounts, but they follow separate rules for profit tax and distribution of net profit. Profit tax of the local RA is paid to the respective local government budget, as a direct tax. Net profit is divided for 10 percent as the profit share of employees, and for 50-90 percent to the local government budget (as a non-fiscal revenue). It is the local council which determines the percent of net profit to be transferred to its budget, within in a range of a

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[17] Note: it was not indicated whether these funds allocated for investment would be given as grants or loans.

[18] Ordinance 69, 24 August 1994, regarding some measures for the organization of local interest state corporations.

minimum of 50 percent and maximum of 90 percent. The share of net profit not transferred to the local authority is to be dedicated by the RA to development or investment purposes.

Table 6
Budget Transfers Between Local Governments and Their *Regii Autonomes*
(1993-1996, millions of current lei)

	1993 (actual)	1994 (actual)	1995 (actual)	1996 (program)
Transfers from State to Local Government for Regii	*151,463*	*249,731*	*410,711*	*723,500*
Subsidy for district heat/urban transport	151,463	249,731	410,587	711,000
Subsidy for investment[a]	0	0	124	12,500
Transfers from Local Government to Regii	*246,197*	*646,774*	*800,467*	*1,459,262*
Subsidies to compensate cost/tariff	151,463	251,150	456,678	778,301
Capital expenditures by *Regii*[b]	94,734	395,624	343,665	668,461
Subsidy for investment[a]	0	0	124	12,500
Transfers from Regii *to Local Government*	*6,910*	*8,077*	*24,718*	*58,320*
Taxes on profit of *Regii*	3,314	6,376	19,906	41,658
Payments from profit of *Regii*	3,596	1,701	4,812	16,662

Notes
a Partly funded by external loan.
b These transfers are financed through the investment subsidy received by local governments.

Transfers of funds which may flow from (and are clearly identifiable in) the local authority budget include the specific subsidies for the urban transport and district heat *regii* (see “Non-Investment Subsidies from the State Budget” on page 27), subsidies for investments of the MUDP I *regii* (45 percent share of the State Budget), and a portion of capital expenditure, undertaken by *regii*, but financed through the local budget. Funds for the latter are distributed from the overall investment subsidy received by the local government. If there are other transfers of funds between the local governments and *regii*, these are not clearly identified or identifiable as such in the budget information available.

BUDGET PREPARATION PROCESS[19]

During annual budget preparation, each municipal and *judet* government prepares an estimate of its expenditures and own revenue sources, often based on previous budget performance and in consultation with the local MOF DTFB. Information is requested from the

[19] This general description of the budget process sets the framework for describing the allocation of shares of wage taxes and investment subsidies. A precise description is included in the chapter on the legal and institutional framework.

local Treasury office, where the most timely information on actual revenue collections is available. Municipal officials generally also solicit the input of the *judet*'s Finance Department. These talks take place based on indicators provided by the Ministry of Finance, such as the methodological norms and initial estimates for inflation and amounts of transfers. The local budget estimate includes both current and investment expenditures[20]. The gap between estimated own source revenues and estimated expenditures reflects the need, and the demand for subsidies from the State Budget.

Once the draft budget is approved by the municipal council, it is forwarded to the *judet* council. The *judet* Finance Department also discusses the proposed budgets with the DTFB, and creates an aggregated *judet* budget, which is the sum of the budgets of the *judet* itself and of each of the municipal governments in the *judet*. At the *judet* level, no modifications can (in principle) be made to the individual draft budgets, but the *judet* still must verify that the budget is (or can be) balanced. It is the *judet* council who will mediate between the initial municipal government request and the amount of transfers ultimately distributed to each municipal government in the *judet*.

The aggregate budget is transmitted by the *judet* to the Budget Department of the MOF. At this time, each *judet* provides the proposed quarterly timetable for MOF to distribute subsidies from the State Budget. The MOF Budget Department analyzes the *judet* budget proposals, and makes recommendations for the amounts of central transfers to be allocated to each *judet*.

Once the State Budget has been approved by Parliament, the MOF will inform each of the *judets* of the amount awarded for subsidies (these amounts are listed in annexes to the State Budget). At this stage, *judets* negotiate with each of their municipal governments on the distribution of State Budget transfers. This final negotiated allocation is approved by the *judet* council, and it is only at this stage that each of the municipal councils can modify their budgets and formally approve the final budget project for the fiscal year. The time lapse between approval of the State Budget by Parliament and final approval of local budgets (and of *regii autonomes* budgets) should not exceed 30 days[21].

Although the finance law stipulates that the State Budget should be submitted to Parliament by October 10 (for the following fiscal year), the Budget has generally not been approved by Parliament until well into the fiscal year it is intended for[22]. This delay creates a great deal of uncertainty for local governments, in order for them to plan the execution of their investments and be certain of revenue transfers from the State Budget, which account

[20] Article 64(1), Law on Public Finance, No. 10/91, as amended by Law No. 72/96.

[21] Article 60(3), Law 10/91, as amended by Law No. 72/96.

[22] The 1993 State Budget Law is dated May 6, 1993, the 1994 Budget Law was published in the Official Gazette on June 10, 1994, and the 1996 Budget Law was published in the Official Gazette on May 6, 1996.

for over 70 percent of total local government income. Until the Budget Law is finally approved, the monthly allowed budget for local governments is one-twelfth (or 8.3 percent) of the previous FY budget, including investment expenditures financed by State transfers. As budget allocations generally do not reach local governments until late June, expenditures are often concentrated in the third quarter, particularly for investment projects.

SHARED WAGE TAX

The transfer of a share of the wage tax to local governments accounts for one-third of total revenues and 48-55 percent of operating revenues. These funds enable local governments to finance many of the essential tasks which have been devolved to them since 1993, such as social assistance, education, health, and culture.

Situation and Evolution to 1996

The wage tax is paid by salaried employees, through a withholding system. Part of the income collected from this tax is distributed to local governments. The Law on Local Public Administration[23], the Law of Public Finance[24] and the Annual Budget Law[25] refer to transfers of taxes from the State Budget, but do not indicate how or on what basis the amounts transferred are to be calculated. Through at least 1996, there was no fixed rule on the percent or proportion of the wage tax to be distributed to local governments, nor on other criteria used to determine the amount of wage tax share allocated.

Table 7
Evolution of Wage Tax and Share to *Judets* (millions of lei, 1993-1995)

	1993 (actual)	1994 (actual)	1995 (actual)
Amount of wage tax collected (current lei)	1,322,682	3,220,599	4,582,354
Amount of wage tax collected (1995 lei)	2,751,179	4,122,367	4,582,354
Percent change from previous year (real)	n/a	49.84	11.16
Share of wage tax to Local Government (current lei)	231,770	668,109	1,203,024
Share of wage tax to Local Government (1995 lei)	482,082	855,180	1,203,024
Percent change from previous year (real)	n/a	77.39	40.68
Percent of wage tax distributed to *judets*	17.52	20.74	26.25

[23] Article 93, No.69/91 as amended by Law No. 24/96.

[24] Article 59(a) of Law No. 10/91 as amended by Law No. 72/96.

[25] Article 27, Annex No.5, and Annex No.9, 1996 Budget Law, in the Official Gazette No. 91 on May 6, 1996.

	1993 (actual)	1994 (actual)	1995 (actual)
Wage tax per capita to Local Government (current lei)	10,185	29,392	53,041
Population	22,755,260	22,730,622	22,680,951
Deflator	2.08	1.28	1.00

Source: Ministry of Finance Budget Department.

Analysis of wage tax allocations since 1993 indicate that the share transferred to the local level has increased each year, from 17.5 percent of the total wage tax collected in 1993, to 26 percent in 1995 (see Table 7 above). Although in 1995 total wage tax collections increased by only 11 percent from the previous year (in constant 1995 lei), the amount allocated to the *judets* increased by over 40 percent. Three *judets* (Bucharest Municipality, Constanţa and Prahova) account for 30 percent of the total wage tax collected in Romania, but for less than 18 percent of the wage tax distributed to the *judets*.

The wage tax allocated to each *judet* as a percent of wage tax collected in the *judet* varies considerably, from only 14.5 percent (Constanţa) to 61.5 percent (Botoşani). The gap between the lowest and highest per capita amounts of wage tax share among *judets* is 2.3, with 35,402 lei per inhabitant at the lower end of the scale (Teleorman) and 82,913 lei per inhabitant at the upper end (Sălaj).

To distribute the wage tax among *judets*, the Budget Department of the MOF examined the aggregated budget proposals of each of the *judets*. The amount requested by the latter is based on the portion of the budget for which local governments could not find own source revenues. Given that no clear allocation rules were defined, local governments may not have been motivated to efficiently estimate or collect their own revenues, as they perceived they would then lose out on central subsidies. Local officials assumed the amounts distributed by MOF to *judets* and by *judets* to local governments were based on subjective and sometimes political criteria.

Judets and their local governments may tend to overestimate their need for wage tax transfers, in order to receive higher subsidies. Thus, MOF examined each of the own source revenue estimates in detail. For example, the estimated taxes of each *judet* were compared with actual collections in the previous and ongoing fiscal years. If an underestimation of less than 20 percent appeared, MOF generally did not comment. However, an underestimate which exceeded 20 percent could lead to an adjustment of the *judet*'s "needs"; this has apparently been the case for 7 to 10 *judets* in past fiscal years. Although MOF also has to consider needs and capacities of the State Budget, a greater portion of the wage tax has been distributed to the *judets* each year, as noted above.

One fixed rule which the MOF seemed to follow for each year is to assure a minimum amount to each *judet*, equal to the allocation received in the previous fiscal year plus inflation and GDP growth. Indeed, for an example in 1995, Hunedoara's allocation increased by 38 percent, in current lei, although the amount of wage tax collected in the *judet* declined. Other implicit considerations by the MOF (although these were never expressed through explicit formulae) included : population, number of schools, and length of roads. Less developed regions were also said to be favored.[26] An internal norm of the MOF includes a list of 30 indicators, as guidance to the *judets* for distribution of the wage tax transfer to their local administrative units.

Preliminary Modifications in 1997

Given the lack of clearly defined rules for the distribution of the wage tax share, MOF modified the system of calculation each year, in a sense, learning by doing. The 1997 Budget Law under preparation (proposed Annex No. 10), is the first wherein specifically defined criteria for distribution of the shared wage tax among *judets* will be set. These criteria reflect some of the implicit considerations which MOF appeared to make in previous years. The criteria have been communicated to *judet* Presidents and to local mayors, for information. *Judet* councils are encouraged (but not obliged) to use the same criteria when distributing these funds among their local governments. The criteria and their respective weight in the distribution of the shared wage tax are:

Number of students (pre-university)	31 percent
Number of hospital beds	27 percent
Population	15 percent
Length of roads / highways, in kilometers	7 percent
Length of streets, in kilometers	5 percent
Number of medical clinics	5 percent
Number of territorial administrative units	5 percent
Length of water network	3 percent
Number of housing units	2 percent
Total	100 percent

~~According to the draft budget law under preparation, the latest scenario (end Ja~~nuary) estimated an overall increase of about 95-97 percent of the amount of wage tax to be transferred to local governments, or about 3,960 billion lei.[27] An amount is calculated for each criteria, based on the defined weights (for example, 15 percent of the 3.9 trillion lei, or 594

[26] In 1996, the Government approved a list of four disadvantaged regions which will be given priority consideration for assistance and infrastructure finance.

[27] Note: these figures are only temporary and are likely to be changed during the debate of the 1997 budget law in Parliament. The numbers provided here were the hypotheses at end January 1997.

billion lei, is based on population). This portion is then allocated to each *judet*, based on their percent of population, compared to the total.

Each *judet* would be guaranteed a minimum increase of at least 90 percent. Thus, if the result of the distribution according to the formula and percentages results in an increase of less than 90 percent (the case for 18 *judets*), an adjustment is made to insure the minimum increase of at least 90 percent. There is no fixed percent of the wage tax to be allocated to *judets* per se, only a numerical amount communicated to the Budget Department, based on the capacity and needs of the State Budget.

Minimum Spending Requirements from Wage Tax Share

The wage tax share is a general fund of local governments, and is generally not targeted to any specific expenditure. However, since 1993, several new tasks have been transferred to the local sector, including social expenditures (retirement homes, handicapped facilities) in 1993, health, education and social assistance (means-tested benefits) in 1995, and culture, sports, youth and religion in 1996. The concern of the MOF has been to ensure that these tasks are adequately funded. One of the means of responding to this concern has been to impose minimum spending levels for certain sectors to be financed from the share of wage tax. However, these minimum spending requirements have not been consistently applied, and the sectors have been modified each year.

Table 8
Evolution of Minimum Spending Requirements from the Wage Tax Share
(millions of current lei, 1993, 1994, 1996)

	1993 (rectified budget)	1994 (rectified budget)	1996 (budget)
Share of wage tax	236,577	670,225	1,600,600
Education: Minimum level			524,500
Percent of wage tax share			32.77
Health: Minimum level	99,146	247,900	492,000
Percent of wage tax share	41.91	36.99	30.74
Social Assistance[a]: Minimum level	26,229	79,325	
Percent of wage tax share	11.09	11.84	

Note
a These are social assistance expenditures for retirement homes, homes for disabled, and canteens.
Sources: Modified budget laws of 1993 and 1994, initial budget law of 1996.

As illustrated in Table 8 on the previous page, the minimum spending requirement determined at the national level accounts for a significant portion of the shared wage tax. In 1993 and 1994, minimum levels for social assistance and health account for about 50 percent of the wage tax share. In 1996, the minimum levels were defined for education and health, which together represented over 60 percent of the allocated wage tax. Although these minimum spending requirements were initially to be eliminated in 1997, it would seem that one will remain for means-tested social assistance benefits. At end January, this minimum spending requirement was estimated at 390 billion lei, for 3.96 trillion of wage tax share (or about 10 percent).

[Note: This section was written before the announcement of increases of oil and natural gas prices and may not reflect the final situation for district heat subsidies in the context of the final reform package.]

NON-INVESTMENT SUBSIDIES FROM THE STATE BUDGET

Subsidies to local governments for non-investment purposes consist of "social protection" or consumer subsidies for district heat and urban transport services. These subsidies are passed through the local government budgets and then transferred to the municipal and *judet regii autonomes* (RA) which provide these services. The district heat subsidy is a price support subsidy, to limit the maximum price paid by consumers. The subsidy for urban transport consists of a subsidy for operation and maintenance and a subsidy to finance free transport for certain categories of riders. Local governments do not have any discretion in the use of these funds, in the sense that they are essentially passed through the local budget to the RA, and must be used for their intended purpose. However, on the basis of the RA's quarterly financial reports, local governments can request a reduction of the amount of the subsidy. The total amount of this subsidy is listed by *judet* in Annex No. 6 of the annual Budget Law, but there is no distinction between heating and transport subsidies in this annex.

Although these subsidies are meant to ease the burden of full service payment from the population, they essentially subsidize the overall operations of the RA, and remove any incentive for these companies to improve the efficiency of their operations.

The amount of social protection subsidies distributed since 1993 is indicated in Table 9, in current and 1995 lei. In real terms, the amount of subsidies distributed increased by less than 2 percent in 1994, almost 30 percent in 1995, and 20 percent in 1996. The share of Bucharest city in the total subsidy has varied from 34 to 42 percent.

For 1997, MOF Budget Department has calculated a need for social protection subsidies of 1,759 billion lei, of which 411 billion lei is for transport and 1,348 billion lei for district heat. However, the amount of State Budget funds to be allocated for these subsidies is only 1,350 billion lei, or 77 percent of calculated needs, with the rest to be covered by local government own budgets (final amounts will be determined by Parliamentary decision).

Table 9
Evolution of Subsidies for District Heat and Urban Transport (billions of lei, 1993-1997)

	1993 (actual)	1994 (actual)	1995 (actual)	1996 (program)	1997[a] (program)
Total subsidy (current lei)	151.46	249.73	410.59	711.00	1,350.50
Total subsidy (1995 lei)	315.04	319.66	410.59	490.59	
Percent change from pervious year (real)	n/a	1.46	28.45	19.49	
Subsidy to Bucharest City (current lei)	51.83	104.57	171.37	252.06	
Subsidy to all other *judets* (current lei)	99.63	145.16	239.22	458.94	
Percent of subsidy to Bucharest	34.22	41.87	41.74	35.45	
Deflator	2.08	1.28	1.00	0.69	

Note
a It should be noted that the amount of this transfer will be fixed only when the 1997 budget law is approved by Parliament. The figure shown here was the amount estimated in early February, 1997.
Source: Ministry of Finance Budget Department

Subsidies for District Heat

The subsidies for district heat are intended to compensate for the real cost of providing heat. The maximum price paid by consumers is established by the Government. The maximum which has been set for 1997 is 21,800 lei/giga-calorie. Among the district heat *regii*, the unit production price varies from 30,000 to 90,000 lei/giga-calorie, and depends on the source used for providing heat. The cost per unit of heat which exceeds the established consumer price is financed by the subsidy. For 1997, MOF Budget Department has estimated the amount of subsidy required for district heat to be 1,348.2 billion lei. However, as the total allocation for both district heat and urban transport subsidies in 1997 is 1,350.5 billion lei (at end January 1997), a part of the subsidy amount for district heat *regii* will be financed from other local government revenues.

There have been many discussions to phase out the district heat subsidy, but it appears that the final decision on this issue has not been determined. One plan which has been proposed is to phase out the district heat subsidy over a period of one year, starting May 1, 1997. For RA which receive thermal heat from RENEL, or for those which use other non-liquid fuels, the subsidy would be completely phased out on May 1, 1997. For all RA which use liquid fuels for heating, the subsidy would be reduced and eliminated in three phases: (1) May 1, 1997—33 percent; (2) September 1, 1997—33 percent; and (3) May 1, 1998—34 percent. However, phasing out of this subsidy would likely need to be accompanied by the development of targeted assistance to poor households to help in paying their heating bills.

Subsidies for Urban Transport

The urban transport subsidy includes two separate elements: an operating subsidy and a ticket subsidy. The larger part of the amount transferred consists of a subsidy to finance up to 50 percent of material expenditures for operation and maintenance of transport infrastructure and vehicles (60 percent in Bucharest). Salaries and investments are not included in the calculation of this subsidy, and there is also the concern to keep RA profits at 6 percent or less. In 1997, the estimated need for the operating and maintenance subsidy is 365 billion lei. The second part of the subsidy pays for free transportation for certain categories of riders: the disabled, veterans and revolutionaries (1989). Financing free transport for the last category represents a significant portion of the subsidy in certain *judets* (for example, Bucharest, Timis, and Cluj). For 1997, the estimated need for this portion of the transport subsidy is 45 billion lei, or 11 percent. However, as the total allocation for both urban transport and district heat and subsidies in 1997 is 1,350.5 billion lei (at end January 1997), a part of the subsidy amount for urban transport RA will be financed from other local government revenues.

According to the MOF Budget Department, there are no plans to reduce or phase out the urban transport subsidies.

OWN OPERATING REVENUES

Own operating revenues of local governments, collected directly at the municipal or *judet* level, account for barely one-fourth of total local revenues (including subsidies for investments), and one-third of operating revenues. These own revenues consist of direct taxes, indirect taxes and nonfiscal revenues, of which direct taxes account for the largest portion (Table 10).

The legal basis for local government fiscal and nonfiscal revenues is included in several legal texts, the main ones being Law 69/91, the Public Finance Law, the Law on Local Taxes and Fees, and Ordinance No. 24/1995 on the amendment and completion of regulations on agricultural income taxes and on local taxes and fees, Law 125/1995 on the income tax of self-employed professionals, independent and family associations. Most local taxes and fees have been attributed to municipal and not to *judet* councils. The revenue base from these taxes and fees is quite limited, and was further reduced for certain taxes by Ordinance No. 24. The situation

Table 10
Structure of Own Operating Revenues (millions of current lei, 1993-1996)

	1993 (actual)	1994 (actual)	1995 (actual)	1996 (program)
Total operating revenues	493,189	1,202,720	2,497,846	3,853,862
Direct Taxes	82,855	206,814	688,674	883,924
Percent of total	16.80	17.20	27.57	22.94
Indirect Taxes	9,852	32,025	45,690	48,881
Percent of total	2.00	2.66	1.83	1.27
Nonfiscal Revenues	17,249	44,545	139,783	221,814
Percent of total	3.50	3.70	5.60	5.76

Source: Ministry of Finance Budget Department.

can be broadly defined as one long list of very minor taxes and fees, with a narrow base to collect rom, and in some instances, difficult to control or follow-up, without the strict cooperation of other agents (veterinarians for the dog tax, hotel owners for the spa fee). In addition, the leverage of municipal councils in setting tax and fee rates is quite limited, with a real possibility for decision existing for only a few taxes or fees.

Direct Taxes

Among direct taxes, specific distinctions are made between individuals and legal entities, in the definition of the tax base and tax rate. Table 11 provides a simple summary of the main direct taxes, the base for taxation and the rates which are applied.

As is illustrated in Tables 11 and 12, the revenues from direct taxes account for about one-fourth of local operating revenues, but the bulk of these revenues are concentrated among 2-3 taxes, in particular the building tax on legal entities and the tax for self-employed persons. The other various direct taxes each represent from less than 1 percent to 3 percent of operating revenues.

Local governments have very little implication or responsibility in the whole local tax process. For most of these taxes, they do not have any possibility to set rates, either by increasing or lowering the rates provided by the Central Government. They are not responsible for tracking, estimating and verifying the tax base. They are not involved in collecting most taxes and fees, with the exception of market fees, permit fees, and stamp duties. And they generally do not receive daily up-to-date information from the local Treasury office about the collection of these taxes.

There are, however, two main direct taxes for which local governments may adjust rates. One is the tax on self-employed professionals, for which the tax rate may be adjusted upward by 30 percent. The second is the fee for the use of state-owned land, which may also be increased by 30 percent. Other taxes and fees, which do not represent large portions of revenue, but for which local government may adjust the tax rate are : fees for public places (market fees), urbanism, construction and utility connections certificates and permits.

There are 3-4 categories of people who are exempt from payment of local taxes: war veterans, war widows, widows of war veterans who have not remarried, disabled individuals and revolutionaries (1989).

