

LOCAL INDEBTEDNESS – A VIABLE OPTION FOR ROMANIA TO OVERCOME THE CRISIS?

Irina Bilan, Florin Oprea, Elena Cigu

Abstract

The economic and financial crisis consistently affected national economies, while reviving political and scientific disputes on possible exit strategies. Although it is obvious that local economies are able to act as driving factors for national development, some national authorities, including Romanian ones, had a narrow vision in coping with the crisis, generating policies less oriented towards supporting local communities.

The main purpose of our research is to determine whether, under Romania's specific conditions (economic, financial and legal ones), local indebtedness could be a viable alternative, identifying both weaknesses of the strategy applied and possible solutions.

The main deficiencies we identified refer to the undifferentiated treatment of local governments' indebtedness capacity and to the lack of concern for granting guarantees for private loans and for stimulating municipal associations, for which we proposed some possible reconsiderations of the legal framework.

Key words: local indebtedness, economic crisis, exit strategies, indebtedness capacity, economic development

JEL Code: H12, H74

Introduction

The economic and financial crisis emerging in late 2008 strongly affected European economies, claiming for major interventions by the national and European monetary and financial authorities in order to support banks in trouble and help the economies in recession resume economic growth. Although the manifestation of the crisis registered particularities in afflicted economies, thus requiring for adapted solutions, the concern for sustaining and increasing investments can be noted as a central pillar, always part of the stabilization and growth strategies. The need to increase investment expenditures on the account of current

(consumption) ones, more significant in terms of the social sacrifices and sometimes electoral costs entailed, can be justified both by the immediate effect on fostering demand, as driving factor for the growth of production, and the positive effects over the medium and long term on the national productive potential.

The anti-crisis programs were most often directed from the central government level, probably as an expression of assigning state's responsibilities to different administrative levels, the central authority being responsible for the macroeconomic stabilization and redistribution of incomes. However, we cannot ignore that engines of national growth and development can also be found at local level, while the effects of the crisis were felt unequally at this level, requiring for particularized treatment and solutions. For our analysis, it is relevant that the evolution of regional GDP registered substantial disparities and the decision to stimulate investments should have been particularized, taking into account local indebtedness capacity.

Our research aims to highlight the correlations between local public investments, financing them by borrowing and the existence of a real capacity to support them in Romania, the ultimate goal being to decide whether local indebtedness is a viable alternative for Romania, in the context of anti-crisis strategies. The response follows four main directions: (a) what is the connection between public investments and local indebtedness and how can it be customized on the background of a crisis?, (b) was this connection taken into account when designing Romanian anti-crisis policies?; (c) how realistic is the option to stimulate local investments, considering the effective indebtedness capacity of Romanian local communities?, (d) what are the recommendations for reconsidering Romanian public policies?

In order to analyze the above mentioned issues, we made use of relevant official statistical data on Romania's current situation reported by national or European authorities, such as the Ministry of Public Finance, the National Institute for Statistics and the European Commission. On the basis of these data we computed well-known indicators on local public debt, its service, etc., that we considered being relevant for our analysis and conclusions.

Issues related to the scope of our research are largely treated in the literature. There are many studies referring to the composition of economic recovery strategies adopted by different countries, including Romania, on the background of the economic crisis emerging in late 2008. Most of them insist, however, mainly on the effects and responses of policy makers at central level, only few of them touching the issues of our research, namely the effects and reactions of local entities (among the most representative are (Cohen, 2011), (Council of

European Municipalities and Regions, 2009), (Kenneth, 2011), (Paulais, 2009), (United Cities and Local Governments, 2009)) and none of them referring to the particular situation of Romania. Also, it is confirmed by numerous theoretical and empirical studies the role of local public investments, mainly infrastructure ones, as engines for economic growth and development, both at sub-national and national level, for the economy as a whole ((Horens and Chevallier, 2006), (Stansel, 2009)). There are not however, as far as we know, studies that distinctively analyze the possibility of using local investments as engines for economic recovery considering the particular context of the current crisis, given the restrictions (primarily of financial nature) that arise or amplify on such a background.