Table 11
Tax Base and Rates for the Major Direct Taxes

Tax	Tax Base	Tax Rate	Notes
Taxes on Individuals			
Building Tax Buildings owned by individuals and not used for commercial / economic activities	Value of surface in m^2, based on type of construction material / purpose of building. Values per m^2 range from 1,500-16,800 lei.	1 percent of the assessed value.	The values per m2 and the tax rate are clearly defined, and there is no scope for modification by local councils.
Land Tax Tax on land occupied by buildings and on land not occupied by buildings	Fixed amount per m^2. Surfaces less than 1,000 m^2 (courtyards without any buildings) are exempt. Unbuilt plots larger than 1,000 m^2 are subject to the tax on agricultural revenues.	From 15 to 120 lei/m^2, according to the type of locality (village, town, city) and the zone within the city (central to outlying areas, defined as A, B, C, D).	The tax rate per m^2 is clearly defined, and there is no scope for modification by local councils. The local council defines the four zones which set the base rate.
Vehicle Tax Tax on mechanized mean of transportation	Cylindrical capacity of the engine, for each 500 cm^3.	From 1,500 to 14,000 lei per 500 cm^3, based on type of vehicle; 6,000 to 38,000 lei per 500 cm^3 for trailers; 1,000 to 500,000 lei for boats, according to type of boat.	The tax rate per vehicle or per 500 cm^3 is clearly defined, and cannot be modified by the local government
Tax on self-employed professionals, artisans, family associations	Progressive income tax on income from activities. For self-employed professionals, artisans and family associations.	Professionals: 17-43 percent of adjusted income, but cannot exceed 37 percent of annual taxable income. For artisans, family associations: 10-54 percent, but cannot exceed 45 percent of annual taxable income.	For the first year of activity, the tax is reduced by 30 percent. *Local councils have the option of increasing the tax by 30 percent.*

Table 11
Tax Base and Rates for the Major Direct Taxes (continued)

Tax	Tax Base	Tax Rate	Notes
Taxes on Legal Entities			
Building Tax Buildings used for commercial/economic activities	Value of book value declared in balance sheets. Assets which have been wholly depreciated are calculated at the value at which they were registered.	1 percent of the assessed value. (Note: The current tax rate was established in 1995, the previous rate was 1.5 percent)	The assessment of building values and of the tax rate are clearly defined, and there is no scope for modification by local councils.
Land Tax Tax on land occupied by buildings	Fixed amount per m^2	From 15 to 120 lei/m^2, according to the type of locality (village, town, city) and the zone within the city (central to outlying, defined as A, B, C, D)	The tax rate per m^2 is clearly defined, and there is no scope for modification by local councils. The local council defines the four zones which set the base rate.
Vehicle Tax Tax on mechanized mean of transportation	Same as for individuals	Same as for individuals	Same as for individuals
Fees for use of State-owned land : Use of land by commercial entities for uses other than agriculture and forestry activities	Fixed amount per m^2 of land used, or per km of rail lines.	From 20 to 120 lei/m^2, according to the type of locality (village, town, city, Bucharest) and the zone within the city (central to outlying, defined as A, B, C, D). 4,200-8,300 lei/km for use of railroad track.	*Local councils have the option of increasing the tax by 50 percent.*

Table 12
Revenue from Direct Taxes (millions of current lei, 1993-1996)

	1993 (actual)	1994 (actual)	1995 (actual)	1996 (program)
Total operating revenues	493,189	1,202,720	2,497,846	3,853,862
Total Direct Taxes	*82,855*	*206,814*	*688,674*	*883,924*
Taxes on profit of *regii*	3,314	6,376	19,906	41,658
Taxes/fees on individuals[a]	36,321	90,846	219,657	271,274
Taxes for use of State-owned lands	9,297	35,841	37,419	45,471
Taxes on buildings—legal entities	28,713	39,613	266,049	321,513
Vehicle Tax—legal entities	3,728	4,286	44,318	60,070
Tax on agricultural income	0	20,579	59,028	82,202
Total Direct Taxes	*16.80*	*17.20*	*27.57*	*22.94*
Taxes on profit of *regii*	0.67	0.53	0.80	1.08
Taxes/fees on individuals	7.36	7.55	8.79	7.04
Taxes for use of State-owned lands	1.89	2.98	1.50	1.18
Taxes on buildings—legal entities	5.82	3.29	10.65	8.34
Vehicle Tax—legal entities	0.76	0.36	1.77	1.56
Tax on agricultural income	0.00	1.71	2.36	2.13

Note
a Taxes and fees on individuals include: taxes on self-employed, craftsmen, family associations; building and land tax on individuals, vehicle fees for individuals, stamp duties and other fees on individuals.
Source: Ministry of Finance Budget Department

Indirect Taxes

Indirect taxes consist principally of the entertainment fee, stamp duties for legal persons, and penalties for late payments. Indirect taxes account for less than 3 percent of local government operating revenues.

Nonfiscal Revenues

Nonfiscal revenues consist of a variety of revenues, including fees for issuance of drivers' licenses, payments and revenues from public institutions under the authority of the local government, revenue from concessions/leasing, payments for legal charges, damages, and payments from the net profit of *regii autonomes*. These revenues account for less than 6 percent of local operating revenues.

LOCAL GOVERNMENT INVESTMENTS

Investment expenditures by local governments have generally accounted for 30 to 35 percent of their total spending since 1993 (Table 13). A portion of investments are completed

Table 13
Local Government Investment Expenditure and Subsidies (1993-1996, millions of current lei)

	1993 (actual)	1994 (actual)	1995 (actual)	1996 (program)
Total investment subsidy	176,177	512,815	789,300	1,187,961
Total capital expenditures	*217,779*	*624,062*	*985,278*	*1,412,375*
By public institutions	123,045	228,438	641,489	731,414
By *Regii*	94,734	395,624	343,665	668,461
Partly funded from external loans	0	0	124	12,500
Percent of capital expenditure financed by subsidy	80.90	82.17	80.11	84.11
Capital expenditures (percent of total expenditures)	31.29	35.97	30.17	27.65
Capital expenditures (percent of operating revenues)	44.16	51.89	39.45	36.65

Source: Ministry of Finance Budget Department.

directly by the municipal or *judet* council, or by a public institution subordinated to it, while another portion is generally undertaken by *regii autonomes*. The percent distribution fluctuates considerably from one year to the next: in 1994, RA carried out 63 percent of local government capital investment, but only 35 percent in 1995. Investment subsidies transferred from the State Budget account for over 80 percent of financing of these capital expenditures. The balance of capital expenditures is financed by revenue from the sale of local assets, and by net savings from the operating section of local budget.

The investment preparation and financing process consists of two separate phases. The first phase concerns the technical approval of investment projects, by the MOF and in some cases, by the Ministry for Public Works and Territorial Planning (MPW). The second phase involves the calculation and distribution of investment subsidies by the Budget Department of MOF. Each of these processes is described in the following subsections.

Technical Approval of Investment Projects

Local governments cannot initiate any investment of more than 100 million lei without the technical approval of the MOF (even if the locality intends to fully fund the investment). If a proposed investment for which the local government is requesting State Budget funding exceeds certain limits (indicated in Table 14) it must be examined by the Interministerial Committee for Public Works, chaired by the MPW, and approved by the Government.

Only upon MOF or Government approval are local governments allowed to include these investments in their budget. Although a financing schedule or plan is associated with each project, neither the MOF nor the Government takes responsibility for the actual financing of the investment. The approval process appears to be mostly based on the technical aspects and norms of a given investment, and not on financial viability.

Table 14
Investment Limits for MOF and Government Approval[a]

	MOF Technical Review	Government Approval by Interministerial Committee
Bucharest Municipality and *Judets*	100 million–4 billion lei	More than 4 billion lei
Municipalities	100 million–3 billion lei	More than 3 billion lei
Towns	100 million–2 billion lei	More than 2 billion lei
Villages	100–500 million lei	More than 500 million lei

Note
a Article 64(2), Law 10/91, as amended by Law No. 72/96.

Before presentation of a project to the MOF and as needed, MPW, the municipal or *judet* council, along with the *regia* will have already prepared the project concept, the pre-feasibility study and the feasibility study. A series of approvals and permissions is required, and may include: urban planning, territorial planning, Ministry of Agriculture, Forestry Department, power supply availability and power utility route approval, transport utilities, gas and oil utilities route approval, Historical Sites and Natural Monuments, Department of Water Management and Ministry of Environment. The elements to be included in the feasibility documentation are defined in a joint order of the MOF and the MPW.[28]

Investments Examined by MOF

The proposal and feasibility study for any local investment which exceeds 100 million lei are analyzed by the Investment Evaluation Office (IEO) in the MOF. This office receives at least 1,200 feasibility studies each year,[29] of which about one-fourth have already been started, with some projects ongoing since 1990. The IEO staff consists of 22 experts to examine these projects. The feasibility studies are analyzed to determine whether technical norms and standards are respected, whether all permits have been obtained, and whether the proposed technical solutions are appropriate. After the MOF gives its visa, the beneficiary prepares the final technical design, which is also submitted to the IEO (there may be a 2-3

[28] No. 1743/69/N1996, published in the Official Gazette No. 232bis of September 26, 1996.

[29] Many of these involve road / highway repairs.

year gap between initial approval of the feasibility study and submission of the technical design). Once the second visa has been given, the MOF participates in the procurement commission. After this stage, the MOF is no longer implicated in the project. Through 1994, the IEO also conducted oversight of the construction stage, but this role has since been ended.

To date, it appears that the IEO has not refused to give its visa to any project, as their role is one of pure technical analysis, not at all related to any priorities for financing investments.

Investments Approved by the Government

If a proposed local project exceeds a certain amount (according to the type of local government), it must be reviewed by the MPW and approved by the Interministerial Committee for Public Works (IC). This Committee comprises 18 members, including representatives of most line Ministries, and is headed by the Minister for Public Works. The IC takes decisions on national investment projects as well as on local projects exceeding the monetary limits indicated in Table 14. Over 900 projects have been analyzed by the IC, weeded out from more than 1,300 proposals. At least 60 percent of these projects involved municipal and *judet* infrastructure (such as wastewater treatment, potable water, and solid waste).

The IC Secretariat at MPW examines the pre-feasibility and feasibility studies, verifies that the project is in conformity with national and local urban plans and ensures that all planning, environmental, network and other necessary permits have been obtained. MPW also verifies the general situation of other ongoing investments in the local government and *judet*, as well as the priority list of investments. The report prepared by the Secretariat is the basis for discussions in the IC. When the IC has given its visa to a project, a Government decision is issued. At this stage, the technical design is prepared and the tender documents are given to the procurement commission (which includes the beneficiary—mayor, *judet*, or RA—a representative of MPW, and a representative of MOF). A separate division of MPW is responsible for construction oversight, to ensure that it is in compliance with the technical design and standards.

Calculation and Distribution of Investment Subsidies

Investment subsidies account for 24-29 percent of total local government revenues, and finance over 80 percent of investment expenditures. Investment subsidies increased in real terms by 20 percent in 1995, but the rectified budget for 1996 indicates a real increase of less than 0.5 percent (Table 15—Investment Subsidies). In addition to the global transfer, there is also a specific transfer for the EBRD MUDP I investments. The investment subsidy for this program would account for about 1 percent of total investment subsidies in 1996, although this proportion may increase in the next two years, as the EBRD program investments were only recently initiated.

Investment priorities and stated policy indicate a clear preference to finance investment projects already underway. It is up to the *judets* to ensure that ongoing investment projects are given preference over new ones when distributing the investment subsidy among municipal projects within the *judet*. Given the fact that there is no guaranteed multi-year financing for capital projects, there are many unfinished investments, which require long construction periods, as municipalities and *judets* scavenge for funds.

Annex 7 of the Budget Law defines approved investment categories for which State Budget investment subsidies may be used. This list simply indicates the sectors of priorities determined by the Government for investments financed wholly or partly with Central Budget funds. It does not establish a hierarchy among the priorities included in the list. The list of

Table 15
Investment Subsidies (millions of current lei, 1994-1996)

	1994 (actual)	1995 (actual)	1996 (rectified)
Investment subsidy (current lei)	512,815	789,176	1,175,461
Investment subsidy (1995 lei)	656,403	789,176	792,120
Percent change in investment subsidy (from previous year)	n/a	20.23	0.37
Subsidy for investment partly funded from external loan (current lei)	0	124	12,500
Percent of total investment subsidy	0.00	0.02	1.05
Investment subsidy per capita	22,561	34,795	51,993
Population	22,730,622	22,680,951	22,608,050
Deflator	1.28	1.00	0.69

Source: Ministry of Finance Budget Office.

priorities in 1994 and 1996 were the same, with no change in any of the investment priorities over the three-year period. In the 1994 and 1996 Budget Law, the list of priorities included[30]:

Rehabilitation, modernization, expansion and new works for the following:

— District heat networks, plants and units;
— Water supply;
— Water treatment plants, collectors, pumping stations, and landfills;
— Sewerage networks;

[30] Annex No.7, 1994 Budget Law, published in the Official Gazette No. 148 on June 10, 1994 and Annex No. 7, 1996 Budget Law, No. 91, May 6, 1996.

— Hydro-technical works of local interest, within the city area;
— Urban and technical works related to housing;
— Local roads and bridges, streets, overpasses, underpasses within localities;
— Urban transportation networks, including tramways, buses and trolley buses;
— New or ongoing works for natural gas networks.

An explanatory note to the Annex also indicates that "... priority shall be given to funding the execution and completion of ongoing investment objectives, depending on the duration of execution...." and that "Among infrastructure projects, priority shall be given to investments that concern the rehabilitation and modernization of existing capacities...."

The local budget project prepared in August of the preceding fiscal year is discussed among the mayor, the *judet* finance department and the local office of the MOF DTFB. The list of investment projects proposed and annexed to the *judet* budget[31] is not transmitted to the MOF Budget Department in Bucharest. The only element which MOF sees are the requests in the aggregated *judet* project for a specific amount of transfer for investment purposes. In the final decision by MOF, the actual attribution of a total subsidy amount per *judet* is 2-3 times lower than the amount initially requested.

Although there are no published, obligatory criteria for the calculation of investment subsidies, and the allocation is not transparent, the MOF does use a set of defined criteria and percentages, similar to the formula which will be implemented for allocation of the wage tax in 1997. These criteria include:

Population	31 percent
Length of water network	15 percent
Length of sewerage network	15 percent
Average value of heat	14 percent
Length of roads / highways, in kilometers	10 percent
Length of streets, in kilometers	10 percent
Potable water capacity	5 percent
Total	100 percent

The calculation of this criteria may be adjusted, in order to reduce disparities in per capita distribution of investment subsidies among *judets*. Upon notification of the amount of investment subsidy for the fiscal year, the *judet* will assign amounts to the local authorities, based on a list of investments proposed, on *judet* priorities, and on discussions between judet and local officials. Local authorities can match the capital subsidies they receive wtih specific investment projects at their discretion.

[31] By this stage, these projects will have already received MOF or Government technical approval as well as all necessary permits.

BORROWING BY LOCAL GOVERNMENTS

Local governments in Romania are entitled to borrow, with an approval of a two-thirds majority of the local council, and only if there is the guarantee that the borrower is capable of paying the ensuing debt service.[32] The contracting of long-term loans must be submitted to approval of the population, through a referendum. According to MOF interpretation, a long-term loan is for more than one year, and therefore engages the local budget beyond the fiscal year. The Law on Public Finance includes the possibility for local governments to raise funds through the issuance of bonds (see "Regulations for Government Borrowings in 1997" on the next page).

In aggregated local accounts, there are only two kinds of borrowing which have appeared to date. The first concerns short-term loans taken out from either the *judet* reserve funds or the revolving fund, to cover temporary cash and liquidity shortfalls. (These funds are constituted by the obligatory transfer of any end-of-year surplus on local government accounts.) If these loans are not reimbursed by the end of the fiscal year, the principal outstanding is payable over 18 months, at a relatively low interest rate (say 15-18 percent). In 1994 and 1995, these short-term loans accounted for less than 0.3 percent and less of operating revenues. Interest and principal payments in 1995 and 1996 accounted for 0.2 percent and less of total expenditures (58 million lei in 1995, 500 million lei projected for 1996).

Regulations for Local Government Borrowing in 1997

According to the Law on Public Finance,[33] local and *judet* councils can finance "expenditures for well-justified actions" through the issuance of bonds. However, they must be authorized to do so in the annual budget law. The authorization process requires the municipal or *judet* council to submit a "Situation", which includes the following information: purpose for which the bond will issued; amount of the bond issuance; own revenues; share of wage tax; transfers; total revenues, and total expenditures. Information on local revenues and expenditures is provided for 1995, 1996 and the forecast for 1997. These applications are analyzed by the local DGPF offices, which check whether the investment is objective is "real"and included in the budget, whether the local government can repay the loan.

As of the end of January 1997, twelve local and *judet* councils had received this authorization, although further applications may yet arrive at MOF. This list is to be published in Annex No. 11 of the 1997 State Budget Law.

At the same time, in the State Budget Law under preparation, an Article 30 (2) is to include a borrowing limit on local governments. This limit is on the annual amount of loan principal which may be contracted by local governments and which has for the moment been

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[32] Article 100, No.69/91 as amended by Law No. 24/96.

[33] Article 54(4), Law 10/91, as amended by Law No. 72/96.

set at 20 percent of the sum of own revenues plus the shared wage tax received from the State Budget.[34] This annual debt limit will present a serious limit on the amount of loans or bonds which could be issued by local governments, but may also require them to think more realistically about their debt carrying capacity. For example, a large city, with about 80 billion lei in total own revenues plus share of wage tax, and wishing to issue a bond for about 150 billion lei, would only be authorized to issue a bond for 16 billion lei in 1997, based on the provisions proposed in Article 30.

EBRD and Other International Loan Programs

The MUDP I program of the EBRD consists of a $28 million loan (15 years, 3-year grace period) to finance water distribution, metering, wastewater treatment and other water / wastewater infrastructure in the municipal councils of Tîrgu Mureş, Craiova and Timişoara, and the *judet* councils of Iaşi and Braşov. The individual projects were developed taking into account local capacity to repay the local share of borrowing primarily through rate increases for water consumption.

The principal borrower of the loan is the Government of Romania, through the Ministry of Finance. Subsidiary Loan and Guarantee Agreements (SLGA) are signed between the MOF, and each of the five sub-borrowers, the *Regia Autonome* (RA) and the municipal or *judet* council (as Guarantor).

As part of their role of Guarantor, the municipal and *judet* councils are required to ensure the financing of 5 percent of the total value of the project, guarantee the performance of the RA's obligations, and transfer to the RA state budgetary allocations (investment subsidy) extended for financing the project (the MOF ensures financing for 45 percent of each project).

The RA are required to establish a separate reserve account for maintenance, replacement and development of fixed assets, and for covering debt service obligations. Each *regia* contributes to its reserve fund an amount at least equivalent to the depreciation of fixed assets, income earned from the sale of fixed assets, and a portion of the net profits of the RA. The municipal or *judet* councils are required to transfer to this reserve account the amount of the profit tax transferred to the local government budget, as well as the share of net profits of the RA. For example, in 1995, for all local government budgets, these two items accounted for 0.7 percent of total revenues.

Another contribution of the local governments as Guarantor includes the creation of a reserve account for the subsidiary loan reimbursements, equal to 10 percent of the annual payment obligations. This reserve is a separate interest-bearing account set up at the State Treasury. The unused balance of the reserve fund will be rolled over each year, until the loan

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[34] This formula may be modified during the discussion of the 1997 Budget in Parliament.

has been completely repaid. Under the terms of the SLGA, the local governments are also prevented from making any changes to the status of the RA without prior consent of the MOF.

The role as Guarantor of the municipal and *judet* councils in the SLGA is complete. Section 6.01 of the accord states:

> The Guarantor hereby agrees to undertake irrevocably and unconditionally the performance of RA's obligations and responsibilities under the SLGA and Project Agreement, and *shall guarantee as primary obligor and not merely as surety* the payment of principal, interest and all other amounts payable under the SLGA [emphasis added].

In addition, according to Section 8.01, the *regia autonome* and the Guarantor agree not to sign any other loan agreements without prior written consent of the MOF. In addition, the *regia* commits itself to "...ensure that no other external debt or long/medium term debt shall have priority over the Subsidiary Loan in the allocation or distribution of its revenues or in the creation of any lien." Based on these requirements of the SLGA, by its participation as Guarantor, the five local governments participants in MUDP I have effectively limited or even exhausted their capacity to borrow for other investment projects.

POLICY ISSUES AND IMPLICATIONS FOR MUNICIPAL CREDITWORTHINESS

The foregoing analysis has discussed the framework for local government finances and the aggregate financial situation for municipal and *judet* councils. One objective of this study is to determine the potential capacity of local authorities to either directly contract loans or issue bonds for the financing of necessary local infrastructure. Given the current structure of municipal revenues, and a number of specific national legal administrative regulations, local governments themselves would not at the present time be creditworthy borrowers. This section will examine the specific limitations and the concerns they raise in the context of local government borrowing.

One of the first major obstacles is the lack of a law on patrimony, which would clearly define the distribution of assets between the State, *judet* councils and municipal councils; and between local authorities and their RA. Enabling local authorities to dispose of clearly defined titles to locally owned and managed land, buildings, assets and infrastructure would, firstly, allow them to earn revenues from the sale, lease or rent of this patrimony. Such revenues could provide initial funds for debt payment financing, until their overall financial situation has improved. Second, clarification of local patrimony would enable the privatization of RA to proceed. Finally, and perhaps most importantly, from a creditworthiness perspective, local governments could pledge assets as security for loans and bonds, thereby immediately lifting one obstacle to borrowing.

The combination of the regulations on the use of local governments budget surpluses, the rigidly annual outlook of local budgets and the restrictions on long-term borrowing create a specific set of circumstances which limit local borrowing capacity. The regulations which deprive local authorities of their end-of-year budget surpluses discourage any efforts for supplementary revenue generation, or multi-year investment planning. Raising additional funds for investment is not logical if they cannot be spent in the same fiscal year, and would thereby be confiscated at the end of the year. Capture of the local budget surplus is to some extent the consequence of a limited perception of allowing local governments to make financial commitments beyond the immediate fiscal year, Thus there is the requirement of recourse to a referendum in the case of any borrowing of more than one year. In parallel with forthcoming debt borrowing ceilings it is possible to imagine a situation whereby annual tranches of a 10-15 year loan would require a referendum for approval of each tranche, during realization of the investment. The cost and delays involved in such a process would be prohibitive, and would also likely discourage any financial institution from engaging itself to disburse a loan which could be rejected by popular will from one year to the next.

The current framework of local revenues, as well as recent transfers of tasks in the social assistance, education, health and culture sectors have led to a situation with almost no spare capacity for debt repayment within local budgets. Recurring net savings represent only 3-4 percent of total revenues and as indicated above, budget surpluses cannot be carried over. The Government's reform program should enable the passing of legislation which could ensure local governments a sure and certain basis for financial autonomy, based on clear, transparent and objective criteria. Strengthening the local revenue base could be ensured through the modification of transfers from the centra budget (including those intended for investment purposes) and/or modifying the bases of certain local taxes.

CHAPTER III.
THE LEGAL AND INSTITUTIONAL FRAMEWORK FOR LOCAL PUBLIC ADMINISTRATION AND FINANCE IN ROMANIA

INTRODUCTION

This chapter provides an overview of the existing legal and institutional framework for local government: (1) administration; (2) finance; and, (3) provision of local public services. It is not intended to provide a complete or authoritative statement of current Romanian law, nor to account for variations in practice that may be found in different jurisdictions across Romania.

The next section introduces the structure of local government administration as defined by the Constitution and laws of Romania. The third section provides an overview of the legal and administrative structures for local public finance and is followed by a description of the legal framework for local public service provision. The fifth section provides a brief overview of the primary features of the current system for regulation of banking and capital markets. Finally, the final section gives some preliminary conclusions concerning the current legal/institutional framework for local public finance and its implications for the possible future creation and operation of a municipal credit facility along the general lines envisioned under EBRD's Municipal Urban Development Project (MUDP) II.

THE STRUCTURE OF LOCAL GOVERNMENT

General Organization

The basic structure of local government in Romania is by defined the Constitution[35] under which local public administration is to be carried out "...in territorial-administrative units...based on the principle of local autonomy and decentralization of public services."[36] These provisions, supplemented by the Law on Local Public Administration,[37] provide for the organization of local government on geographically defined administrative subdivisions. These include districts (*judet*), municipalities (*municipiu*), towns (*oras*) and communes (*communa*), consisting of one or more villages or hamlets.[38] At present, there are 41 *judets*, 260 *municipiu* and *oras* and 2,688 *communa* in Romania. Each administrative unit is constituted as a legal person, having all the rights duties and obligations assigned to that status by Romanian law.[39]

Municipalities, Towns and Communes

Basic Structure and Function

As the basic units of local government in Romania, municipalities, towns and communes, perform both a legislative and an executive function. At the municipal, town and communal levels, the legislative function is performed by local councils whose members are elected for 4 year terms[40] through direct, universal suffrage[41] within the administrative

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35 Ch. V, Sec. 2, Const. Rom. (1991).

36 *Id.* at Art. 119.

37 *Law on Local Administration*, No. 69, November 26, 1991, as amended by Law No. 24, April 12, 1996.

38 Arts. 3(3), 120, 121, Const. Rom. (1991); Art. 2, Law No. 69/91, as amended by Law No. 24/96.

39 Art. 4, Law No. 69/91, as amended by Law No. 24/96. Frequently, Bucharest is treated as a special case under the law. For the purposes of this analysis, these differences will be ignored.

40 *Id.* at Art. 21.

41 See, *Law on Local Elections*, No. 70, November 26, 1991, as amended by Law No. 25, April 12, 1996.

territory.[42] The number of council members is determined by the population residing within of the administrative territory, ranging from as few as 11 members for communes with a population of less than 3,000, to a maximum of 65 in the case of Bucharest.[43] Once constituted, local councils elect a chair for each meeting by majority vote and meet monthly in ordinary session, or in extraordinary session, either at the request of the mayor or by vote of one-third of the council's membership.[44] In addition, local councils establish standing "specialist committees" that are responsible for developing draft decisions in their respective areas of competence.[45]

Mayors

The executive operation of local government is carried out by a mayor and a vice mayor.[46] Mayors are elected for terms of 4 years.[47] Vice mayors are appointed by majority vote of the council and serve for the duration of the council's mandate unless removed for cause.[48] The mayor serves as the principal executive officer of the local government and is accountable to the local council for the efficient operation of the local government.[49] In addition to other duties, mayors:

— Serve as the legal representative of the community to ensure that all legal obligations are met;[50]
— Prepare and submit annual draft budget requests and closing accounts (reconciliations) to the local council for approval;[51]
— Authorize and verify expenditures from the local budget;[52]

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42 Arts. 5, 6, 13, Law No. 69/91, as amended by Law No. 24/96.

43 *Id.* at Art. 14.

44 *Id.* at Arts. 21(3), 23(1), (2).

45 *Id.* at Art. 36.

46 *Id.* at Art. 37. In the case of county municipalities, two vice mayors are elected. In Bucharest, the law provides for the election of a mayor general and four vice mayors.

47 *Id.* at Art. 40.

48 *Id.* at Art. 47.

49 *Id.* at Art. 42(1).

50 *Id.* at Arts. 42(2), 44(1),(f).

51 *Id.* at Art. 44(1)(e).

52 *Id.* at Art. 44(1)(g),(h).

— Develop and implement urban development plans and projects;[53]
— Manage local public services;[54] and
— Make recommendations to the local council concerning hiring, supervision and dismissal of managers of business organizations and public institutions of local public interest (e.g., *regii autonomes*).[55]

County (Judet) Government

Basic Structure and Function

As noted above, Romania's system of local government organization includes 41 *judets*, or county-level territorial-administrative units that substantially mirror the local government structures previously described. Council size is based on the population of the territorial-administrative unit and can range from 37 to 45 members.[56] Members are elected for 4 year terms through direct popular election.[57] County councils are led by a chair, 2 vice chairs and 4 to 6 councilors (representing, to the extent possible, the political composition of the council). Together, they comprise the council's executive body, the Standing Delegation.[58] County councils meet in ordinary session on a bi-monthly basis and in extraordinary session, as necessary, either at the request of the chair, two-thirds of the council's membership, or on motion of the Standing Delegation.[59]

The function of county governments is to "...coordinat[e] the activity of Communal and Town Councils, with a view to carry out the public services of county interest."[60] Among other things, county councils:

— Organize and manage county public services and approve their operating rules and procedures;[61]

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53 *Id.* at Art. 44(1)(p).

54 *Id.* at Art. 44(1)(sch).

55 *Id.* at Art. 44(1)(v).

56 Art. 121, Const. Rom. (1991); Arts. 60, 61, Law No. 69/91, as amended by Law No. 24/96; See also, Art. 75 et seq. concerning public administration of the municipality of Bucharest.

57 Art. 64, Law No. 69/91, as amended by Law No. 24/96; See also, Law on Local Elections, No. 70/1991, as amended by Law No. 25/96.

58 Arts. 7, 66, Law No. 69/91, as amended by Law No. 24/96.

59 *Id.* at Art. 65.

60 Art. 121(1), Const. Rom. (1991); See also, Art. 63, Law 69/91, as amended by Law No. 24/96.

61 Art. 63(1)(b), Law No. 69/91, as amended by Law No. 24/96.

- — Provide legal, technical and other forms of support to local counsels on request;[62]
- — Develop, adopt and implement county-wide economic and social development plans;[63]
- — Prepare and adopt the county's annual budget and reconciliation;[64]
- — Manage the county's public and private property;[65]
- — Establish county taxes, fees and special assessments;[66]
- — Create and manage business organizations of county interest;[67]
- — Hire, supervise and dismiss managers of county-owned or controlled enterprises;[68] and
- — Associate with other county or local authorities to carry out "...certain works and services of public interest...."[69]

Council Chair

The council chair serves as the county's chief executive officer and is responsible for directing and managing the operations of the county's specialist or administrative departments, as well as those of all commercial organizations under the council's jurisdiction. As is the case with mayors of local councils, county chairs are given broad executive powers to fulfill the legal mandates of the county council and carry out the county's day-to-day operations. In addition to other duties, council chairs are responsible for preparing and presenting draft annual budgets for approval by the council, authorizing public expenditures and overseeing the hiring, supervision and dismissal of county administrative personnel.[70]

Council Secretary

In addition to the structures described above, each administrative-territorial unit of local government in Romania has a secretary nominated by local authorities, approved by the *judet*

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62 *Id.* at Art. 63(1)(c).

63 *Id.* at Art. 63(1)(e).

64 *Id.* at Art. 63(1)(f).

65 *Id.* at Art. 63(1)(h).

66 *Id.* at Art. 63(1)(m).

67 *Id.* at Art. 63(1)(n).

68 *Id.* at Art. 63(1)(o).

69 *Id.* at Art. 63(1)(t).

70 *Id.* at Art. 71(e), (f), (g).

prefect and whose salary is paid out of the local budget.[71] Local council secretaries are civil servants, subject to applicable laws governing public employees, and can be removed from office by the prefect on a two-thirds majority vote by the local council.[72] In addition to performing a variety of administrative and functionary duties, the secretary is responsible for verifying the legality of projects of local council decisions and local government operations.

Local Representatives of the National Government

Prefecture

■ **Basic Structure and Function.** The prefecture is the primary administrative mechanism for interface between the national and local governments in Romania. In organization and function, it serves as the local representative of the national government at the local territorial-administrative level. As defined by law, the prefecture:

— "Ensure(s) the achievement of national interests, and the observation of law and order;"
— Exercises control[73] over the legality of administrative actions of local government;
— Advises the Government on appointment and dismissal of the heads of the local representative offices of the line ministries;
— Oversees law enforcement and protection of citizen's rights;
— Organizes local measures for civil preparedness of a non-military nature; and
— Prepares and submits an annual "State-of-the-*Judet*" report to the national Government.[74]

As discussed in detail below, the administrative functions of the prefecture are carried out by the prefect, a Sub-prefect and an executive body.

■ **Prefect and Sub-Prefect.** Prefects are appointed by a decision of the Government and function as the "...representative of the Government at the local level and shall direct any decentralized public services of the Ministries and other central agencies in the territorial-

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[71] *Id.* at Arts. 51, 51, Law No. 69/91, as amended by Law No. 24/96. A slight variation exists in the case of secretarial appointments at the county level. In this case, the appointment is made by the council's Department of Local Administration. Where a competitive appointment is an option at the municipal level and below, it is compulsory at the county level. See also, *Id.* at Art. 73.

[72] *Id.* at Art. 52(3), (4).

[73] As discussed in greater detail Section 2.5 below, the word "control" in English may connote a relation of legal or administrative subordination that may not in exist in practice. In this instance, the original text "*exercita controlul*" appears in the French text as "*exercer le controle sur*...." But see Art. 108 (1) in which "*vegheaza ca activitatea*" is rendered as "supervise" in the English text and "*veille a*" in French. In this case, a more accurate rendering might be "to verify" or to "to ensure".

[74] *Id.* at Art. 100(1).

administrative units".[75] Among other things, prefects "....supervise (*vegheaza*) the activity of the local ...and county councils and of the mayors, in order that it be carried out according to the law".[76] As concerns the relationship "[b]etween the prefects...and the local councils...and mayors...there shall be no relations of subordination".[77] Among other things, the prefect is charged by law to "[e]xercise control in regard to the legality of administrative deeds of the local and county public authorities".[78] In exercising this authority, the prefect may challenge the acts of local governments by bringing an action in the Court of Administrative Contestations.[79] In such cases, the challenged act of the local government is suspended, *de jure*, until a ruling on its legality can be obtained.[80] In practice, however, the role of the prefect appears to be less invasive as might be suggested by the law. In effect, the prefect monitors, but does not supervise or exercise direct control the activity of elected local government officials.

- **Administrative Commission.** According to the Law on Local Administration, the prefect chairs the prefecture's executive and policy coordinating body, the Administrative Commission.[81] By law, its members include the mayor of the municipality in which the county seat is located, the heads of local representative agencies of the Ministries and other instrumentalities of the national government represented at the county level, and directors of the local branches of national *regii autonomes*.[82] While the law appears to assign a significant policy and operational coordination function to Administrative Commissions, in practice, they do not. Instead, policy coordination and consultation occur directly between the local representatives of the line ministries and the *judets* council chairs and mayors directly.

Local Representatives of the Ministry of Finance

The Ministry of Finance is represented in each *Judet* by the Directorate General of Public Finance and State Financial Control (DGPF).[83] The DGPF in turn is composed of a Directorate General of State Control, a Local Treasury Office (LTO), a Department of Taxes,

75 Art. 122(2), Const. Rom. (1991).

76 Art. 108, Law No. 69/91, as amended by Law No. 24/96.

77 *Id.* at Art. 108(2).

78 *Id.* at Art. 110(1)(b).

79 "*L'instance de contentieux adminsitratif*".

80 Art. 122(4), Const. Rom. (1991); Art. 111(1), Law No. 69/91, as amended by Law No. 24/96.

81 Art. 116 et seq., Law No. 69/91, as amended by Law No. 24/96.

82 *Id.* at Art. 116.

83 Arts. 25(2), 69, *Law on Public Finance*, Law No. 10/91, as amended by Law No. 72, July 12, 1996.

Fees and Budget (DTFB) and a Tax Inspectorate.[84] As described in greater detail in Chapter II on local government finance, the DTFB is concerned primarily with coordinating and assisting local governments in the budget preparation process. LTOs carry out treasury operations and tax administration and collection operations at the local level. The Tax Inspectorate performs a tax enforcement function within the territorial limits of the respective *judets*. [85]

Local Representatives of Other Line Ministries

Generally, each of the line ministries of the national government is represented at the *judet* level through a local office. These include the Ministries of Health, Education, Environment, Agriculture, Interior, Public Works and others.[86] To a significant degree, interaction between local governments and national government occurs through these local representative offices. Local ministry offices serve as the primary channel through which national policy directives are transmitted and implemented at the local level. When local questions arise within the jurisdictional purview of a particular ministry, consultations will take place between the local ministry representative and officials from the local administrations concerned. If the matter cannot be satisfactorily resolved at the *judet* level, local officials can take the matter up directly with the responsible ministry.

Local Administrative Courts

■ **Court of Administrative Contestations.** As discussed above, the Court of Administrative Contestations (CAC) is the court of first instance in settlement of legal disputes concerning official administrative acts carried out by local governments in Romania.[87] Closely paralleling the French system of administrative law,[88] a person may contest an official act (or

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[84] *Id.* at Art. 25(2).

[85] See, Art. 3, *On Establishment and Management of State Treasury Funds*, Ordinance No. 66/94, authorizing the use of accounts at commercial banks approved by MOF in cases where there is no LTO (including Bucharest and the Ilfov Agricultural Sector, among others). In the smallest hamlets, tax collection is carried out by a local clerk. Treasury functions are performed by the LTO in the town or municipality in which the smaller territorial-administrative is located.

[86] Among these, the role of the Ministry of Public Works and Territorial Planning (MPW) is most directly relevant to this analysis. The MPW, and its participation in the local budget and investment approval process, is described in detail in Chapter ii of this report (see "Technical Approval of Investment Projects" on page 35).

[87] Arts. 12(1), 111(1), 128(1), Law No. 69/91, as amended by Law No. 24/96. See generally, Ch. VI, Const. Rom. (1991). A detailed examination of the structure and operation of Romania's judiciary is beyond the scope of this analysis. For a useful summary of the organization and jurisdiction of the courts, see, Gavril Iosif Chiuzbaian, *The System of the Judiciary in Romania*, Romanian Legislation--Collection of Texts, *Sucursala Poligraphica, "Bucharestii-Noi"* (1995).

[88] The CAC's structure parallels that of the District Courts, Courts of Appeal and High Court of Justice. Art. 17, *Law For Administrative Contentions*, No. 29, November 7, 1990, as amended by Law No. 59/93.

failure to act) of local government by petitioning the authority within 30 days of the act or omission being challenged.[89] If within 30 days of petitioning, the local authority has failed to redress the grievance, an action may be lodged with the CAC of the District Court of the jurisdiction in which the petitioner resides.[90] In such cases, the act challenged is legally suspended until a ruling of the CAC can be obtained.[91] To initiate the action, the petitioner files copies of the challenged document along with the local authority's denial of petition.[92] Thereafter, the CAC may compel attendance and production of documents before rendering a decision.[93] The law does not stipulate a period of time in which the Court must render its decision.

■ **Court of Accounts.** The Court of Accounts[94] (COA) was established with local branches at the *judet* level. As a stand-alone system, the Courts of Accounts are subject only to parliamentary control. The COA "...exercises control over the formation, administration and use of financial resources of the state, the public sector and administrative-territorial units."[95] Essentially, the COA performs a financial audit and control function over all expenditures of state funds and the use of state property. The COA, *inter alia*, has oversight and audit responsibility for monitoring:

— Budget preparation and execution of local governments as well as financial transfers among them;[96]
— Creation, use and administration of special funds and treasury funds;[97]
— Public debt levels and the issuance of state guarantees to secure internal and external debt;[98]

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89 *Id.* at Art. 5.

90 Art. 12, Law No. 69/91, as amended by Law No. 24/96.

91 *Id.*

92 Art. 6, Law No. 29/90, as amended by Law No. 59/93.

93 *Id.* at Art. 10.

94 *Law on The Organization and Operation of the Court of Accounts*, Law No. 94, August 8. 1992.

95 *Id.* at Arts. 16, 17, 18(a), (c), (d), 19(a), (c), (d), 22(e).

96 *Id.* at Art. 17(a).

97 *Id.* at Art. 17(b).

98 *Id.* at Art. 17(c).

— Application of budget allocations for investments, subsidies, transfers and other forms of financial support for local government;[99] and
— Administration of state and private property companies under concession or rental agreements by local governments, *regii autonomes*, (state-owned) commercial companies and other legal persons.[100]

The COA's jurisdiction is both prospective and retrospective. It exercises "preventive" control over claims on the state budgets through an approval mechanism utilizing "visas" for the allocation of credits, transfers and subsidies. Contracting out of public services is also subject to preventative control of the COA since concession and rental agreements concerning the use of public assets are included within the Court's jurisdiction.[101] The COA's audit authority extends over the local government annual budgets and treasury funds.[102] The audit function of the COA concerning local government financial operations includes verification that:

— MOF methodologies and deadlines are being complied with;
— Actual expenditures have been made;
— Investment subsidies and transfers have been properly applied;
— Payments on the principal and interest on state loans are current; and
— "...[A]ccounts receivable and obligations of the...administrative-territorial units are justified and the assets protected according to law."[103]

Property Rights of Local Government

Local government property ownership is specified in Article 135 of the Constitution and elaborated, at least partially, by the Law on Local Administration: "...[p]roperty (patrimony) of the territorial administrative unit shall consist of the moveable and immovable assets of local interest, belonging to the public domain or to its private domain...."[104] It is further provided that: " All assets which, according to the law or by their nature are affected to a public utility, are of public use or interest, and were not declared of national interest, shall belong to the public domain of the local or county interests." While the law provides that public assets are "...inalienable, imprescriptible... [or] ...distrainable...", local authorities do have the authority to decide whether these assets should be turned over to self-managed state public companies (*regia*) or rented or leased under competitive conditions. In contrast, "private" property held

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99 *Id.* at Art. 17(d).

100 *Id.* at Art. 17(f).

101 *Id.* at Art. 22(1).

102 *Id.* at Art. 27(c), (e).

103 *Id.* at Arts. 30-32.

104 Art. 79, Law No. 69/91, as amended by Law No. 24/96.

by local governments can be sold upon approval of the local council.[105] "Private" property owned by a municipality refers to property originally held by private owners but acquired by a municipality through gift or purchase. It is a small factor in municipal property holdings and therefore does not give municipalities significant flexibility in selling, leasing, or mortgaging property.

The question of property ownership is a central issue in the process of decentralization of government and the promotion of local autonomy. Since adoption of the Constitution and subsidiary organic legislation, there has been a need to clearly define the ownership of specific classes of assets as between the national and local governments, among various units of local government and between the government and citizens.[106] Understandably, this lack of definitional clarity has led to conflict and confusion. Local governments have felt that the national government's claims to certain assets (and the income streams that they produce) have unfairly limited their ability to raise sufficient own source revenues to fund their budgetary needs. Conversely, the national government's responsibility to ensure provision of minimum levels of social support has been relied on to support the position that certain assets should remain under national control where and when local governments are unable to fully carry out those functions.

Resolving this complex issue is identified as a priority in the Government's recently adopted Program for 1997-2000.[107] The precise methodology for accomplishing a comprehensive national-local property division will have far-reaching administrative and financial implications for local governments. At present, there appears to be no formal, effective means through which a national-local dialog can be facilitated on this and other questions relating to decentralization and local autonomy.

Non-Subordination of Local Government Authority in Theory and Practice

The Principle of Non-Subordination

With adoption and ratification of the Constitution in 1991, local governments were given legal autonomy to perform governmental functions of local interest. Since that time, a tension has existed between the right to local autonomy as stated by law, and the reality of a system

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[105] The Government has identified privatization of *regii autonomes* as a priority. It is unclear whether Art. 82, Law No. 69/91, as amended by Law No. 24/96, presents a legal obstacle to accomplishing this objective since amending it requires a majority vote of both Chambers of Parliament. Additionally, given that local *regii* are owned by local territorial-administrative units, it is unclear the extent that local governments would be required to participate in a privatization program.

[106] See, e.g., *Land Law*, Law No. 18, February 19, 1991 that has reportedly spawned many thousands legal actions since its adoption.

[107] Chapter VIII, Sec. 2(A), *Romania's Macro-Stabilization and Development Basic Program*, 1997-2000 (Government Program).

of administrative and financial control that remains in many respects highly centralized. The process of decentralization has bogged down for many complex reasons beyond the scope of this analysis.[108] Nevertheless, there are several fundamental issues around which the debate concerning decentralization of government and promotion of local autonomy seem to have coalesced. Stated simply, these include:

- As discussed above, what are the boundaries between local, national and shared responsibilities concerning ownership of specific public assets and associated governmental functions?

- What level and type of financial resources are "sufficient" for local government to meet the responsibilities that have been shifted to local governments?

National government ownership of assets that by tradition have been locally owned and managed implies a limitation of local autonomy and a concomitant restriction on the local government's ability to raise tax revenues from local sources.[109] It is therefore useful to draw a distinction between legal, administrative and financial subordination. While local governments are not legally subordinated to MOF and other aspects of the national government, the current pattern of centralized administrative and financial structure combine to create the reality of subordinate relations between and among the various levels of government in Romania.

Conformity of Romanian Law with the European Charter of Local Autonomy

The disparity between the theory and practice of decentralization and local government autonomy in Romania, and the extent to which Romanian law conforms to European standards, is best measured against the specific requirements of the European Charter of Local Self-Government to which Romania has been a signatory state since 1993. As regards local administrative autonomy, Article 4 of the Charter provides, in pertinent part, that:

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[108] For a more complete treatment of this subject, see, *Introductory Reports, Conference on Local Democracy & Development in Romania*, Conference sponsored by the Government of Romania, The European Union, the World Bank and the Federations of *Judets* Councils and Municipalities, Bucharest, October 28-30, 1994.

[109] A recent example from Pitesti, south of Bucharest, illustrates this point. In that case, a local market was reorganized under Law No. 15/90 and then transformed into a commercial company operating under the Law on Commercial Companies, Law No. 31/90. This transformation resulted in 70 percent ownership by the State Property Fund with the remaining 30 percent of the shares held by the Private Property Fund. The outcome was viewed by local authorities as an incursion on its traditional role in operating local markets. Because the local government had the right to appoint board members, it was able to reduce the social capital of the company and transfer ownership back to the local administration.

— Local authorities shall, within the limits of the law, have full discretion to exercise their initiative with regard to any matter which is not excluded from their competence nor assigned to any other authority...;[110] and

— Powers given to local authorities normally shall be full and exclusive. They may not be undermined or limited by another central or regional authority except as provided for by law.[111]

Concerning local financial autonomy, Article 9 of the Charter provides that:

— Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, which they may dispose freely within the framework of their own powers;[112]

— At least part of local government resources shall be derived from local taxes and fees and, within limits established by law, local governments will have the power to establish tax rates and fee amounts;[113]

— Financial resources of local governments shall be commensurate with the responsibilities reserved to them by the constitution and the law;[114]

— Local authorities will be consulted on how redistributed tax revenues are allocated to them;[115] and

— Local governments have access to national capital markets to finance capital improvement projects.[116]

National Priorities for Local Government Administration

The Government's Program for 1997-2000 identifies the following specific priorities for reform of the existing legal and administrative framework for local government:

— Create a legislative framework mechanisms for its implementation that will make genuine local government autonomy attainable;

— Harmonize existing legislation and regulations with the European Charter for Local Self-Government;

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110 Art. 4(2), *European Charter of Local Self-Government*, Strasbourg (1985).

111 *Id.* at Art. 4(4).

112 *Id.* at Art. 9(1).

113 *Id.* at Art. 9(3).

114 *Id.* at Art. 9(4).

115 *Id.* at Art. 9(6).

116 *Id.* at Art. 9(8).

— "...[T]ransfer...decentralized services... [to] ...the direct authority of local communities;" and
— Transfer decision-making authority...(to local governments) for monitoring and enforcement of policies of local interest relating to the provision of public services.[117]

To the extent that these objectives can be realized, conditions for the creation and operation of a municipal credit facility should be improved significantly.

THE LEGAL FRAMEWORK FOR PUBLIC FINANCE

The Budget Process

Local Budgets

Among the powers reserved to the various subdivisions of local government is the right to develop, adopt and administer annual budgets for local public administration.[118] Decisions concerning the local budget are required to made in public session and by an absolute majority of the local counsel.[119] In such cases where a budget cannot be adopted after second reading, local government operations will be financed at the level of the prior year's budgetary allocation until a new annual budget can be adopted.[120]

Local governments' fiscal year corresponds to the calendar year. The annual budget preparation cycle begins on or before May 1 of each year when local government budgets must be submitted to local counsels for approval. In preparing draft budgets, mayors and county government chairs respectively prepare budgets based upon the previous year's budget, adjusted for anticipated increases in budgetary requirements for the prospective fiscal year. During this phase of the budget preparation process, local government authorities consult with the MOF-DGPF Department of Local Taxes, Fees and Budget to obtain information to establish a rough correlation between specific budgetary requests and the projected levels of state financing for such local needs. Through a process of negotiation and compromise, agreement concerning the local budgetary request is reached. The proposed budget is then finalized and submitted to the local council for approval. Once the local budgets of communes, towns and municipalities are approved, they are forwarded to the country level where they are consolidated into a single global budgetary request for the

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[117] Ch. VIII, Sec. 2(C), Government Program.

[118] Art. 20(2)(e), Law No. 69/91, as amended by Law No. 24/96.

[119] *Id.* at Arts. 25(3), 28(3), 63(1)(f), (m), 71(1)(f).

[120] *Id.* at Art. 28(3); See generally, Ch. III, Law No. 10/91, as amended by Law No. 72/96.

county that is forwarded to the MOF for approval.[121] Once the Annual Budget Law has been adopted by Parliament, global county budgetary allocations are disbursed to MOF-DGPF LTOs. At this point, negotiations between and among the various levels of local government start anew concerning how available budget resources will be shared.

As discussed in detail in “Regulation on Use of the Local Government Budget Surplus” in Chapter II (page 21), short-term local government deficits may be covered by interest-free loans from treasury funds on approval of the MOF-DGPF. These loans are funded through the Treasury’s capture of other local governments’ annual surpluses. The loans must be repaid by year end or, in exceptional cases, within 18 months with interest charged at the maximum rate set by MOF.

Significantly, the issue of local government default on these or other types of loans is nowhere addressed. The implication is that the national government is ultimately responsible for covering any budgetary short-fall of local government, including possible default on commercial debt. This impression is reinforced for external loans by the annual State Budget Law, which contains a special category for State transfers to local governments that are necessary to meet local debt service under international agreements.

Local budget surpluses, if any, are accumulated in special treasury funds administered by the LTO and allocated at year end to satisfy any outstanding debt held by local governments.[122] Any remaining surplus, whether from local or state sources, may be accumulated up to a maximum of 5 percent of total revenues. These surplus funds can be used by local governments to cover short-term liquidity shortages until year end. Any local surplus at year end is recaptured by MOF.[123]

National Budget for Local Government Administration

The legal framework for public finance at the national level is defined, primarily, by the Law on Public Finance and the annual budget laws.[124] The Law on Public Finance establishes a unitary budget system that includes the state budget, a state social insurance budget, local budgets, a special funds budget, a state treasury budget and the budgets of various autonomous public institutions which, taken together, represent the public financial

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121 Art. 67, Law No. 10/91, as amended by Law No. 72/96.

122 *Id.* at Art. 62. Art. 82(2) expressly prohibits public institutions from accumulating surpluses in commercial banks where, presumably, interest rates would be more attractive than those available from MOF.

123 *Id.* at Art. 76(2).

124 For the purposes of this analysis, the Annual Budget Law of 1996 will be used. For a specification of annual budget law contents, see, Art. 28, Law No. 10/91, as amended by Law No. 72/96.

resources of the Romanian state.[125] The national budgetary process is coordinated by MOF[126] and conducted on a calendar basis, closing on December 31.[127] The budgetary process is initiated on or before May 1 of each year when main authorized beneficiaries (MABs)[128] are required to notify MOF of proposed changes to budgetary requests from the current year, providing justifications as necessary.[129] Local governments have a similar obligation to inform MOF of requests for increased transfers, quotas or other amounts from the state budget.[130]

By May 15, main authorized beneficiaries of local budgets are required to submit their draft budgets to MOF's local general directorates for public finance and state financial control. These draft budgets are forwarded to the county administration after analysis and negotiated adjustment. Local budgets are then consolidated and forwarded to MOF by June 1 as a global request for funding for the county in the prospective budgetary year.[131] MOF reviews the draft consolidated local budgets from the county administrations and, by July 1, the Minister of Finance consults with the Prime Minister to establish budget year expenditure ceilings based government policy. These ceilings are communicated to the MABs and final revisions to local budgets are made and submitted to MOF by August 1.[132] Based on this information, MOF prepares the state, social insurance and special funds budgets, along with a draft annual budget law, and submits them to the Cabinet of Ministers by September 25.[133] Thereafter, by October 10, the Cabinet submits annual budget requests and the draft annual budget law to the Parliament for legislative action. Provisional budgetary allocations contained in the annual budget law can be modified by "rectification laws" that must be submitted to

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[125] *Id.* at Art. 1(3), (4).

[126] *Id.* at Art. 21.

[127] *Id.* at Art. 75(1).

[128] *Id.* at Art. 33(1) defines main authorized beneficiaries as: "...management of public authorities, ministers, and management of other specialized bodies of central public administration." Secondary and tertiary authorized beneficiaries are defined in subsection (3) of Art. 33 as: "...management of public institutions with legal personality subordinated to the main authorized beneficiaries, financed from the state budget, state social insurance budget and special funds budgets." But see, Art. 25 that references MABs of local budgets and seems to conflict with the foregoing definition.

[129] *Id.* at Art. 24(1).

[130] *Id.* at Art. 24(2).

[131] *Id.* at Art. 25(2).

[132] *Id.* at Art. 25(3), (4).

[133] *Id.* at Art. 25(5).

Parliament by November 30.[134] In cases where an annual budget law is not adopted by Parliament at least 3 days before the budget year-end, the MABs continue operations based on prior year allocations.[135]

Once approved, state budgetary allocations, as well as expenditures, are allocated on a quarterly basis. These amounts are available to MABs only after they are credited to accounts established by the DGPF-LTO.[136] Once budgetary resources for the quarter are received into these accounts, MABs may in turn disburse funds to Secondary and Tertiary Authorized Beneficiaries according to budgetary allocations.[137] Direct state transfers for *regii autonomes* are disbursed through this mechanism.

The system of fiscal and budgetary controls mandated by the Law on Public Finance requires that all disbursements or expenditures of state budgetary funds receive prior approval from both the authorized beneficiary (e.g., county chair) and the Court of Accounts (COA).[138] Once these expenditures are approved, actual disbursement may only be made after confirming documentation is submitted and reviewed by COA.[139]

Local or "Own Source" Revenues

Local Taxes and Fees

The authority of local governments to levy local taxes and fees derives from the Constitution that provides: "[l]ocal taxes and duties shall be established by the local or county councils, within the limits and terms of the law."[140] The legal framework for local taxes is contained in several primary laws and a number of subsidiary government ordinances, regulations and instructions.[141] For the purposes of this analysis, the most relevant of these include:

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[134] *Id.* at Art. 29 (7), (8). Parliament may reduce or block certain budgetary allocations in order to achieve a balanced national budget. In cases where a local budget allocation is undertaken, the law provides that this alteration will be negotiated between MOF and the local territorial-administrative unit of government.

[135] *Id.* at Art. 27.

[136] *Id.* at Arts. 30, 31.

[137] *Id.* at Art. 34.

[138] *Id.* at Art. 36(2). Presumably, the local representative of MOF's Treasury Department.

[139] *Id.* at Art. 40.

[140] Art. 138(2), Const. Rom. (1991).

[141] For a more detailed description of local sources of tax revenue and the implications for local government finance, see "Own Operating Revenues" in Chapter II, page 29.

— The Law on Local Administration, specifying that local governments shall have the right to collect and spend tax revenues within their respective territories in amounts sufficient to meet local needs;[142]
— The Law on Public Finance providing a general framework for government finance in Romania and a system of local government finance within that context;[143]
— The Law on Local Taxes and Fees identifying the various classes and types of local revenues and specifying how they are administered;[144] and
— Annual budget laws specifying the amounts allocated to local governments through shared taxes.[145]

The Law on Local Taxes and Fees specifies the following classes and types of taxes that may be levied by local governments:

Tax Class	Types	Based on
Buildings	2	Depreciated value
Land Used for Building	6	Area/location
Private Transport	18	Engine displacement/capacity/primary use
Use of Public Places	14	Type of business activity/goods sold/area
Notarial Services	31	Type of business activity/various
Publicity	17	Area/business activity/goods sold/language
Resorts	1	Duration of stay (if more than 48 hrs.)
Museums, etc.	3	Per capita/age/day of the week
Miscellaneous	13	Goods produced/type of dog
Total	105	

Local tax collection is accomplished either through local MOF-DGPF personnel, or at the source, as in the case of the notary tax.[146] Taxpayers have the right to challenge tax assessments in the first instance by lodging a protest with the MOF-DGPF, who consult with local government authorities before making a determination. Administrative appeals are taken to MOF at the national level. Thereafter, recourse is available through the local courts.[147]

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142 Arts. 91-98, Law No. 69/91, as amended by Law No. 24/96.

143 Law No. 72/96.

144 *Law on Local Taxes and Fees*, Law No. 27, May 17, 1994.

145 Art. 137(2), Const. Rom. (1991).

146 Art. 61, Law No. 27/94.

147 *Id.* at Art. 63.

As discussed in greater detail in the section on "Direct Taxes" of Chapter II (page 30), while local governments have the legal authority to establish local tax rates within certain ranges and under certain conditions, their ability to expand the tax base (by adding new taxes and fees), deepen it (by redefining tax assessment methodologies) or consolidate it (by reducing the number and kinds of taxes assessed) is significantly limited. As discussed in the section on "Local Representatives of National Government" above (page 47), the trend since 1993 has been toward an increase in local government administrative responsibility, while the growth of the local taxing power has not kept pace. In this respect, the existing legal framework for local taxes and fees, as applied in practice, appears to stand in contradiction to the Constitutional principle of local financial autonomy. If this trend continues, it is anticipated that local governments' ability to finance local services through own source revenues will continue to deteriorate over time.

Transfers from the National Budget

- **Capital Investment.** Under current law, local units of local government are responsible for construction and repair of local public works within their respective territorial jurisdictions.[148] Transfers for capital investment are governed by the Law on Public Finance and the annual budget laws respectively. Under the current legal regime, proposals for local capital investment projects are drawn up by local authorities (or *regii* under their control) and submitted to the local MOF-DGPF for financial assessment and approval. If the project is judged technically and financially sound, a request for the associated investment transfer is included in the local budget, adopted by the local council and forwarded to the county for inclusion in the investment project annex to the global budget as described in the section "Local Budgets" above.[149]

As mentioned previously, the annual state budget adopted by Parliament provides aggregate allocations for local investment transfers on a county-by-county basis. Frequently, this allocation represents significantly less than the total transfers requested by the various units of local government. Because the state budget provides an aggregate investment transfer, a process of negotiation and compromise begins between the county on one hand, and the various levels of local government on the other. Because each unit of local government is, to varying degrees, dependent on the investment spending of the territorial-administration in which it is located, a process of investment transfer allocation occurs that is the reverse of the budget preparation process. In this case, negotiations often begin with the largest municipalities and cities within a county, and then proceed to smaller units of local government until investment transfers within the county budget are fully allocated.

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[148] Art. 87, Law No. 69/91, as amended by Law No. 24/96.

[149] Art. 64(1), Law No. 72/96.

■ **Subsidies.** The Law on Public Finance authorizes direct subsidies to local governments for "...financing of social and municipal services and social protection actions."[150] As reflected in annual budget laws,[151] the most significant direct subsidies to local government are for district heating and urban transport. The mechanism for requesting, approving and reallocating direct subsidies to local governments is substantially similar to that described for capital investment above and need not be repeated here. For a more complete discussion of direct subsidy transfers to local governments and their impact on local government finances, see the section "Shared Wage Tax" of Chapter II (page 24).

Extraordinary, Non-Recurring Revenues (Asset Sales)

During the period under consideration for this analysis, a significant source of revenue for local investment has been asset sales.[152] To date, these have been realized primarily through the sale of local housing stock. Unlike other countries in Central and Eastern Europe, Romania has been unable to sell substantial amounts of other property, largely because of legal uncertainty surrounding ownership rights. The potential of this source of income to local governments will be enhanced by a clarification of ownership relations between the national and local levels of government through revision of the Law on Patrimony, as well as through progress in implementing the Government's privatization initiatives.

Local Expenditures

As noted above, the principle of local government autonomy in the raising and use own-source revenues is guaranteed by the Constitution, and elaborated in the Law on Local Administration, the Law on Public Finance, the Law on Local Taxes and Fees and the annual budget laws, respectively. In practice, however, the exercise of local government autonomy, particularly in the area of budget and finance, are constrained by an administrative framework of financial control that is centralized and bureaucratic. Autonomy in decisions concerning local expenditures implies an autonomy to raise local revenues that does not currently exist in Romania. Until the legal framework for local budget and finance is made to reflect this, the legal guarantee of local government autonomy will remain a half-fulfilled promise.

Authority of Local Governments to Incur Debt

Loans

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[150] *Id.* at Art. 23(2).

[151] See, e.g., Arts. 25(2), 27, Annual Budget Law, 1996.

[152] Presumably, the legal authority to dispose of these assets derived from Art. 84(2) of Law No. 69/91, as amended by Law No. 24/96. As noted elsewhere, the law does not provide a clear set of rules for determining which assets fall within the "public" versus the "private" domain. Assets falling within the public domain cannot be sold.

The legal authority of local governments to borrow is clearly established by law. An important distinction exists, however, between local governments to engage in short-term borrowing from LTO surplus funds as discussed in the section "Local Budgets" above (page 55), and accessing capital markets for long-term commercial debt. The authority of local governments to contract commercial debt for capital improvement projects arises from operation of three laws: (1) the Law on Local Administration; (2) the Law on Public Finance; and, (3) the Annual Budget Law. Taken together, they require that, before a local government may obtain a long-term loan, it must first:

— Obtain approval of the loan by a two-thirds majority of the local council;
— Hold a referendum on the question within its territorial jurisdiction;[153]
— Demonstrate to MOF-DGPF that the repayment of the loan can be guaranteed through projected local revenues and shared wage tax allocations;[154]
— Show MOF-DGPF that the total obligations of the local government will not exceed the debt ceiling established in the Annual Budget law;[155] and
— Verify that the underlying investment that the loan is intended to finance falls within a category identified by the Government as an investment priority.[156]

The Law on Local Public Administration does not provide a definition of what constitutes a "long-term" loan.[157] This gives rise to a question not only of legal definition, but also of accounting practice. From a budgetary perspective (as represented by MOF), long-term debt is any loan obligation that extends beyond the current fiscal year since, according to the Law on Public Finance, all government budgets are annual and must be in balance.[158] From the perspective of local government, however, some believe that a long-term obligation is one that extends beyond the current term of office (up to 4 years, depending on the circumstances).[159] The practical impact of this definitional uncertainty is that it places a

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[153] Art. 100(2), Law No. 69/91, as amended by Law No. 24/96.

[154] *Id.* at Art. 100(3).

[155] See, e.g. Art. 24(3) Annual Budget Law, 1996.

[156] Annex 7, *List of Categories of Approved Local Investment Projects*, Annual Budget Law, 1996.

[157] But see, Art. 19, *Law on Banking Activity*, Law No. 33, March 29,1991, that defines long-term debt as any loan or lending operation with a maturity of more than 5 years.

[158] Art. 4, Law No. 72/96. Current government accounting practices in Romania do not treat capital budget and operating budgets separately. The Law on Public Finance specifies that annual budgets must be in balance. Because there is no accounting mechanism that allows local governments to carry capital investment and expenditures forward into future years, any outstanding obligation at year end is treated as a deficit.

[159] See, e.g., Art. 21, Law No. 69/91, as amended by Law No. 24/96. This conclusion based in part by the specific requirement that a referendum be organized to approve long-term loans. The rationale is that by incurring an obligation extending beyond its term of office, a local government exceeds its legal mandate to act

significant constraint on local governments' ability to plan, budget and finance long-term capital investment projects like those contemplated under MUDP II.[160]

In addition to the definitional issues raised above, it is also important to note that current law does not specify how referenda should be organized, or what requirements must be met (e.g., simple majority or two-thirds majority)[161] for popular approval of long-term loans. Depending on how the former questions are addressed, it may be necessary and useful to specify conditions for organization of referenda on these and similar matters that might arise in the future.

Another question arises from the legal requirement that local governments must be able to guarantee loans by showing that the obligation can be satisfied from projected local revenues and allocations of the shared wage tax for the budget year in question. The practical significance of this requirement appears limited in the case of loans with a term of 1 year or less. It is not clear, however, how this requirement would operate for loans for more than a year. Because there has been no prior experience in this regard, it is unclear what outcome might be expected.[162]

The mechanism for approval of local government borrowing exists within the budget preparation process outlined above. In this case, the local government seeks approval from the DGPF based on the criteria discussed above.[163] Once approval for the loan is obtained, the principal amount of the loan is reflected in the proposed budget that is consolidated at the county level and submitted for approval to MOF in the normal course of the budget preparation process.

Municipal Bonds

The authority of local governments to issue municipal bonds arises primarily from the Law on Public Finance that provides:

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in a representative capacity for the citizenry. Hence, a referendum represents an express authorization by the people to incur an obligation for which they may not be held accountable in the future.

[160] This obstacle might be avoided, albeit clumsily, by structuring lending to local governments as a series of one-year loans functioning as a line of credit secured against current operating revenues.

[161] Art. 100(1), Law No. 69/91, as amended by Law No. 24/96, ("...local...councils may decide, by a two-thirds majority of the number of their members, the raising of loans, under the terms of the law.").

[162] This question did not arise in connection with the MUDP I loans since the *regii*, not local governments, were the borrowers under the terms of the Subsidiary Loan and Guarantee Agreement.

[163] This process is distinct from that employed where local governments take short-term loans to cover current operating revenue shortfalls the local government budget surplus fund held by the LTO to cover

> At the request of local and county councils...annual budgetary laws may authorize administrative units throughout the territory to make loans to cover their expenditure for well grounded actions, by issuance of securities, provided however that the respective units are able to guarantee interest payment and redemption of respective securities. Guarantee authorization is extended through MOF local bodies.[164]

The intention of this provision appears to be substantially similar to that concerning commercial debt contemplated in the Law on Local Public Administration except that the latter does not mention the possibility of issuing local government securities. This appears to be an oversight in drafting rather than an intentional limitation of local government means for raising investment capital. In addition, the language of the Law on Public Finance seems to suggest that the "guarantee" to be issued is in the nature of a legal undertaking by the MOF whereas in the previous case, the "guarantee" was merely a verification of a present ability to repay the loan from current revenues.[165]

Methods for Securing Local Government Debt

Local Revenues

One mechanism used by local governments to secure debt is to dedicate all or a portion of specific revenue streams to service that debt.[166] The revenues for a local sales tax, for example, might be dedicated to service long-term debt incurred for the construction of a bridge. As discussed above, within the existing legal framework, local governments' ability raise own-source revenues is rather restricted both in terms of the kind and level of local taxes that can be levied. One possible means of addressing this problem within the existing law would be to rely on the "Other Taxes" provision of the Law on Local Taxes and Fees to create new sources of revenue.[167] This strategy was employed in Baia Mare and subsequently abandoned after it was challenged on legal grounds. Given the restrictions

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[164] Art. 54(4), Law No. 72/96.

[165] For a brief overview of the legal and regulatory framework for capital markets in Romania, see "Legal Framework for a Municipal Bond Market" on page 70.

[166] See, Art. 97, Law No. 69/91, as amended by Law No. 24/96.

[167] Art. 58, Law No. 27/94.

imposed under the law, even this option for raising additional own-source revenues is severely restricted.[168]

Another significant constraint on the ability of local governments to secure debt with own source revenues is linked to the question of property ownership. Because a given source of revenue (or conversely, of expenditure) may shift from local to national ownership and back again, there is uncertainty concerning the precise composition of local tax bases from one fiscal year to the next. These circumstances combine to make it virtually impossible for local governments to establish a reliable and predictable sources of local revenue that could be dedicated to service of long-term debt.

Local Assets

Romania's Civil Code provides a mechanism for pledging locally owned assets to secure debt. While the lack of an effective central registry to record security interests represents a probable constraint to lending of this type in the future, this concern is of secondary importance to the larger and more complex issue of clarifying national-local property rights generally. As discussed in detail elsewhere in this analysis, until a clear set of rules and principles for resolving confusion over asset ownership is accomplished, it appears unlikely that operation of a mature municipal credit market would be possible in Romania. The Government has correctly identified this difficult issue as a legislative priority for 1997.

Intercepts

An explicit mechanism for using tax intercepts (e.g., dedicating a fixed percentage of locally generated shared tax revenues) by the national government to secure local government debt does not currently exist in Romanian law. The degree of financial control exercised by MOF under the Law on Public Finance suggests that, in the short-term, this type of mechanism could be elaborated by government decision or regulation. It would remain to be seen whether, given current market conditions in Romania, this type mechanism would provide the requisite degree of protection to attract interest from the capital markets.

Service Fees

[168] See, e.g., *Id.* at Annex 3, that provides: "The list of public services for which the local authorities may charge new taxes according to Art. 58 of the law (includes): (1) Verification and maintenance of the water supply network...; (2) Waste collection; (3) Operation of public baths; (4) Drain cleaning services; (5) Use of sand and gravel from rivers and quarries; (6) Use of pastures; (7) Breeding services; (8) Bringing cattle to village markets; (9) Slaughter of livestock at locally-owned facilities; and (10) Weighing services."

The ability of local governments to establish an collect fees for services provided directly, or by private contractors, is authorized by the Law on Local Public Administration.[169] Additionally, the Law on Local Taxes and Fees authorizes "...other taxes, other than those indicated in this law, for new public services...on the condition that the taxes charged will cover at least the cost of providing those services. A more immediate question is what the respective capacity is of the users to pay and the government to collect such fees.

National Priorities for Reform of Local Government Finance

The Government has identified the following priorities for reform of local government finance over the next three years:

— Establish transparent rules governing allocation transfers from the state budget to local governments including allocation methodologies;
— Increase predictability and timing of revenue flows to local governments in terms of local and shared taxes and transfers fro the state budget;
— Simplify and streamline the annual budget preparation process;
— Increase the capacity of local governments to raise local revenues to finance local government activities;
— Improve the capacity of local governments to collect local taxes and cut back expenditures; and
— Create conditions of genuine local autonomy for public administration in gaining access to capital markets, particularly for financing capital investment in infrastructure.[170]

LOCAL PUBLIC SERVICE PROVISION

Structure and Function of Regii Autonomes

Public service provision in Romania is carried out at the national, county and municipal levels by *regii autonomes* (RA), or autonomous state-owned enterprises. This business form, patterned after the French model, was created by law in Romania in 1990[171] and serves as the primary mechanism through which local governments "...organize public services...under

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169 Art. 63(n), Law No. 96/91, as amended by Law No. 24/96.

170 Ch. II, Sec. 3, Government Program.

171 *Law on State Owned Enterprise Restructuring*, No. 15, August 8, 1990.

conditions of efficiency and operativity, and ensure their proper functioning."[172] Under Romanian law, a *regia autonome* is a legal person created through ratification of an Act of Establishment by the territorial-administrative unit under whose jurisdiction it falls.[173] National RAs "...are organized and operate within the economy's strategic branches—armament industry, power industry, mining and natural gas exploitation, mail systems and railway transports [sic]—as well as in other fields of activity established by the Government."[174]

At the local level, a *regia* is a wholly owned operating company, owned by the municipality. Board members are appointed by the local council. Enterprise managers are appointed by the municipality.[175] The municipality is financially responsible for the *regia*'s operating results and exercises corporate governance over the region. Municipalities' practical over a *regia*, however, is limited by two factors: lack of technical knowledge on the part of the local council, and lack of competent alternative managers who could replace a poorly performing *regia* management team. Nonetheless, some of the larger municipalities in particular are moving to tighten control over regie performance.

Classification and Ownership

The precise legal status of *regii autonomes* has been in unsettled since their creation in August of 1990, despite several attempts to clarify the matter. As originally formulated, RAs nominally owned their own assets and had the right to freely possess, use or dispose of them in any manner consistent with the terms of their charter.[176] In contrast to the autonomy implied by the name, however, RAs were expressly subordinated to a "managerial body" that, depending on the case, was either one or more of the national government's ministries, or a unit of local government at the county or municipal level.[177] The apparent general intent of the law was to create locally controlled and financed RAs. Nevertheless, a number of specific provisions relating to corporate governance, finance and operations defined a dominant role for the national government.[178] In addition, the absence of an express formula for distinguishing between "national" and "local" activities, and "county" from

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[172] Art. 20(2)(l), Law No. 69/91, as amended by Law No. 24/96.

[173] Arts. 1-3, Law No. 15/90.

[174] *Id.* at Art. 2.

[175] *Id.* at Arts. 13, 15.

[176] *Id.* at Art. 5.

[177] See, e.g., *Id.* at Art. 12.

[178] See, *Id.* at Art. 3 ("Autonomous companies of national interest can be created by Government decision or, for administration of local interest...by decision of district (county) or municipal authority.").

"municipal" functions, has heightened the uncertainty about the appropriate attribution of RAs to particular territorial-administrative units.[179]

In August, 1994, an attempt was made to clarify the legal status of RAs by defining local interest RAs as those engaged in the delivery of water, heating and urban transport services, in addition to construction and maintenance of local hosing, roads, bridges and public areas for municipalities with more than 30,000 inhabitants.[180] A single RA conducts all of the functions identified as local in character in municipalities with a population less than 300,000. Above 300,000 population, 2 RAs are authorized.[181] Significantly, while the question of classification was addressed, ownership of the local RAs was still not resolved.[182] Local governments are given an organizational and supervisory role, while RAs retain "...financial and accounting autonomy..." with the Department of Local Public Administration and local representatives of ministries providing unspecified support and technical assistance.[183]

The ownership of local RAs was addressed most recently in April 1996 with amendment of the Law on Local Administration.[184] While local governments were clearly given the responsibility for providing administrative oversight and financial support for local RAs,[185] the question of ownership remained unanswered: " The deduction and passage into property of the communes, towns, or counties, as the case may be, of assets and valuables of local interest from the private and public domain of the state shall be made by Government decision, under the terms of the law on public and private patrimony."[186]

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179 In certain instances, this has lead to anomalous results. In one case, a specialized cardiology facility has been classified as municipal property even though it serves a county-wide function. Currently, there appears to be no well defined legal or administrative mechanism for reclassifying property in such cases.

180 *Regarding Some Measures for the Organization of Local Interest Regii Autonomes*, Ordinance No. 69, August 24, 1994, as approved by Law No. 135/94. For territorial-administrative units with a population of less than 30,000, the same public services are provided by local commercial companies organized and operating under the Law on Companies, Law No. 31/90.

181 The law authorizes 3 RAs for Bucharest.

182 The political sensitivity of this question is suggested by the fact that ambiguity continues to exist despite a fairly clear constitutional adopted in late 1991, provides in pertinent part that local municipal governments "...shall act as autonomous administrative authorities and manage public affairs..." while county councils shall...coordinat[e] the activity of Commune and Town Councils, with a view to carry out the public services of county interest. Arts. 120, 121, Constitution of Romania, 1991.

183 Arts. 4-6, Ordinance No. 69/94, as approved by Law No. 135/94.

184 Law No. 69/91, as amended by Law No. 24/96.

185 See, e.g., *Id.* at Arts. 20(2)(l), 54, 63(1)(a),(b),(p), 80, 85, 127.

186 *Id.* at Art. 127.

The extent to which local authorities may extend financial support to local RAs under their responsibility has been interpreted by the Court of Accounts. In several decisions, the Court has taken the position that local public administrations cannot subsidize their RAs from own municipal or *judet* resources.

Various proposals and draft bills concerning the legal status of local property have been submitted to and circulated within the Government since 1992. During this period, the opposition, now in the majority, has pressed for a harmonization of the constitutional principles of local autonomy and decentralization of public services with existing laws that give local government the responsibility, but not the authority (or financial means) to operate effectively and autonomously. At present, passage of an organic law[187] defining local property rights, particularly relating to the *regii autonomes*, is seen as a top priority for the newly elected Government. Although it remains to be seen whether a law is passed, or what form it will assume in the parliamentary process, early indications are that a bill resembling earlier drafts will be submitted to Parliament by mid-1997.

Rate Regulation

The Law on Competition establishes a legal basis for price regulation of the provision of public services in Romania.[188] Until passage of the Law on Competition, prices for local public service delivery were ultimately controlled by the Office of Competition within the MOF (MOF-OCP). In practice, rate increases sought by RAs would be submitted for approval to the local council. If approved, an application for a rate increase would then be submitted to MOF-OCP for review and action. Effective October 1996, the Office of Competition Policy became independent of the MOF, but appears to have retained its dual function of monitoring anti-competitive practices and approving rates charged by RAs. Although a detailed analysis of the current regulatory framework for public service provision is beyond the scope of this analysis, it appears that rates are to based on full cost recovery with price equal to the long-run marginal cost of providing the service.[189] The model appears to be comparable to that in use in the United Kingdom (i.e., single regulator, *RPI-X* formula).

***Bankruptcy of* Regii Autonomes**

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[187] Art. 72(3)(o), Const. Rom. (1991), provides that laws affecting local public administration shall be organic laws. Organic laws require a majority vote of each of the chambers of Parliament. Art. 74(1), Constitution of Romania, 1991. Earlier attempts to address this issue, except for Law No. 69/91, as amended by Law No. 24/96, were legally infirm because they failed to meet this requirement.

[188] See, e.g., Art. 20(j),(k),(s), Law No. 69/91, as amended by Law No. 24/96. Compare, Art. 48, Law No. 15/90.

[189] See, e.g., Art. 6, Law No. 15/90.

Romania's Law on Reorganization and Liquidation[190] presents well-defined framework for the initiation and administration of bankruptcy proceedings against insolvent debtors. *Regii autonomes*, however, are explicitly excluded from its operation and no specific legal provision for bankruptcy of RAs has been adopted.[191]

National Priorities for Provision of Local Public Services

The Government Program for 1997-2000 identifies demonopolization and privatization of the *regii autonomes*,[192] the elimination of operating subsidies for inefficient SOEs and improved enforcement of the bankruptcy law as key elements of its strategy to control national budget deficits. The absence of specific legislation dealing with the question of *regii* insolvency and reorganization not only raises issues of practical significance in the context of possible future privatization of the *regii*, but also has relevance to the question of *regii* creditworthiness. The application of bankruptcy law to *regii* implies the existence, at some level, of hard budgetary constraints. This is one step toward financial accountability since it implies, at a minimum, that long-term marginal cost recovery will be an objective of the firm.

It is premature to speculate how this complex issue might be addressed in the context of local public service provision generally, and in the natural monopoly sectors (e.g., electric transmission, water supply, wastewater treatment, district heating) in particular. As the Government's Program for *regii* unbundling and privatization is more fully elaborated and moves toward implementation, the question of how local *regii* will be affected (beyond the obvious impact of eliminating operating subsidies) will gain increasing immediacy. Perhaps well before this point, the question will present itself in another form, as local governments struggle to keep up with the increasing financial demands that decentralization implies.

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[190] Law No. 184, June 24, 1995.

[191] *Id.* at Art. 129.

[192] A question exists whether *regii* are constitutionally eligible for full privatization since Art. 135(5) of the Constitution specifies that "Public-owned assets shall be inalienable. They may be taken over for administration by self-managed public companies or public institutions, or may be leased or granted in concession, in accordance with the law." Art. 80, Law No. 69/91, as amended by Law No. 24/96 seems to classify public works as "public property" that would fall within the constitutional prohibition. The regulatory model implied is the French model of regulation by contract.

FINANCIAL SYSTEM REGULATION AND OVERSIGHT

Banking Law and Regulation

Regulation of banking activities in Romania is governed by the Law on Banking Activity[193] and the National Bank Regulation on Authorization of Banking Activities in Romania.[194] These provisions supplement generally applicable legal provisions governing the corporate form in Romania as defined by the Law on Companies.[195]

Banking is regulated by the National Bank of Romania through the issuance of licenses and the exercise of supervisory and enforcement powers granted to it by law.[196] Banking activities may be conducted in any authorized corporate form other than that of a limited liability company.[197] Ownership participation by non-banking entities is limited to a maximum of 20 percent of authorized capital and outstanding loans to any single debtor may not exceed 20 percent of the sum of a bank's combined capital and reserves. Twenty percent of annual gross profits of banks are to be held as reserves until the reserve fund reaches the equivalent of the bank's authorized capital and, thereafter, 10 percent of gross profits until the reserves are equal to 2 times the authorized capital of the bank. Once the reserve fund reached this level, additional allocations are made from net profits.

Regii autonomes and state-owned commercial companies may participate in the capital formation of a banking operation provided, however, that they can demonstrate that they are not receiving subsidies from the state budget. Total participation by any one *regia* or commercial company is limited to 2 percent of the bank's capital and a maximum combined total of 10 percent for all holdings by *regii* and commercial companies. In cases where a new banking entity may be created, National Bank regulations require that at least one shareholder be a foreign bank or international financial institution.

Relating specifically to the creation a municipal credit bank, it should be noted that: "[b]anking companies shall be prohibited from entering into contracts or agreements, or adopting practices of any kind, which would give them a monopolistic position on the money, financial and foreign exchange markets, or from engaging in manipulative practices in order to obtain an unfair advantage...for third persons."[198] This prohibition, read in conjunction with

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193 Law No. 33/91.

194 Regulation No. 6, June 12, 1995.

195 Law No. 31/91.

196 *Id.* at Arts. 2, 3.

197 Art. 5, Law No. 33/91; Art. 2, Law No. 31/90.

198 Art. 12, Law No. 33/91.

the Law on Competition,[199] seems to foreclose the possibility of establishing a monopoly position for any future municipal credit facility without special legislation to that effect.

Legal Framework for a Municipal Bond Market

The creation, operation and regulation of capital markets in Romania are defined by the Law on Securities and Stock Exchanges of 1994.[200] The law governs the issuance, intermediation and cancellation of securities in Romania's capital markets. Securities are defined as "...shares, bonds, as well as derivatives or any other credit instruments...classified as such by the National Securities Commission (NSC).[201] Significantly, the issuance of bonds and other securities by county or other units of local government is specifically excluded from the operation of the Law No. 52/94.[202] To date, no law has been adopted that specifically addresses the issuance of local government debt instruments. The result is a gap in the legal framework that will have to be addressed if a functioning municipal bond market is to exist in the future. At present, the MOF regulates issuance of securities by authorizing (or withholding authorization) in the annual budget law.[203] Given that the authority of local government securities was established in 1996, the 1997 Annual Budget Law will be the first to include a list of local governments authorized to issue bonds.

CONCLUSIONS AND RECOMMENDATIONS

General

The existing legal and institutional framework for local government in Romania is, in several important respects, in conflict with the principles of decentralized government and local autonomy. The reasons for this conflict between are complex and go to the very heart of civil society. The question addressed is how a society can best organize itself to fulfill the aspiration of individuals to organize and manage local affairs locally.

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199 See, *Law on Competition*, Law No. 21, April 10, 1996.

200 *Law Regarding Securities and Stock Exchanges*, Law No. 52, July 7, 1994.

201 Arts. 2, 14, Law No. 52/94.

202 *Id.* at Art. 3.

203 Several attempts have been made by local governments to issue bonds. The town of Sinaia (population 20,000) proposed a 10 year, 200 billion lei ($32.8 million) bond issue offered at an initial rate of 60 percent variable to finance the construction and rehabilitation of the local water supply network. The effort was abandoned after MOF refused to guarantee the bonds. It appears that similar efforts to issue municipal bonds by Bucharest and Brasov were likewise abandoned when MOF refused to guarantee the obligation. Finally, although unconfirmed, it is reported that Constanţa is preparing a bond issue secured in part by real property within its jurisdiction and, significantly, with MOF approval.

To a significant degree, this difficult question has already been addressed in Romania. A three tier system of government—national, county, and local—exists and functions on a day-to-day basis. The challenge, therefore, lies not so much in changing the existing system, as in making it function more efficiently. During the past several years, and as a result of much discussion and hard work, a general consensus seems to have emerged that a few core obstacles stand in the way of achieving local self-government on the level called for by Romania's Constitution, its laws and the European Charter of Local Autonomy. Given recent changes in Romania, it appears that conditions are more favorable today than they have been since 1991 for addressing these challenges. It is also appears true that the need for resolving these questions may be more urgent now than it has been since 1991.

The process of decentralization of government implies a shift in economic, as well as political, power. The economic power of local government derives from two basic sources—the ownership of assets and the ability to tax and spend. Since in many societies a certain portion of the tax base derives from the value of specific assets, the question of who owns the assets is of fundamental importance. Where property ownership is unclear, the economic power of the local government is consequently undermined. Similarly, where a local government that cannot meet the minimum needs of its constituents, its political mandate will be eroded over time to the point of irrelevance.

The basis upon which a market-oriented economy is founded are the rules governing the definition, ownership and transfer of property. Where the rules are absent, ambiguous or contradictory, uncertainty and conflict are almost certain to follow. As discussed above, Romania's rules concerning the definition, ownership and transfer of property are in certain respects incomplete and contradictory. The two primary fault lines in this area involve the definition of local versus national ownership on one hand, and state versus private ownership on the other. The result as been persistent uncertainty and conflict concerning the ownership of property that exists between different levels of government, and between the government and the citizenry. This uncertainty and conflict, not to mention economic inefficiency, will most probably persist until a clearly stated, predictable and transparent means of defining and assigning property rights is established. The first general recommendation, therefore, is that the highest priority be assigned to drafting a law on property consistent with European standards and practices that will eliminate the uncertainty that currently exists concerning local versus national, and state versus private, ownership.

The second general recommendation that arises from this analysis is that the financial and administrative structures of local government should be re-engineered to operate in a manner consistent with the principles of decentralization of government and local autonomy. The emphasis should be to redefine administrative structures that will give local governments autonomy in operational and financial decision-making while providing them with a sufficient base of raising own-source revenues to fund local operations.

Specific

The following are some specific reforms that might be considered in order to enhance local government creditworthiness and promote the formation of municipal credit markets in Romania:

— Clearly define property ownership rights as between the national and local levels of government and as between the state and the citizenry;
— Clarify the distinction between "public" and "private" patrimony as identified in the Law on Local Administration and the implications concerning ownership, use and transfer of assets of each type;
— Develop and strengthen supporting institutions concerning the ownership, transfer and pledge of tangible assets including systems for cadastre and recording security interests;
— Reform existing laws governing the ability to local governments to raise own-source revenues (particularly the Law on Local Taxes and Fees) by giving them greater flexibility in defining the tax base (i.e., what assets or activities are taxed), the method of taxation (e.g., per capita, ad valorem, flat or progressive) as well as in establishing local tax rates;
— Clarify the circumstances under which local governments can incur long-term financial obligations and the specific mechanisms for approving them (e.g., referenda);
— Specify legal and regulatory mechanisms for the issuance of municipal bonds and the protection of investors including the financial implications of local government default on long-term financial obligations;
— Guarantee non-interference by the national government in local taxation matters as a means of increasing the stability and predictability of own-source revenue flows;
— Adopt government accounting standards and methods that accommodate and encourage long-term planning and budgeting for capital investment;
— Eliminate local budget surplus "clawback" provisions contained in the Law on Public Finance and other legal and regulatory disincentives to savings (investment), long-term planning and economic efficiency;
— Streamline the local budget preparation process and eliminate direct national government intervention in local decisions concerning investment;
— Transfer responsibility for local treasury operations to local governments;
— Clarify the role of the county governments in terms of asset ownership, public service provision and financial coordination and control for smaller units of local government;
— Clarify the legal and ownership status of the local *regii autonomes* and their accountability to local and national government authorities;
— Conduct a detailed study of the legal, financial and economic efficiency implications of unbundling services provided by local *regii* and, where appropriate, privatizing

and contracting out those functions that can be provided more efficiently by private sector providers;

— Elaborate and strengthen a transparent regulatory framework that promotes the efficient delivery of public services by local *regii* in natural monopoly sectors on a full cost recovery basis;
— Define the legal and financial implications of *regii* insolvency by providing an explicit mechanism for restructuring or liquidation either within the existing legal and institutional framework for bankruptcy, or under a specialized system;
— Elaborate a legal framework governing the issuance of financial guarantees by local governments that explicitly authorizes the use of pledged assets, revenue streams and other mechanisms to secure long-term obligations;
— Develop a transparent mechanism for allocation of shared tax revenues on a stable and predictable basis;
— Develop a transparent mechanism for allocating direct transfers and subsidies from the state budget to local governments for investment and provision of public services; and
— Form a consultative body that will bring together key decision-makers at the national and local levels to discuss the implications of the reforms suggested above, establish priorities for reform and assign responsibility for developing the specific policy responses required.

CHAPTER IV.
FINANCIAL ANALYSIS OF
EIGHT GENERAL PURPOSE LOCAL GOVERNMENTS

INTRODUCTION

This chapter describes the results of the analysis of the current financial condition and financial management capacity of four *judets* (Bihor, Constanţa, Dâmboviţa and Maramureş) and four municipalities (Baia Mare, Constanţa, Oradea and Târgovişte) in Romania. The purpose of the analysis was to develop an understanding of the issues that might constrain the participation of general purpose local governments in the Municipal Credit Facility.[204]

The first part of the analysis looked at the financial condition of each of the eight local governments based on actual results for the period from 1993 to 1996.[205] An attempt to look at their future financial condition through the year 2001 proved to be too speculative to be useful given the current state of flux of laws and regulations governing local government finances in Romania. The second part of the analysis looked at the financial condition of the *regii* that provide water, waste water, transport, solid waste and heating services in each local jurisdiction.

USAID and the EBRD selected the eight local governments included in the analysis based on programmatic criteria. Bihor, Constanţa and Dâmboviţa, and the corresponding municipalities of Oradea, Constanţa and Târgovişte, were selected because they are areas in which the EBRD anticipates investments under its MUDP II loan program. Maramureş and the corresponding municipality of Baia Mare, were selected because USAID has numerous current activities in the area. Given the selection process, the eight local governments cannot be considered a representative sample of all *judets* and municipalities in Romania.

FINANCIAL CONDITION OF THE LOCAL GOVERNMENTS (1993-1996)

Overall Results

The overall financial results of the eight local governments for the period from 1993 to 1996 are quite similar. Generally, they recorded large to moderate surpluses in 1993 and 1994 trending toward a balanced budget in 1995 and 1996.[206] There is no significant

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[204] The full report *Financial Profile of Eight General Purpose Local Governments in Romania* (The Urban Institute, UI Project 06610-804, February 1997) is available as a separate document in both English and Romanian.

[205] In some cases data for 1996 was not yet available.

[206] The only two exceptions occurred in the *Judet* of Constanţa and in Oradea. Each recorded a small deficit in 1994 and 1995, respectively. Given the requirement that expenditures not exceed revenues, these results should not occur. We did not obtain an explanation for this apparent anomaly. In any case, the reported deficits were of less than one percent of total revenues.

difference in the results of the *judets* and the municipalities. National rules governing all *judets* and municipalities require that total expenditures not exceed total revenues. The rules also oblige local governments to give back all but a small part of any overall surplus. Under these conditions it is not surprising that the local governments over time would seek to balance revenues and expenditures.

However, these results by themselves reveal little else about the finances of the local governments included in the analysis. In fact, as the following sections of this chapter will show, there are significant differences in the financial condition of the local governments.

Recurring Surplus or Deficit

An important part of the analysis was to look at the recurring surplus or deficit of the local governments. This is different than the overall surplus or deficit, discussed above, which *judets* and municipalities currently calculate. That analysis looks at the difference between total revenues and total expenditures. The recurring surplus or deficit looks only at the difference between operating expenditures and recurring revenues.

The calculation uses the standard income and expense data reported by *judets* and municipalities in Annexes 12 and 14 of their quarterly and annual financial statements. These forms include all revenues and expenditures by line item for any given year, including budget and actual information. The calculation of the recurring surplus or deficit first requires identifying and classifying those expenditures related to the cost of administering the local government or of providing local services. This includes as well any subsidies or transfers to other organizations, such as the *regii*, to pay for similar costs. These are the *operating expenditures* of the local government. The second step is to isolate those revenues that are available on a continuing basis to pay for operating expenditures. These *recurring revenues* include all local taxes and most fees, as well as shared national tax revenues and any operating subsidies provided by the state. They do not include certain fees that are not recurring, such as those charged for entertainment events. They also do not include non-fiscal revenues, such as the distribution of profits from the *regii* or the proceeds of loans or of the sale of assets, or those revenues provided by the state specifically to pay for investments.[207]

The recurring surplus or deficit of the local government is determined by subtracting its total operating expenditures from its total recurring revenues. This will produce:

— A recurring surplus when recurring revenues are greater than operating expenditures; and
— A recurring deficit when operating expenditures are greater than recurring revenues.

[207] Appendix A explains the calculation of operating expenditures and revenues using the data available in Annexes 12 and 14 of the standard financial reports.

This is a significant result. Should the local government want to enter into a loan or issue bonds, the recurring surplus will be the amount available to pay the maturing principal and interest payments on the debt. It will largely determine the maximum amount the local government *can* borrow. A local government that has a recurring deficit has no free recurring revenues available for debt service. It should not consider entering into any new loans until it has taken steps to identify and address the causes of the problem.

Table 16
Recurring Surplus (Deficit) As Percent of Recurring Revenues

	1993	1994	1995	1996
National Average	(0.6)	4.0	3.2	(1.9)
Bihor	(0.5)	0.4	0.8	n/a
Constanţa (*Judet*)	45.2	9.6	9.4	11.3
Dambovit	14.3	13.4	17.6	5.1
Maramureş	n/a	4.5	2.6	n/a
Oradea	(4.2)	(3.8)	(4.6)	n/a
Constanţa (Municipality)	n/a	(28.5)	0.9	(2.3)
Târgovişte	(3.1)	(7.9)	(1.1)	(6.5)
Baia Mare	(6.6)	(1.9)	(2.3)	(6.7)

Table 16 shows the results of the analysis of the recurring surplus or deficit separately for the four *judets* and four municipalities. It reveals that taken together, the eight local governments included in the analysis had a recurring deficit half the time. This is not inconsistent with aggregate national data which showed an average recurring deficit based on actual figures for 1993 and on the approved budget for 1996. The results suggest that local governments have been unable or unwilling to generate savings from recurring revenues to dedicate to investments. Since these are the same savings that the would be required to pay the maturing principal and interest payments on the debt, the results are not encouraging.

It is interesting to note that the municipalities have had a recurring deficit in almost every year. Only the municipality of Constanţa recorded a surplus in 1995. In contrast, *Judets* consistently have had a recurring surplus. Bihor recorded the only recurring deficit among *judets* once in 1993. These results are shown graphically in Chart 1, which shows the highest and lowest recurring surplus or deficit recorded by *judets* and municipalities, correspondingly, in each year. The consistent pattern of deficits suggests that municipalities may be facing difficulties generating savings from recurring revenues. If so, then they would be less likely than *judets* to be able to borrow successfully.

Both *judets* and municipalities receive other operating revenues that were considered extraordinary or non-recurring for purposes of this analysis. This includes items such as revenues from penalties or fines. It also includes the share of the profits of the local *reg*ii that the *judets* and municipalities receive. This is a less conservative basis for calculating net operating results. If these non-recurring operating revenues were included, then the municipalities would have recorded a deficit in seven of the fourteen years covered by the analysis.[208] This is still a weak performance that would be of concern in considering their credit-worthiness.

Revenue Trends

Chart 1
Comparison of Recurring Surplus (Deficit)

The analysis looked at how the revenues of the *judets* and municipalities included in the analysis changed over the period from 1993 to 1996. As shown in Tables 17 and 18, below, the change in real terms from 1993 to 1996 in total revenues and recurring revenues followed a similar pattern in *judets* and municipalities, increasing or decreasing in roughly the same proportion from year to year.

What is interesting, however, is the difference in the rate of change in recurring revenues between the four *judets* and the four municipalities, as shown in Chart 2. Clearly, recurring revenues have been growing much more consistently among the municipalities, with an increase in real terms through 1995, then leveling off in 1996. With the *judets*, recurring revenues increased in real terms through 1995 in all cases, except Constanţa, and then decreased across the board in 1996. The pattern for total revenues, as noted above, would be very similar.

The pattern of growth in revenues fails to explain the different operating results recorded by the *judets* and municipalities included in the analysis. As discussed in Section 2.3, the four *judets* consistently had a recurring surplus from 1993 to 1996, while the four municipalities had a recurring deficit in almost every year of that period. One possible explanation for the difference would have been a higher rate of growth of recurring revenues among the *judets*. The reverse is true. The municipalities ran deficits despite a relatively high rate of growth of recurring revenues in real terms. This is not encouraging.

Table 17
Cumulative Change in Total and Recurring Revenues—*Judets*

	1993	1994	1995	1996

[208] The municipalities covered the balance of the operating deficit by using non-fiscal revenues and local capital revenues, such as the proceeds from the sale of assets, to pay for operating expenditures. This is an accepted use of the funds under existing rules. It is not a good long-term financial practice.

Bihor				
Total Revenues	1.00	1.37	2.24	n/a
Recurring Revenues	1.00	1.38	2.30	n/a
Constanţa				
Total Revenues	1.00	0.77	0.50	0.41
Recurring Revenues	1.00	0.72	0.48	0.41
Dâmboviţe				
Total Revenues	1.00	2.03	1.63	1.36
Recurring Revenues	1.00	1.36	1.55	1.28
Maramureş				
Total Revenues	n/a	1.00	1.32	n/a
Recurring Revenues	n/a	1.00	1.40	n/a

Table 18
Cumulative Change in Total and Recurring Revenues—Municipalities

	1993	1994	1995	1996
Oradea				
Total Revenues	1.00	1.49	2.17	n/a
Recurring Revenues	1.00	1.37	2.03	n/a
Constanţa				
Total Revenues	n/a	1.00	2.88	2.97
Recurring Revenues	n/a	1.00	3.38	3.49
Târgovişte				
Total Revenues	1.00	1.65	2.50	2.59
Recurring Revenues	1.00	1.61	2.34	2.64
Baia Mare				
Total Revenues	1.00	1.09	2.18	1.97
Recurring Revenues	1.00	1.02	2.07	1.99

During the same period, as shown in Charts 3, 4 and 5, the composition of the recurring revenues of the eight local governments included in the analysis changed significantly. The two sets of lines on the charts correspond to the highest and lowest annual share of each revenue source for *judets* and municipalities. The four *judets* have come to rely almost exclusively on national tax revenue transfers. The four municipalities are receiving a larger share of their recurring revenues from local taxes and fees than they were in 1993, but a smaller share than in 1994 and 1995. The importance to the four municipalities of national tax revenue transfers has decreased slowly over the period. The relative weight of state operating subsidies has remained fairly constant.

Chart 2
Comparative Growth in Recurring Revenues
***Judets* versus Municipalities**

Local Tax Management

As a complement to the analysis of overall revenue trends, the analysis also looked at the performance of the four municipalities in the management of local taxes and fees.[209] This actually involved two separate analyses. One looked at the arrears, that is the percent of tax assessed versus tax collected. The second analysis looked at the use by the Municipal Council of its discretionary authority to raise revenues through local taxes and fees.

Chart 5
Trend in Relative Weight of State Operating Subsidies

The concept of arrears only applies to those taxes which are subject to an assessment based on a known or projected value related to the tax base. In the case of municipalities in Romania this includes:

Chart 3
Trend in Relative Weight of Local Taxes and Fees

— Taxes on the income of self employed professionals and tradesmen;
— Property taxes on land and buildings owned by individuals;

— Proper

Chart 4
Trend in Relative Weight of Shared National Tax Revenues

[209] The analysis only looked at tax performance of municipalities because local taxes and fees represent a small and declining share of revenues of *judets*.

ty taxes on personal vehicles;
— Property taxes on land and building owned by corporations; and
— Property taxes on corporate vehicles.

These sources together represent a significant share of total tax and fee revenues of the four municipalities, ranging from 72 percent in Constanţa to 95 percent in Târgovişte.

Table 19 below shows the result of the analysis of arrears for each of the four municipalities. The incidence of arrears is greatest in Baia Mare and Oradea, where the largest amounts are owed by corporate tax payers. In Romania this would include many state owned firms which are in poor financial condition. Many of these firms are in arrears in the payment of bills and taxes to the public sector. Otherwise, the record is not bad. Târgovişte actually succeeded in reducing corporate, and therefore, overall arrears in 1996.

Table 19
Current Year Tax Arrears by Municipality as of 1996

	Current Arrears			Current Arrears as Percent of	
	Individual	Corporate	Total	Amount Assessed	Total Local Taxes and Fees
Baia Mare	113,240	564,892	678,132	18.1	9.6
Constanţa	395,679	173,314	568,993	5.1	2.4
Oradea	110,617	737,997	846,614	12.5	n/a
Târgovişte	71,261	(530,506)	(459,245)	n/a	n/a

The second part of the assessment of local tax management performance looked at the degree to which the Municipal Council used its discretionary powers to raise local taxes. This includes two different situations. The first covers those taxes for which the base rate is determined by national law, but the Councils have the authority to increase the base rate by a determined amount. These include:

— Taxes on the income of self employed professionals and tradesmen;
— Notary fees on personal transactions; and
— Fees for the use of state property.

In all three cases, under present law the Municipal Council can increase the national base rate by thirty percent. Table 20, below, summarizes the results of the analysis of this part of local taxing authority. None of the municipalities have used the discretionary power to increase the national base rate. As the table shows, the potential additional revenues are not very significant, ranging from 8.5 to 10.6 percent of total revenues from local taxes and fees.

The other situation covers those taxes and fees which the Council can impose at its own discretion. This includes:

— Penalties for violation of Municipal Ordinances, particularly in the areas of trade and construction
— Leases of Municipal property and assets
— Fees for concessions, such as market stalls

Table 20
Potential Additional Local Tax Revenues from
Authority of Municipal Council to Increase National Base Rate (1996, current Lei)

	Baia Mare	Constanţa	Oradea	Târgovişte
Tax Self Employed Professionals				
Base revenues	589,882	6,934,116	944,000	461,080
Potential municipal surcharge (30%)	176,965	2,080,235	283,200	138,324
Notary Fees				
Base revenues	814,076	828,474	1,890,080	1,096,633
Potential municipal surcharge (30%)	244,223	248,542	567,024	328,990
Fees on Use of State Property				
Base revenues	880,100	820,000	550,000	219,043
Potential municipal surcharge (30%)	264,030	246,000	165,000	65,713
Total potential surcharge	685,217	2,574,777	1,015,224	533,027
Total current revenues from local taxes and fees	7,091,901	24,192,197	n/a	6,250,013
Potential surcharge (percent of revenues from local taxes and fees)	9.7	10.6	n/a	8.5

Table 21
Maximum Potential Increase in Revenues from Local Taxes and Fees (1996)

	Baia Mare	Constanţa	Oradea[a]	Târgovişte
Potential Increase as a Percent of 1996 Revenues from Local Taxes and Fees				
Recovery of current arrears	9.6	2.4	n/a	0.0
Revenues from tax surcharge	9.7	10.6	n/a	8.5
Total potential increase in revenues	19.3	13.0	n/a	8.5
Potential Increase as a Percent of 1996 Total Recurring Revenues				
Total potential increase in revenues	9.6	5.3	n/a	3.1

Note

a Actual data for 1996 for Oradea is incomplete, so it was not possible to calculate the corresponding percentages.

Târgovişte did not provide information on revenues from discretionary taxes and fees. Constanţa and Oradea do appear to be generating significant revenues from leases and concessions. Baia Mare and Constanţa have made the most use of the authority to levy penalties. Unfortunately, there is no simple way to estimate the revenue potential from these sources. These potential revenue sources were not included in the analysis of the local tax performance.

Finally, Table 21 above shows the aggregate impact of arrears and potential revenues from the use of discretionary authority to increase national tax base rates in certain categories. Except possibly in the case of Baia Mare, which has a higher incidence of arrears than the others, the revenues from local taxes and fees that the municipalities have failed to receive or raise is not very significant. In fact, the overall tax performance of the municipalities is reasonably good.

Expenditure Trends

The analysis looked at how the expenditures of the eight local governments have evolved over the period from 1993 to 1996. As shown in Table 22 and 23 (on the next page), both total and operating expenditures increased rapidly in real terms, matching the rapid growth of revenues. There are interesting differences in the patterns of *judets* and municipalities. Municipal expenditures are growing much faster than those of the *judets*. It is impressive that municipal expenditures more than doubled in all cases in real terms in four years. That is a huge increase. For the *judets*, the rate of growth in operating expenditures was much smaller. In fact, expenditures in the *judet* of Constanţa decreased by one-third in real terms between 1993 and 1996. Those in Dâmboviţe have been decreasing since 1994.

There is a difference between *judets* and municipalities as well in the relationship between the growth in total expenditures and the growth in operating expenditures. In the case of the *judets*, the two increase roughly in the same proportion. In the case of the municipalities, total

Table 22
Cumulative Change in Total and Operating Expenditures—*Judets*
(constant 1995 lei, thousands)

	1993	1994	1995	1996
Bihor				
Total expenditures	1.00	1.40	2.25	n/a
Operating expenditures	1.00	1.37	2.27	n/a

	1993	1994	1995	1996
Constanţa				
Total expenditures	1.00	1.19	0.78	0.66
Operating expenditures	1.00	1.18	0.79	0.66
Dâmboviţe				
Total expenditures	1.00	2.04	1.67	1.41
Operating expenditures	1.00	1.38	1.49	1.41
Maramureş				
Total expenditures	n/a	1.00	1.30	n/a
Operating expenditures	n/a	1.00	1.43	n/a

Table 23
Cumulative Change in Total and Operating Expenditures—Municipalities
(constant 1995 lei, thousands)

	1993	1994	1995	1996
Oradea				
Total expenditures	1.00	1.48	2.18	n/a
Operating expenditures	1.00	1.37	2.04	n/a
Constanţa				
Total expenditures	n/a	1.00	2.88	2.98
Operating expenditures	n/a	1.00	2.61	2.78
Târgovişte				
Total expenditures	1.00	1.76	2.75	2.81
Operating expenditures	1.00	1.69	2.30	2.73
Baia Mare				
Total expenditures	1.00	1.18	2.34	2.12
Operating expenditures	1.00	0.98	1.99	2.00

expenditures increased at a faster rate than operating expenditures. This suggests that municipal capital expenditures—the other component of total expenditures—increased faster than municipal operating expenditures.

Chart 6
Comparative Growth of Recurring Revenues and Operating Expenditures—Municipalities

As shown in Chart 6, the rapid rate of growth of operating expenditures does not explain the consistent recurring deficits recorded by the municipalities between 1993 and 1996. As illustrated by the chart, recurring revenues and operating expenditures of municipalities grew at almost identical rates.

The composition of operating expenditures also changed over the period from 1993 to 1996. These changes reflect certain functions that were transferred from the national government either to the *judets* or the municipalities. For example, in 1995 all four municipalities included in the analysis assumed responsibility for maintenance and operating costs of local schools from the national government. Up to that point, the municipalities had no responsibilities at all in the area of education. It is now one of their largest expenditures. Sometimes, the process has gone the other way. In 1996, the Ministry of Culture apparently decided to take back responsibility for supporting certain local cultural institutions from the *judets*. The expectation was that responsibility for the institutions would return to the local budgets in 1997. Changes also have occurred between *judets* and municipalities under instructions from the national government. For example, in 1996, the local public transport *regia* shifted from the *judet* of Constanţa to the municipality. With it came the responsibility for managing mass transit subsidies received from the national government, which doubled the municipality's expenditures in this area. Finally, the *judets* and the municipalities also shift expenditures off budget to local entities that are under their authority, including the *regii autonomes*. This leaves on the budget of the local government only the net transfer of subsidies, if any, and any revenues received back from the entity. All these changes taken together have created a complicated and difficult context in which local governments must try to manage their operating expenditures. It also complicates the task of analyzing local government budgets and expenditure trends.

There is one additional accepted practice that further complicates the analysis of local government expenditures. Financial results reflected in the various statements prepared by local governments are recorded on a cash basis. Only revenues actually collected in cash and expenditures paid in cash appear in the income and expense statements. Local governments do not report delinquent revenue accounts as receivables, but they do accumulate accounts payable. This means that expenditures as reported in the statements can be lower than the total commitments incurred during the period by a local government. The outstanding commitments are reported in the year end balance sheet as an account payable. These commitments appeared in two different circumstances among the local governments included in the analysis. In one case, a *judet* had an unexpected shortfall in revenues late in the fiscal year. It offset this shortfall by delaying payment for road repairs performed by a *regia* that is under its authority. The other case also involved road repair work, this time performed for a municipality by a private contractor. The contractor completed the quantity of work authorized by the municipality, but found that impact of inflation on costs was higher than anticipated. The additional amount was carried forward into the next fiscal year as an account payable. We did not determine whether such transactions are exceptional or routine or whether the volume of accounts payable has been increasing in real terms. The very fact that the transactions are feasible, however, makes it more difficult to analyze the financial condition of local governments in Romania.

Debt

None of the *judets* or municipalities included in the analysis have borrowed funds to finance investments. Starting in 1994, several of them have used short-term loans from the local treasury fund for cash management purposes. The incidence and size of such loans has been increasing, as shown in Table 24, below. A change in the applicable rules makes it possible to extend the repayment of these loans to eighteen months. This could be risky. Loans used during a single fiscal year to facilitate cash management are not necessarily a sign of problems, since local governments face a difficult task matching the payment of expenditures with cash receipts. When such loans extend from one fiscal year into another, however, they may be a sign of growing difficulties managing the expenditures in the local budget. Repaying the outstanding balance in the second year places added pressure on the budget, particularly if revenues remain stable or decrease in real terms, as they did in 1996.

Two of the municipalities also have plans for future loans to finance investments in infrastructure. Oradea is contemplating a $20 million loan to finance new roads. The municipality of Constanţa is planning a $100 million bond issue in international capital markets to finance several large infrastructure projects in the city. The municipality has signed an agreement with Solomon Brothers for assistance in the process. The local officials anticipate that they would pay interest only on the bonds and repay the principal by issuing new bonds.

It is very important that any early incursion by local governments in Romania to the credit markets be successful. The proposed loans represent a difficult challenge for both Oradea and Constanţa. Interest payments alone on a $20 million loan would represent half the recurring

Table 24
Short-term Cash Management Loans—*Judets* and Municipalities

		Amount (lei)		
	Year	Borrowed	Repaid (P&I)	Outstanding
Târgovişte	1994	200,000	200,000	0
Maramureş	1995	150,000	150,000	0
Bihor	1995	8,970,000	8,970,000	0
Constanţa (*Judet*)	1996	32,000,000	32,330,000	0
Baia Mare	1996	1,000,000,000	107,242	900,000,000
Târgovişte	1996	2,000,000,000	492,765,000	1,507,235,000

revenues of Oradea in 1996. Interest payments on $100 million would exceed the annual recurring revenue of Constanţa in that year. They may need to consider scaling back the proposed magnitude of the borrowing.

FINANCIAL MANAGEMENT PRACTICES

The basic structure of local government finance in Romania is based on principles of local autonomy. In practice, as described in Chapters Two and Three of this report, the structure is characterized by incomplete legislation, by a system of intergovernmental finance that has lacked both stability and transparency and by a propensity on the part of national authorities to modify the details of the rules governing both local revenues and expenditures on a yearly basis. Local governments only truly learn the level of their revenues from both national and local sources and the extent of their expenditure responsibilities for any given year after the national budget is approved and published. This has occurred frequently as late as May or June in a fiscal year that runs from January to December. After that point, local governments do appear to exercise significant, autonomous authority over their budgets for what remains of the fiscal year. That autonomy ends with the fiscal year. The local governments must return any unspent funds received from the national budget. They keep only a very small part of any surplus funds from local taxes and fees. And, they begin once again the process of waiting for the next national budget. In effect, local financial autonomy exists in yearly tranches that last six to nine months of each fiscal year. This is a serious obstacle to sound financial management at the local level. The following discussion describes how the local governments included in this analysis are coping with this situation.

The Annual Budget Process

The local governments included in the analysis follow a fairly comprehensive process in developing their annual budget. Oradea, for example, has a sophisticated performance budget process which relates proposed expenditures to specific outcomes or targets. In general, all local governments start roughly in June or July with a request to internal offices for a proposal of expenditures for the next year. The materials presented by these offices vary in their complexity. Sometimes they involve data. Sometimes, they describe in words what is needed for the next year. The total amount requested may be twice or more the amount they actually expect to receive. When the final budget is decided many months later, the offices will reprioritize their proposals to adjust to the budget limits. In general, the offices present their needs in current year costs. The office or person preparing the composite budget will use projected inflation factors from the National Statistics Department to estimate future costs. Then, the technical and economic departments of the *judet* or municipality analyze the budget proposals together and establish priorities.

At this point, roughly three months before the beginning of the fiscal year, local government officials have a pretty good idea of their needs. They know that certain expenditures will have minimal levels determined in the national budget. This has been the case for education and health expenditures. They must wait for a national decision on public sector wages, since all national and local government employees work under the same pay scale. Local officials also may have received verbal indications from their national government counterparts of possible changes in local expenditure responsibilities and in the distribution of revenues from local taxes and fees between *judets* and municipalities. The key issue for them is what level of revenues they will receive from the national budget.[210] It is this issue which drives the budget request that municipalities send to the *judets* and the consolidated budget request that *judets* prepare and forward to the Ministry of Finance. It is a process that uses projected expenditures to justify revenue levels.

This puts the local government in the position of having to explain and defend its proposed operating expenditures and investments, although these are nominally autonomous decisions of the local council. For example, if a municipality wants to add new personnel, it may have to explain to the *judet* or to the Ministry of Finance why it needs more staff. These officials may indicate that they disagree with the proposal. Later, once the national revenues have been fully allocated to each local government, the corresponding local council will have full authority to add the new positions at its own discretion without needing outside approval. However, since the municipality will have to go through the same budget process the following year, the council cannot afford to treat the views of the outside officials lightly. In practice, therefore, the budget request process undermines local financial autonomy. It also presents an obstacle to sound management of local finances by distorting the use of budgets as an instrument to plan revenues and expenditures.

In the four years included in this analysis, the national budget was never approved in time for the beginning of the fiscal year. When this happens, the local governments can continue spending at a rate of one-twelfth of their actual expenditures in the prior year. They are locked into this spending pattern until they receive the actual allocation of funds from the national budget and until any new spending earmarks or responsibilities are spelled out in that same budget. At that point, the council in each local government approves its first real budget for the fiscal year. This is the "initial" budget reported in the financial statements. In the past, this has occurred as late as June or July. For the remaining six or nine months of the fiscal year, the local governments do operate with considerable autonomy. And then, the budget process begins all over again.

Monitoring Expenditures

Implementation of the budget also presents challenges for local governments because they only control one half of the process. All revenue accounting is done for the local governments by the Directorate General of Public Finance and State Control (DGPF) of the Ministry of Finance, which also collects virtually all local taxes and fees. The Local Treasury Office of the Ministry acts as the bank for local governments. It keeps their cash accounts and pays bills on orders from the local government. Local governments control the expenditure side of budget implementation. The challenge is to match revenues with expenditures. Some of the local governments included in the analysis wait to receive the

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[210] Many local officials seem to believe that they are assured a minimal level of revenues to cover basic operating costs plus any increase from inflation. The data collected and analyzed for this study supports that view. The challenge for local officials seems to be how to secure revenues in excess of that minimal level.

monthly report from the DGPF on actual revenues received and collected before authorizing any spending. Others try to project monthly revenues based on past history.

It is ironic that many local officials consider the revenues received from the national budget as a more reliable and predictable source than revenues from local taxes and fees. The latter are subject to shortfalls based on arrears in collections and other causes. For example, one municipality tried to enhance its revenues by approving a package of new local fees that were within the discretionary authority of the local council. One month later, after the municipality had started spending the projected revenues, the prefect challenged the package in the Court of Accounts. This paralyzed the proposed new fees until the challenge could be addressed, leaving the municipality with a sudden, unexpected revenue shortfall. One of the most frequent complaints of officials from the eight local governments included in the analysis was the lack of control over their own revenues, particularly those from local taxes and fees.

As the fiscal year comes to an end, expenditures must match revenues exactly. There is little incentive for local governments to follow a prudent and conservative course of action by planning a small surplus. This would give them the latitude to cover last minute unexpected shortfalls in revenues or increases in expenditures. It also would be place them in a favorable starting position for the next year. Local governments must return any unused funds they receive from the national government for specific purposes. They can keep only a small part of any remaining funds from other sources. As a result, most of the local governments seem to try to spend all their revenues. This creates an additional obstacle to sound financial management at the local level. It can produce the situation described earlier of expenditures that are incurred but not paid and carried forward into the next fiscal year. Under existing rules, these accounts payable have first claim on future revenues. The pressures appear on the revenue side as well. Three of the eight local governments included in the analysis used short term loans in 1996 to help them address the difficulty in balancing the flow of revenues and expenditures. Two of them repaid only part of the loan during the fiscal year. The outstanding loan balance also will have first claim on future revenues.

These practices are not positive signs. They do not necessarily reflect an inherent inability of local governments to manage their own finances. There certainly is a need to strengthen and improve the financial management knowledge and skills of local government officials. They probably would be the first to recognize this. But there also is a need to create a structure of local government finance in Romania that does not create obstacles to sound financial management at the level of local governments. This means doing away with a distorted budget process that is driven by the need to justify revenues through higher expenditures. It means eliminating the disincentives to generating an overall surplus. It may mean revising accounting standards and practices to reflect the impact of expenditures carried forward into the next fiscal year or of outstanding year-end balances on short-term cash management loans.

FINANCIAL ANALYSIS OF *REGII AUTONOMES* UNDER THE AUTHORITY OF LOCAL GOVERNMENTS

Organizations Responsible for Local Services

The analysis of the four *judets* and four municipalities also included an analysis of the financial condition of the *regii* that are under their authority and provide infrastructure services. The purpose of the analysis was to look at the potential impact of the *regii* on the financial condition of the local governments. This included a total of ten *regii*, as shown in Table 25, below. There was no particular pattern. Some of the *regii* provide multiple services. Others have a single purpose. Oradea, for example, uses both approaches. RAGCL (Oradea) produces and distributes heat, distributes water and collects waste water. RAOTL (Oradea) manages just the public transportation system. *Regii* under the authority of the *judets* largely are responsible for road construction and repair. Municipal *regii* provide basic services, such as heating and water. However, the water *regia* in Constanţa is under the authority of the *judet*. Together, the ten *regii* provide a diversified picture of the provision of infrastructure services at the local level.

Net Operating Profit (Loss)

Table 26, below shows the net operating profit margin for the ten *regii* for the years between 1994 and 1996.[211] It also shows the projected margin for 1997. The four *judet regii* have solid operating profit margins. The *regii* that operate under the authority of the municipalities have a less positive record. They recorded an operating loss in nearly two of every three years for which there is actual data. The difference in performance, however, is not related to the association with a *judet* or municipality. Rather, it appears to be a function of the type of service provided. Three of the four *judet regii* provide road construction and maintenance services. They have one major client—the *judet*. The weakest performances were recorded by *regii* that provide heating or public transport services. Their problems seem to stem from a

Table 25
***Regii Autonomes* Included in the Analysis**

	Services Provided				
Jurisdiction/*Regia*	Heating	Water	Waste Water	Mass Transit	Roads
Judets					

[211] The figures for 1996 in most cases are actual results through the end of the second or third quarter, with a projection for the balance of the year. The projections for 1997 were prepared in consultation with the management of the *regii.* However, with given the expectation of profound changes in the price structure of local services in 1997, these projections must be considered approximations based on current trends and policies.

	Services Provided				
RAJDP (Bihor)					■
RAJDP (Constanţa)		■	■		■
RAJA (Constanţa)					
RADP (Dambovita)					■
Municipalities					
RA URBIS (Baia	■	■	■	■	■
Mare)	■				
RADET (Constanţa)				■	
RATC (Constanţa)	■	■	■		
RAGCL (Oradea)				■	
RAOTL (Oradea)	■	■	■	■	■
RAGC (Târgovişte)					
Totals	4	4	4	4	5

Table 26
Net Operating Profit (Loss) Margin (percent)

	1994	1995	1996 (estimate)	1997 (projected)
Judets				
RAJDP (Bihor)	14.3	12.4	12.6	14.9
RAJDP (Constanţa)	n/a	33.1	19.5	31.3
RAJA (Constanţa)	5.5	4.7	0.9	6.1
RADP (Dambovita)	(0.2)	3.8	4.6	7.9
Municipalities				
RA URBIS (Baia Mare)	(0.4)	0.2	(4.1)	(5.7)
RADET (Constanţa)	(38.4)	(47.4)	(7.1)	(16.3)
RATC (Constanţa)	(0.6)	2.9	(4.7)	(5.2)
RAGCL (Oradea)	1.5	0.6	3.5	6.7
RAOTL (Oradea)	(0.3)	1.8	(19.0)	(47.0)
RAGC (Târgovişte)	(10.8)	(0.6)	2.4	7.6

combination of relatively low prices and growing difficulties passing on increases in costs to their clients. The exception is the heating *regia* in Oradea, which has had consistently positive operating results.

Although the operating results provide important information about the finances of the various *regii*, they may not provide a complete understanding of their overall financial condition. The following analysis will attempt to provide additional insights.

Net Cash Flow Analysis—Rationale and Methodology

The Income Statement and the Balance Sheet of a local *regia* or commercial company that provides essential infrastructure services to a community present valuable information both to the managers and to the Local Councils and other interested parties such as investors and creditors. Yet, it is important to look beyond the results reported in the Income Statement and Balance Sheet at other results that can be calculated using the information available in those statements.

Under the present conditions in the Romanian economy, it is not unusual to find commercial companies, including many local *regii*, with high levels of both accounts receivable and accounts payable. A growing inability to collect payments owed by clients for services provided, reflected in the increase in accounts receivable, poses a potential threat to the liquidity of many companies, including some of the *regii*. By and large, companies have tried to offset the loss of cash implicit in the increase in accounts receivable by a corresponding increase in accounts payable. The situation often is described as one of "financial blockage"—no-one pays anyone else. This involves serious risks. It is not sustainable over time. What might happen, for example, if a large creditor (such as the national power company, RENEL) demands payment of accumulated bills? In the absence of a compensating reduction in receivables (an increase in the collection from its debtors), the commercial company or *regia* would face a serious cash problem that might impair its ability to continue to operate normally.

The existing situation of "financial blockage" distorts the picture of the financial condition of a company or *regia*, as shown in its financial statements. Assets, as shown by accounts receivable in the balance sheet, may not be what they seem. It is likely that in the future not all receivables will be recovered. Consequently, companies should be making provisions for losses from bad debts. Conversely, liabilities, as shown by accounts payable, may also be inaccurate. As companies begin to face the obligation to repay accumulated arrears, there is a potential for late payment fees or penalties. Therefore, companies (including *regii*) which have a high volume of accounts payable should start introducing provisions for losses on penalties and litigation.

The most immediate problem, however, is whether the company is generating sufficient cash to ensure its continued operations. In answering this question, it is necessary to look beyond the operating results as reported in the Income Statement to the Net Cash Flow of the company. By projecting, for the near future, the level of cash that flows through the company, the management can predict the company's cash position at every instant in time, assess liquidity risks, and prevent unpleasant moments of illiquidity. In the case of the *regia*, liquidity is also a concern for the municipality which has an obligation to provide a reasonable level of infrastructure services to the local community. Barring any *force majeure* and using good sense in estimating the risks, the trend in the ending cash position can show well in advance when a liquidity problem might arise.

The purpose of the Net Cash Flow analysis is to identify the sources and uses of cash during the accounting period. To do this, the analysis divides the operations of a company or *regia* into three main activity groups that cause assets to change: operations, investments and financing. Beginning with net income calculated on an accrual basis the analysis makes a series of adjustments intended to transform net income into cash flow. The adjustments are of three types:

- — Expenses not involving cash outflows are added back; e.g., depreciation, deferred taxes, increase in accounts payable and in accrued interest payable;
- — Cash outflows not treated as expenses are subtracted; e.g., increase in inventory, dividends; and
- — Revenues not involving cash inflows are subtracted as well; e.g., increase in accounts receivable and in accrued interest earned, and gain on sale of property. [212]

The first activity covered in the analysis are the income and expenses related to the operations of the company or *regia*. Most expenses involve a corresponding outflow of cash. Depreciation, amortization and provisions, however, although deducted as expenses do not require the use of cash. Since they are a non-cash reduction in net income, they are added back to adjust the cash flow from operations. The same is true for the increase in accounts payable (the difference is deducted from net income but not yet paid) and the decrease in accounts receivable (similarly, this is an increase in sales for which the *regia* has not been paid). In addition, the increase in inventory is deducted to reflect the cash used to produce the additional inventory. This part of the analysis looks at the trends in accounts payable and accounts receivable, as well as net cash generated from operations.

The final two parts of the analysis then look at the impact on net cash flow of *investment and financing activities*. The first involves changes in a firm's long-term investments in property, plant and equipment. These activities are not reflected in the income statement but represent a use (or a source of) cash.[213] *Financing activities* include cash raised from debt (inflows) and cash outflows for the dividends paid.[214]

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212 Whatever cash is generated by the sale of property will appear on the cash flow statement as proceeds from the sale of property under the heading *"cash flow from investments."* The gain (or loss) on the sale is the difference between the property's selling price and its balance sheet value when sold. Because this gain is already part of the line -/+ (purchase)/sale of property, plant or equipment, showing it also as part of operating activities would amount to double-counting.

213 Because of little information on the changes in property, plant and equipment, we assumed that all changes come from revaluation of the assets. This is a change that does not affect either the cash flow or net income.

214 In the particular case of Romania and the *regii*, we have also observed the use of unearned revenues as a way to bridge-finance the shortfall of cash at the end of the year. Similarly, this is sometimes compensated by an increase in prepaid expenses. Both are a masked form of short-term financing.

Table 27
Cash Flow Analysis (constant 1995 lei, thousands)

RAGCL Oradea	1994	1995	1996	1997
Net Income	**(131,774)**	**100,508**	**942,679**	**1,767,797**
Cash Flow from Operations				
Adjust Net Income to net cash provided by operating activities				
Add back depreciation, amortization, provisions	905,486	3,205,850	3,488,405	1,068,162
Adjust for change in assets and liabilities				
Add back increase in A/P and any other payable (including accrued liabilities and penalties)	8,035,437	2,552,423	2,410,445	2,481,434
Subtract increase in A/R and any other accrued receivable	(9,178,404)	(2,555,355)	(13,536,660)	(8,046,007)
Subtract increase in any of the Inventory	(1,273,114)	427,952	193,220	310,586
Net Cash Flow from Operations	**(1,642,368)**	**3,731,379**	**(6,501,910)**	**(2,418,028)**
Cash Flow from Investments				
-/+ (Purchase) / sales of property, plant and equipment				
-/+ (Purchase) / sale of other investments				
Net Cash Flow from Investments	**0**	**0**	**0**	**0**
Cash Flow from Financing				
Subtract increase in prepaid expenses	(145,276)	(287,601)	88,181	
Add increase in unearned revenues	58,164	(58,042)	10,074,414	
Add increase in credits and loans	877,872	(532,774)	(377,458)	
Subtract dividends paid to the owner		(50,254)	(471,340)	(883,899)
Net Cash Flow from Financing	**790,759**	**(928,671)**	**9,313,797**	**(254,721)**
Net Cash Flow for the Period	**(851,609)**	**2,802,708**	**2,811,887**	**(2,672,749)**
Beginning Cash	**921,068**	**69,460**	**3,099,709**	**6,782,773**
Ending Cash	**69,460**	**3,099,709**	**6,782,773**	**4,110,024**

Table 27 shows an example of the result of a net cash flow analysis for a specific *regia,* in this case RAGCL, which provides heating, water and waste water services in Oradea. This *regia* is the one that has had a consistently solid operating profit margin for the entire period included in the analysis. As Table 27 on the previous page shows, however, the profits, registered on an accrual basis, actually are masking growing difficulties collecting payments for services from clients. Cumulative accounts receivable grew by more than four times in real terms between 1994 and 1996. As a result, RAGCL had a substantial negative net cash flow from operations in 1994 and 1996, two years in which it recorded a profit on an accrual basis.

Cash Flow Analysis—Trends in Accounts Receivable

The problems of the *regii* stem from the growth in accounts receivable, that is, from the amounts billed to clients for services and not paid. Table 28 shows the trends in the cumulative value of accounts receivable by *regia* measured in constant 1995 lei, with 1994 as the base year. For nine of the ten *regii*, the receivables increased by two times or more over three years, and up to eleven times more in one case. RADET, the heating *regia* in Constanţa, stands out as a notable exception with no real growth in receivables during the period.

Obviously, the clients of the *regii* are unable or unwilling to pay for the services they receive. In the case of the *regii* that provide road construction and road maintenance services, the client is the *judet* or municipality, whichever has authority over the *regia.* It is surprising that some of the highest rates of growth of client arrears in real terms were recorded by these *regii*. This means that the *judet* or municipality is not paying the *regia*. As noted in the discussion of expenditures and financial management practices, deferred payments do not appear in the annual income and expense statement of local governments. These accumulated debts owed by the *judet* or municipality to the *regia*, therefore, serve to improve the overall annual results reported by the local government. This is a disturbing practice.

Table 28
Cumulative Change in Accounts Receivable (constant 1995 lei)

	1994	1995	1996 (estimate)
Judets			
RAJDP (Bihor)	1.0	3.8	5.5
RAJDP (Constanţa)	n/a	1.0	2.6
RAJA (Constanţa)	1.0	1.6	2.5
RADP (Dambovita)	1.0	3.6	8.8
Municipalities			

	1994	1995	1996 (estimate)
RA URBIS (Baia Mare)	1.0	4.3	7.9
RADET (Constanţa)	1.0	1.3	1.1
RATC (Constanţa)	1.0	2.2	3.3
RAGCL (Oradea)	1.0	1.3	4.2
RAOTL (Oradea)	1.0	6.1	11.0
RAGC (Târgovişte)	1.0	2.6	2.4

The majority of the *regii* included in the analysis sell their services to the general public. This means that households and firms that receive the services are not paying their bills.[215] This reflects a growing inability of the *regii* to pass on higher operating costs to their clients in the form of higher rates. Increasingly, the largest share of debtors are private households.

The study looked at the possible causes of the growing arrears in payments for services among private households. As described in greater detail in Appendix II, the analysis involved calculating the total burden per household of payments for all local taxes, fees and services. Household expenses were grouped in three categories:

- Category 1 includes expenses for electricity, transportation and telephone. This is a category of expenses for which the suppliers have an important "retaliatory power." That is, if the bills are not paid, the suppliers can either cut off the service provided (electricity and telephone) or refuse it (transportation) on an individual basis.

- Category 2 includes water, heating, hot water supply, and garbage collection. Households can delay payments for these services for long periods. For one, in the case of blocks of flats, it is physically impossible to cut of the services for those households that are in arrears without also cutting off service to their neighbors who are current. For another, the *regii* have a difficult time cutting off services for water and heating because of its social impact.

- Category 3 includes the taxes on property and cars which are paid once a year to the local government.

Household income data for Constanţa, Târgovişte and Oradea was taken from a study prepared for the EBRD.[216] Income data for Baia Mare was developed directly using data provided by the branch of the National Commission for Statistics in that city.

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[215] The case of RATC Constanţa is somewhat different. In the case of this *regia*, the arrears are owed by the firms that sell transportation tickets on its behalf and by firms that place advertisements on the buses and trams.

[216] The study was conducted by the Dutch consulting firm Haskoning and The Center for the Improvement of Management Performance (CIMP) in November 1996.

Table 29, below, summarizes the results of the analysis for households in the second and fourth deciles of the income distribution in each city, indicated in the table as “20th” and “40th.”

The results have to be interpreted with caution. Income data used in the analysis is not based on a representative sample in each city. In addition, income levels may be underestimated because the persons interviewed may not have distinguished between income from salaries only and total income which includes salaries and other sources of household income. In any case, the order of magnitude of the results shows that many households probably do pay a high percentage of their total income for taxes, fees and services. In a country in which food costs represent more than 50 percent of the income of lower income households, adding anywhere between 23 and 50 percent more for taxes, fees and services clearly places a huge burden on

Table 29
Total Annual Tax and Utility Payments (percent of household income)

	Category 1		Category 2		Category 3		Total Tax and Services	
	20th	40th	20th	40th	20th	40th	20th	40th
Constanţa	13.8	7.0	21.2	10.8	0.8	0.4	35.7	18.2
Târgovişte	12.1	6.2	24.4	12.5	0.7	0.4	37.2	19.1
Baia Mare	8.5	n/a	14.4	n/a	0.4	n/a	23.4	n/a
Oradea	13.0	6.5	37.8	18.8	0.7	0.4	51.6	25.6

the family budget. It is interesting that the share of household expenditures in Category 3, which includes only local taxes is very small. The largest share corresponds to Category 2, which includes water, heating and hot water.

Under these circumstances, it is not surprising that the *regii* are having difficulty passing on to their clients any increase in their production costs. The situation will not improve simply by becoming more aggressive in collection efforts. There are households that genuinely cannot afford to pay the full range of local taxes, fees and services. Existing subsidies available to compensate for high energy costs and for transportation are not means tested. That is, they are not allocated based on an analysis of the ability to pay of individual households. It may be necessary to institute a new subsidy scheme that addresses the needs of specific households with lower incomes.

Cash Flow Analysis—Trends in Accounts Payable

Because of the increase in accounts receivable, the working capital of the *regii* has been largely financed through a corresponding increase in accounts payable. Table 30, below, shows the trend in the cumulative value of accounts payable of the *regii*, measured in constant 1995 lei.

Accounts payable have increased dramatically over the period from 1994 to 1996. The principal creditors are other public *regii*, especially the national energy utility, RENEL. The notable exception is RAJDP, the roads *regia* in Constanţa, which paid off 50 percent of its accounts payable outstanding at the beginning of the period.

The *regii* have used other techniques to generate cash. Some have accelerated income from future years by negotiating agreements with large institutional clients to prepay services. Others have shielded income from taxation by increasing the depreciation expense. Yet others have borrowed funds to replenish their cash reserves. Except for the increased depreciation expense, none of these techniques represents a sustainable response to the underlying problems of the *regii*. They are simply measures to allow the *regii* to remain solvent for some additional period of time.

Table 30
Cumulative Change in Accounts Payable (constant 1995 lei)

	1994	1995	1996 (estimate)
Judets			
RAJDP (Bihor)	1.0	5.7	16.8
RAJDP (Constanţa)	n/a	1.0	0.5
RAJA (Constanţa)	1.0	1.6	2.3
RADP (Dambovita)	1.0	2.1	6.8
Municipalities			
RA URBIS (Baia Mare)	1.0	2.7	4.2
RADET (Constanţa)	1.0	1.8	1.7
RATC (Constanţa)	1.0	3.0	2.9
RAGCL (Oradea)	1.0	1.4	1.7
RAOTL (Oradea)	1.0	1.7	3.1
RAGC (Târgovişte)	1.0	2.0	2.7

Net Cash Flow—Actual Results

Because of the parallel increase in the level of receivables and payables, the analysis of net cash flow from operations produced a pattern that tends to follow operating results. That is, a *regia* with an operating profit in a given year also has a positive cash flow from operations in that year. A *regia* with a loss has a negative cash flow. This was the case in twenty of twenty-eight years for which data was available for the ten *regii*. Five *regii* succeeded in generating a positive cash flow from operations despite recording a loss. Three *regii* had a negative cash flow from operations despite reporting a profit. Tables 31 and 32 show the trend from 1994 to 1997 of the value of cumulative cash generated from operations and net overall, respectively. In general, the *regii* appear to be dealing with their short-term cash position successfully.

Four *regii* show some signs of having cash problems. RAJDP Constanţa has a negative ending cash position from operations, as well as minimum ending cash balance overall. This is the result of a 260 percent increase in accounts receivable in 1996. This is not necessarily part of a continuing pattern. The *regia* should recover in 1997. RATC Constanţa also has a negative ending cash position from operations and a declining overall ending cash balance in 1996. This shows the combined impact of an operating loss in 1996 and of steps taken by the management of the *regia* to reduce its accumulated accounts payable. Should the losses continue, RATC may face serious solvency problems in 1997. The public works *regia* in Târgovişte, RAGCL, has a negative ending cash position from operations. It reflects a 211 percent increase in receivables in 1996. The *regii* negotiated an equally large advance payment for services to be provided in 1997. This unearned income produced an overall increased in the ending cash balance for 1996. Obviously, this is not a sustainable practice. Finally the heating *regia* in Constanţa, RADET, shows a consistently declining net cash flow from operations for the period from 1994 to 1996. The *regia* also has borrowed funds in each of those years to maintain a positive ending cash balance. Should this pattern continue, RADET may face difficulties securing short-term

Table 31
Cumulative Change in Net Cash from Operations (constant 1995 lei)

	1994	1995	1996 (estimate)
Judets			
RAJDP (Bihor)	1.0	5.6	8.0
RAJDP (Constanţa)	n/a	1.0	(3.5)
RAJA (Constanţa)	1.0	10.7	12.1
RADP (Dambovita)	1.0	3.4	7.0
Municipalities			
RA URBIS (Baia Mare)	1.0	1.0	5.4
RADET (Constanţa)	1.0	0.9	0.4
RATC (Constanţa)	1.0	3.1	(6.7)
RAGCL (Oradea)	1.0	5.1	(2.0)
RAOTL (Oradea)	1.0	1.0	1.1
RAGC (Târgovişte)	1.0	0.3	1.7

Table 32
Cumulative Change in Net Overall Cash (constant 1995 lei)

	1994	1995	1996 (estimate)
Judets			
RAJDP (Bihor)	1.0	6.1	7.7
RAJDP (Constanţa)	1.0	1.3	0.3
RAJA (Constanţa)	1.0	8.4	9.0
RADP (Dambovita)	1.0	3.5	7.1
Municipalities			
RA URBIS (Baia Mare)	1.0	1.0	2.7
RADET (Constanţa)	1.0	0.2	11.4
RATC (Constanţa)	1.0	1.6	0.7
RAGCL (Oradea)	1.0	44.6	97.7
RAOTL (Oradea)	0.0	1.0	1.1
RAGC (Târgovişte)	1.0	0.4	2.4

loans. If the imbalance in operating results is not corrected, the *regia* could face serious solvency problems.

Impact on Finances of the Municipality

All ten *regii* included in the analysis show one or more symptoms of strains that could have an adverse impact on their financial condition. Five of the six *regii* that provide services to the general public operated at a loss in at least two of the three years from 1994 to 1996. This may reflect a problem passing on cost increases to their clients in the form of higher prices. A growing volume of accounts receivable, common to all ten, suggests that the clients of all the *regii* increasingly are unable or unwilling to pay for the services they receive. The *regii* have adjusted to this problem by deferring payments to their creditors and through other measures, such as short-term cash management loans and negotiating advance payment for services. These measures have worked for now, but they do not address the underlying root problems.

If this pattern continues, some of the *regii* could face serious solvency problems in 1997 or 1998. These problems will spill over to the *judets* and municipalities. Presumably, the *regii* will be operating at a loss. Therefore, the local governments will not receive either their share of the tax on profits or from the distribution of profits from the *regii*. This is the most immediate impact. It is not significant in the overall revenue picture of the local governments. The more serious problem for the *judets* and municipalities will be how to address the breakdown in the delivery of one or more basic local services. The local governments are not financially liable for any payments owed by the *regii*. They do have a political and social obligation to ensure that their local citizens receive the services they demand and need. It is likely that the solution to the financial problems of the *regii* will have some impact on the finances of the local governments.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

As would be expected, there are considerable differences in the financial condition and in the administrative division of service responsibilities among the four *judets* and four municipalities included in the analysis. However, several general patterns emerged of relevance both to the future policy on decentralization and to the credit worthiness of local governments.

■ **Municipalities appear to be in significantly weaker financial condition than *judet*s.** Although the sample of local governments was selected by USAID and EBRD largely on programmatic criteria, and thus does not constitute a representative sample, the difference between municipal and *judet* finances was striking. The growth of both revenues and expenditures has been considerably faster at the municipal level than at the *judet* level, as local service delivery has been focused on municipal governments. For all of the municipalities examined, there was significant real growth in both revenues and expenditures over the period 1993-1996.

Although growing faster in their total budgets, municipalities also were far more likely to be incurring operating deficits. The municipalities in the sample had operating deficits in 13 of the 15 years for which operating budget data were available. In contrast, the *judets* in the sample incurred operating deficits in only one of the 13 years for which financial results were available.

Municipalities have been going through a period of very rapid fiscal change, much of it beyond their administrative control. The operating deficits of the municipalities in the sample reflect their inability to fully keep up with this change, despite real growth in revenues. The instability of financial conditions clearly has implications for municipal capacity to borrow. Until municipal budgets are further stabilized through national legislation, the recent record of individual operating deficits implies that municipalities will have a difficult time clearing the way for debt service.

■ **National rules and practices regarding local finances create obstacles to sound financial management at the local level.** Local governments in Romania are buffeted by a great deal of intergovernmental uncertainty. They must prepare their initial budgets each year without having a clear picture of either their revenues or expenditures for the next year. They must manage their finances for several months of the fiscal year without knowing their actual intergovernmental revenues or their full expenditure responsibilities.

On the revenue side, the transfer of funds from the state budget follows practices that have lacked consistency or transparency from year to year. The rules governing local taxes and fees as well as the distribution of central revenues between *judets* and municipalities changed in each year between 1993 and 1996. Only now is the Government beginning to move toward clearly defined formulas that will establish local entitlements to revenue transfers.

On the expenditure side, both *judets* and municipalities were subject to numerous changes in functional responsibilities over the period. There was no consistent direction of change. Responsibility for spending on certain functions was shifted back and forth between the national and local governments and between *judets* and municipalities. Local governments also moved certain expenditures off budget by shifting them to local entities under their control.

Actual revenue distributions and expenditure responsibilities for local governments for any given year are included in the state budget, which is approved several months into the fiscal year.

Faced with growing pressures to balance revenues and expenditures, some of the local governments are turning to solutions that may not be sustainable in the long run. There is evidence of a growing propensity to carry forward from one fiscal year to the next some part of expenditures as accounts payable. This has the effect of reducing expenditures as recorded in the annual income and expense statement in the first fiscal year. On the opposite side, some local governments are carrying forward from one fiscal year to the next a substantial unpaid balance of funds borrowed for short-term cash management. This has the effect of increasing the revenues as recorded in the annual income and expense statement in the first fiscal year. These practices distort the picture of the financial condition of the local government. They also may be masking an underlying imbalance between revenues and expenditures.

■ **Many of the *regii autonomes* that provide basic infrastructure services at the local level face serious financial difficulties.** In general, the *regii* are having problems passing on increased operating costs to their clients. They face growing arrearages. To compensate and conserve scarce cash, many of the *regii* are delaying payment of bills to their creditors.

The *regii* that provide heating, hot water and public transportation services face the greatest difficulties. Several of them may run out of cash as early as 1997 or 1998. The problems are serious but less severe for *regii* that provide water and collect waste water. The *regii* that handle road maintenance and repairs and those providing solid waste collection are generally in acceptable financial condition.

■ **Poorer households face significant difficulties in paying for local services.** Payment of all local taxes, fees and service charges would require between 36 percent and 52 percent of the income of households in the bottom twentieth percentile of the income distribution in Constanţa, Oradea, and Târgovişte. Households in the bottom 40th percentile would have to pay from 18 percent to 26 percent of household income to cover all taxes and fees for their current consumption levels. The weight of fees, service charges, and local taxes in household income obviously constrains the extent to which new local debt can be incurred and repaid through user fees.

Recommendations

Many of the measures recommended in prior chapters of this report will begin to address the difficulties encountered in the management of finances at the local level. Among these are the need to establish a transparent, stable basis in law for wage-tax sharing and capital subsidies to local government. This process would spell out how the aggregate amounts of both transfers are to be determined and how the aggregate amount is to be allocated among municipalities. There also is a need to reform the current set of rules that discourage and prevent local officials from adopting a multi-year perspective on budgeting and financial planning at the local level, especially those that prohibit the accumulation and carry forward of local budget surpluses.

The analysis described in this chapter point to other, additional measures that are necessary to ensure sound financial management at the local level in Romania.

- There is a need to improve project planning and feasibility analysis practices among the local governments and *regii*, especially if local investments in infrastructure increasingly are financed at least partly with the proceeds of loans.

  Local governments and *regii* must compare the cost and risks of alternative strategies to finance capital improvements with the importance and priority of specific capital improvement projects. They must select the best approach and set the corresponding investment priorities. The first step is to conduct a complete analysis of the merits of individual projects. There are several techniques and approaches that a municipality can use in this process. They include economic, social and environmental analyses that look at the merits of the project in the broader context. A financial analysis will show to what extent the project could be self-financing. If all or part of the cost of operating and financing a project can be repaid from the revenues generated by the project itself, then the municipality may not need to provide as much, if any, financing for project operating and capital costs from its own budget. A technical analysis may show that the design modifications can lower the cost of the project.

  It is beyond the scope and purpose of this report to review and discuss these techniques. The important point is that before considering a project, a local government or *regia* should consider all the factors included in these various types of analysis. This need not be complicated or expensive. Sometimes, they may gain valuable insights simply by asking the right questions about a project before making a final decision to proceed.

- There also is a need to modify the accounting and financial reporting standards and practices that apply both to the local governments and to the *regii* so that they provide a more accurate picture of the financial condition of these entities. If local governments are going to be allowed to adopt practices in which both revenue and expenditure decisions have an impact across more than one fiscal year, then it will be important to ensure that the effect of these decisions on the financial results in each year are recorded and reported accurately. In the case of the *regii*, there is a need for measures to reflect the impact of growing receivables and payables on the current financial condition of the entities.

  All these measures taken together will eliminate the current obstacles to sound financial management at the local level. They will provide the authority and the tools which local officials need to address the financial challenge of meeting the demand for local services in their communities. They also will make those officials clearly accountable for the financial condition of the local governments. This will create an environment in which local governments can participate successfully in a system of credit financing for investments in infrastructure.

- The high cost of user fees relative to the level of income of poorer households argues for a national policy of income-targeted household subsidies for basic services, such as is now found in many countries. If the *regii* are to participate successfully in the credit finance system, they must be able to operate on a sound business-like basis. This means that they must act aggressively in pursuing collections of arrears from their clients. The *regii* will not be in a position to pursue such a course of action as long as there are households that genuinely cannot afford the monthly user fees. Existing subsidies do not address this problem.

APPENDIX A

DEFINITIONS

1996 Code	Category/Sub Category
	Recurring Revenues
	Local Taxes and Fees
	Shared National Salary Tax Revenues
	State Operating Subsidies
	Local Taxes and Fees
01.02.	Taxes on Profits of Regii
03.02.	Taxes and Fees on Individuals
04.02.	Fees for Use of State Property
05.02.	Corporate Property Tax
06.02.	Corporate Vehicle Fees
07.02.	Tax on Revenues from Agriculture
08.02.	Other Direct Taxes
17.02.	Other Indirect Taxes
	Shared National Tax Revenues
34.02.	Shared National Salary Tax Revenues
	State Operating Subsidies
37.02.01	Subsidies for Social Assistance, Heating & Public Transport
	Non-Recurring Revenues
	Non-Recurring Local Operating Revenues
	Local Capital Revenues
	Other Capital Revenues
	Non-Recurring Local Operating Revenues
15.02.	Entertainment Fees
20.02.	Distribution from Profits of Regii
21.02.	Revenues from Public Institutions
22.02.	Other Various Revenues
40.02.	Donations
	Local Capital Revenues
30.02.	Proceeds from the Sale of Public Property & Housing
45.02.	Proceeds of Short-term Loans
	Other Capital Revenues
37.02.02	State Capital Investment Subsidies
37.02.03	Capital Investment Subsidies from External Loans

46.02. Proceeds of Loans from Revolving Funds

APPENDIX B

ANALYSIS OF LOCAL TAX, FEE AND SERVICE BURDEN

Scope

The scope of this section of the study was to assess the financial burden of average households in each of the four cities studied. The importance of the analysis is that it can help shed light on how much the taxes and fees could be raised without increasing arrears among individual tax payers and service clients.

Sources of Information and Key Assumptions

■ **Household size.** The local branches of the National Commission for Statistics (CNS) were the source for the average number of persons per household. For Constanţa, Târgovişte and Oradea the analysis used an average of three persons household as recommended during the discussions at the local branches of the National Statistics Commission (CNS). For Baia Mare the figure used was 3.5 persons per household.

■ **Monthly household expenditures.** The local *regii* provided the estimates of the expenses for heating, hot water, transport and garbage collection in all four cities. Section II.6, below, explains the calculation of each expenditure. The analysis classified household expenditures in three main categories:

- Category 1 includes electricity, transportation and telephone. This is a category of expenses for which the suppliers have an important "retaliatory power". If the bills are not paid, the suppliers can either cut off the service provided (electricity and telephone) or refuse it (transportation) on an individual basis.

- Category 2 includes water, heating, hot water supply, and garbage collection. The payments for these services can be postponed with minimal consequences. For one, in the case of blocks of flats, it is not possible to cut off service to delinquent clients without harming the others. For another, there is an adverse social impact to leaving households without water and heating services

- Category 3 includes all local taxes on real property and cars.

■ **Household income.** The studies of affordability of water user fees in Constanţa, Târgovişte and Oradea prepared last November for the European Bank for Reconstruction and Development by the Dutch Consulting firm Haskoning and The Center for the Improvement of Management Performance (CIMP) were the source for the average household income data and for the monthly expenditures for water in those three cities. In the case of Baia Mare, the analysis used data supplied by the local branch of the CNS to estimate the average household income. All the estimates on income and expenses were considered to be valid as of December 1996.

Table B.1, below, shows the average household income for each of the four cities. The difference in methodology may account for the difference between the average incomes calculated for Baia Mare and the other three cities. Another possible explanation is the fact that

Table B.1
Average Annual Household Income in the Four Cities (lei)

	Lowest Income	Ratio of Lowest income to Lowest Income in Baia Mare (percent)	Average Income	Ratio of Average Income to Average Income in Baia Mare (percent)
Constanţa[a]	2,100,000	58.96	6,710,196	82.82
Oradea[a]	2,100,000	58.96	6,032,424	74.46
Târgovişte[a]	2,100,000	58.96	6,277,320	77.48
Baia Mare[b]	3,561,960	100.00	8,101,716	100.00

Notes
a Source: Haskoning and CIMP studies.
b Results obtained by Urban Institute using information supplied by CNS branch in Baia Mare.

many employees in Baia Mare are working in mining where the salaries are higher. If this were the reason for differences in reported income, however, the second highest levels would be in Târgovişte where many persons work in the COST steel mill where the salaries are also high. In December 1996, the net average salary in steel mills represented 91.5 percent of the net average salary in mining, while according to the table below the average income in Târgovişte is 77.48 percent of the average income in Baia Mare. The result is not absurd in itself, but raises a note of caution about the issue of calculating the average household incomes using two different methodologies.

Results

Table B.2 shows the comparison in household expenditures as a percent of income in all four cities. The largest share of household expenditures falls into the second category with water, heating and hot water accounting for the highest costs. The range in absolute terms is between an average monthly amount of 52,317 lei in Constanţa up to 94,569 lei in Oradea. The amount of the monthly utility fees in Oradea is higher by 25 percent than those in Baia Mare, which ranked second.

The price the population pays for electricity, telephone and per giga-calorie (Gcal) for heating is the same all over Romania. The difference in prices the *regii* charge for the services can be explained by their relative efficiency and by the level of service they offer. It is difficult to compare costs because the level of service differs. For example, Oradea has water, hot water and heating twenty-four hours a day, while Târgovişte has water only about eight hours a day and hot water for even a shorter period depending on the temperature outside. Local weather conditions also have an impact on monthly expenditures. For example, generally in Constanţa the weather is milder and the severe winter weather does not last as long. This would reduce household expenditures for heating.

Table B.2
Annual Tax and Utility Expenditures (percent of household income)

	Category 1		Category 2		Category 3		Total Tax and Utilities	
	Low	Average	Low	Average	Low	Average	Low	Average
Constanţa	13.76	4.31	21.20	6.63	0.75	0.23	35.71	11.18
Târgovişte	12.11	4.05	24.37	8.15	0.73	0.25	37.22	12.45
Baia Mare	8.53	3.75	14.44	6.35	0.43	0.19	23.41	10.29
Oradea	13.04	4.54	37.82	13.16	0.73	0.26	51.58	17.96

Finally, as mentioned earlier, different *regii* use different ways to calculate the average consumption of heating per family. This makes it more difficult to make comparisons among them.

Future Developments

The process of transition in Romania will be accelerated by the new government. The liberalization of prices (energy, transport and telephones included), the free foreign exchange market and the restructuring of the economy will have an impact on household income in a way that is hard to predict at this point. Local economists anticipate that the impact of the new measures will begin to show most probably during the last quarter of 1997.

That is why it will be important to assess the local tax and fee burden on the households again at some future date using a statistically representative urban sample of Romanian towns. At that time, it will be important to ensure the participation of the National Statistical Commission and/or of the specialized research institutes, such as CURS or IRSOP.

Detailed Tables by City

Table B.3
Tax and Utility Annual Burden—Baia Mare (lei per year)

	Amount	Lowest Income	Average Income
Household income		3,561,960	8,101,716
Electricity	120,000	3.37%	1.48%
Telephone	30,000	0.84%	0.37%
Transport	154,000	4.32%	1.90%
Subtotal	*304,000*	*8.53%*	*3.75%*
Water	66,066	1.85%	0.82%
Heating	217,128	6.10%	2.68%
Hot water	201,432	5.66%	2.49%
Garbage	29,750	0.84%	0.37%
Subtotal	*514,376*	*14.44%*	*6.35%*
Property tax	14,000	0.39%	0.17%
Car tax	1,400	0.04%	0.02%
Subtotal	*15,400*	*0.43%*	*0.19%*
Grand Total	*833,776*	*23.41%*	*10.29%*

Table B.4
Tax and Utility Annual Burden—Târgovişte (lei per year)

	Amount	Lowest Income	Lowest 40% Income	Average Income
Household income		2,100,000	4,103,244	6,277,320
Electricity	120,000	5.71%	2.92%	1.91%
Telephone	30,000	1.43%	0.73%	0.48%
Transport	104,328	4.97%	2.54%	1.66%
Subtotal	*254,328*	*12.11%*	*6.20%*	*4.05%*
Water	159,443	7.59%	3.89%	2.54%
Heating	181,376	8.64%	4.42%	2.89%
Hot water	144,000	6.86%	3.51%	2.29%
Garbage	27,000	1.29%	0.66%	0.43%
Subtotal	*511,819*	*24.37%*	*12.47%*	*8.15%*
Property tax	14,000	0.67%	0.34%	0.22%
Car tax	1,400	0.07%	0.03%	0.02%
Subtotal	*15,400*	*0.73%*	*0.38%*	*0.25%*
Grand Total	*781,547*	*37.22%*	*19.05%*	*12.45%*

Table B.5
Tax and Utility Annual Burden—Constanţa (lei per year)

	Amount	Lowest Income	Lowest 40% Income	Average Income
Household income		2,100,000	4,129,200	6,710,196
Electricity	120,000	5.71%	2.91%	1.79%
Telephone	30,000	1.43%	0.73%	0.45%
Transport	139,012	6.62%	3.37%	2.07%
Subtotal	*289,012*	*13.76%*	*7.00%*	*4.31%*
Water	122,125	5.82%	2.96%	1.82%
Heating	156,200	7.44%	3.78%	2.33%
Hot water	130,800	6.23%	3.17%	1.95%
Garbage	36,000	1.71%	0.87%	0.54%
Subtotal	*445,125*	*21.20%*	*10.78%*	*6.63%*
Property tax	14,000	0.67%	0.34%	0.21%
Car tax	1,750	0.08%	0.04%	0.03%
Subtotal	*15,750*	*0.75%*	*0.38%*	*0.23%*
Grand Total	*749,887*	*35.71%*	*18.16%*	*11.18%*

Table B.6
Tax and Utility Annual Burden—Oradea (lei per year)

	Amount	Lowest Income	Lowest 40% Income	Average Income
Household income		2,100,000	4,228,416	6,032,424
Electricity	120,000	5.71%	2.84%	1.99%
Telephone	30,000	1.43%	0.71%	0.50%
Transport	123,750	5.89%	2.93%	2.05%
Subtotal	273,750	13.04%	6.47%	4.54%
Water	145,985	6.95%	3.45%	2.42%
Heating	376,704	17.94%	8.91%	6.24%
Hot water	235,440	11.21%	5.57%	3.90%
Garbage	36,000	1.71%	0.85%	0.60%
Subtotal	794,129	37.82%	18.78%	13.16%
Property tax	14,000	0.67%	0.33%	0.23%
Car tax	1,400	0.07%	0.03%	0.02%
Subtotal	15,400	0.73%	0.36%	0.26%
Grand Total	1,083,279	51.58%	25.62%	17.96%

Calculation of Average Monthly Expenditures

The analysis used average amounts as follows:

- For electricity, the analysis used an estimate of consumption for the average family of 3 persons having refrigerator, TV, radio. The analysis considered that 30 percent of the households have a washing machine and 50 percent a 500 watt heater (which is common in Romania). The average monthly bill of 10,000 lei is probably under estimated for the household with an average income, but possibly over estimated for the poorest segment of households.

- For the transportation the methodology probably underestimates the number of journeys per day in using between 1.33/family/day for Târgovişte (where the industrial area is close to downtown) to 1.5 for Constanţa and Baia Mare.

- The analysis assumed that only 25 percent of the households have telephones.

- As mentioned for the water bills in Constanţa, Târgovişte and Oradea, the analysis used the figures given by average income category by the EBRD studies.

- For Baia Mare the analysis took into consideration the average water consumption per capita supplied by the local *regii*.

- For heating, the analysis used the data supplied by the *regii*. It is interesting to note that in some cases the *regii* calculated the average consumption per capita (Constanţa), in other they took into account the average thermal radiant area per household (Oradea) and in other cases the area of the average apartment (Târgovişte).

- The average hot water consumption/capita was provided by the local *regii*.

- The analysis assumed that 70 percent of the households are privately owned. This percentage is probably underestimated. Nevertheless, the weight of this tax burden is insignificant if one considers it within the framework of the whole picture of tax and utilities burden.

- The analysis assumed that 10 percent of the households have a Romanian made Dacia car (which is the most common) with an annual tax of about 14,000 lei.

APPENDIX C

MUNICIPAL CREDIT FACILITY ANALYSIS
NATIONAL TEAM

LIST OF PERSONS MET
JANUARY 27-FEBRUARY 8, 1997

Romanian Parliament/Chamber of Deputies

Ioan-Sorin Marinescu	Deputy Secretary of the Commission for Public Administration, Regional Planning and the Environment	

Ministry of Finance

Dan Rasu Ruşanu	Secretary of State	410-3500 x2163
Constantin Ene	General Director, Foreign Exchange Directorate	410-0592
Marin Cojoc	Director General Adjunct, General Directorate for the State Budget	410-7767
Viorel Cristea	Chief of Service, Coordination of Local Budgets	410-3400 x1180
Georgetta Soviani	Chief of Service, Synthesis of Local Budgets	410-3400 x1030
Mrs. Monolescu	General Director, Accounting Department	410-3400x2405
Mariana Dragoi	Chief of Service, Balance Sheets	
Marina Antofie	Expert	
Mrs. Cornelia Petranu	Deputy General Director, Direct Taxation	410-1651
Keith J. Krchak	U.S. Department of the Treasury, Government Securities Advisor	410-0833
Richard Bartholomew	U.S. Department of the Treasury, Advisor	410-1949

Ministry of Public Works and Regional Planning

László Borbély	Secretary of State	614-1690
Ioana Chirva-Suţă	Secretariat for MUDP II (?)	615-6286

Department for Local Public Administration

C. Geo Călugăru	Director, Department of Local Public Administration	311-0140
ing. Doru Mustăţoiu	Director, Department of Control and Synthesis	222-3674
Dan Zaharia	Government Inspector	
Mihai David	Government Inspector	

Office of Competition Policy

Mr. Prigoreanu	Under-Secretary of State	

Federation of Municipalities of Romania

Ileana Pascal	Director	
Irina Frimu	Program Assistant	

Other Institutions

USAID / Bureau for Eastern Europe and NIS

Nancy Hooff		
Bonnie Walter	Program Manager	(202) 736-4411

USAID / Bucharest

Roberto Figueredo	Director, Office for Democracy, Energy and Environment	336-8851
C. Scott Johnson	Senior Public Administration Advisor	336-8851
Ruxandru M. Datcu	Office for Democracy, Energy and Environment	336-8851
Raymond H. Morton	Private Sector Development Officer	336-8851

European Bank for Reconstruction and Development

Dana Craciunescu	Project Officer	210-5521

Haskoning

Johan E. Schaapman	International Coordinator, Division of Environmental Affairs	(3124) 328-4284
Vasile Ciomos	MUDP II	781-7381

Bank Nederlandse Gemeenten

Reinier van Woerden	Head Corporate Planning and International Department	

Dimensie Advising and Management

Egbert van der Pol	Senior Advisor	