The added value of our research therefore comes from establishing the potential correlations between local indebtedness, local investments and economic recovery on the background of the crisis, as well as from highlighting the way these correlations were taken into account when designing the Romanian anti-crisis strategy, as support for formulating some public policy recommendations. This study continues some of our previous work on the issues of loans, investments and indebtedness capacity of Romanian local governments ((Bilan and Oprea, 2011), (Oprea and Bilan, 2011)).

1 Economic crisis exit strategies and local indebtedness – what is the connection?

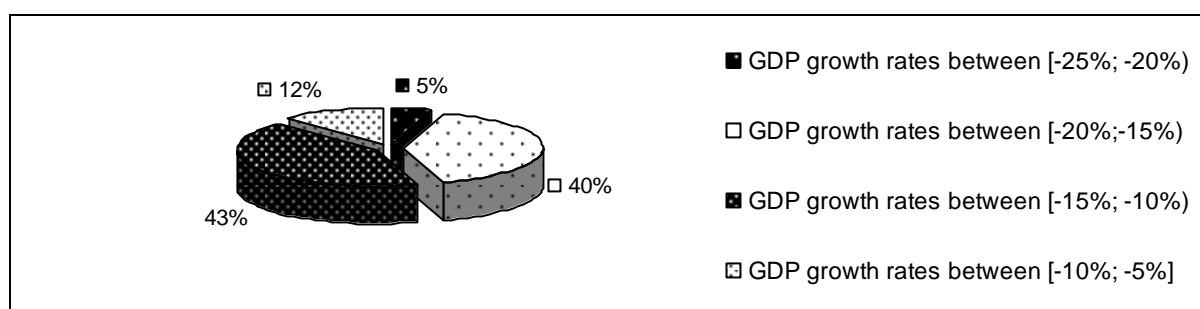
Usually, the financial policy objectives of economic stabilization and growth stimulating are associated with the decisions and actions of the central authorities. At the same time, however, a large part of the socio-economic activities are effectively carried out at local level. In these circumstances, it is justified to more carefully look at the theoretical possibility to deal with the crisis through measures generating upward effects from the level of local communities.

Such an approach would have as core element economic growth resulting from increased investments, the financing of which is, in times of crisis, put in balance with the obligation of providing public services, often being easier to suspend or abandon investment plans. Basically, the reduced local public revenues as a result of the crisis also affect the co-financing capacity of local administrations, restricting the potential access to European funds. Thus, the only viable theoretical alternative remains that of local borrowing, at its turn depending on local financial capacity, guarantees and central authority's authorization, conditional on falling within the legal local indebtedness ceiling.

The viability of such an approach finds rationality in the legally imposed condition that the amounts borrowed by local authorities have to be used only to finance investment projects, either directly or by providing co-financing resources for projects financed from EU funds, current expenditure being excluded.¹

In Romania, the magnitude of the crisis effects was felt unequally at the level of local communities, significant differences being registered from one regional group to another, as reflected in Figure 1. Thus, GDP per capita has decreased in 2009 compared to 2008 with 15.38%, compared to an EU average of only 6%. At local level, this average hides significant differences from one county (NUTS 3 region) to another, with minimum GDP contraction of 5.71% in Giurgiu and maximum 21.27% in Galati.

Fig. 1: Distribution of regional GDP growth rates between 2008 and 2009 by NUTS 3 regions*



*data were compiled using GDP per inhabitant (expressed in EUR/inhabitant) of Romanian NUTS 3 regions; (-) indicates a decrease in regional GDP

Source: computed by the authors, data from EUROSTAT

The above highlighted situation, showing obvious and deep discrepancies of regional GDP contraction, should have been considered as a consistent reference point in formulating the anti-crisis programs, mainly when deciding upon investment financing. So, it would ensure a rational treatment of the cause-effect links, budgetary measures with clear target being outlined. Although it appears to be obvious the need to complement anti-crisis measures adopted at central level by specific measures taken at lower administrative levels and adapted to the particularities and intensity of crisis manifestation at every administrative level, this, as we will see throughout the paper, did not happen.

¹ the Act of Local Public Finance no. 273/2006, art. 61(1)

2 The Romanian crisis exit strategy – was local indebtedness part of the equation?

Defining the content and imposing the Romanian anti-crisis strategy can often be characterized as brought to extremes. On the one hand, in early 2009 public authorities were still announcing that Romanian economy was not going to be affected by the crisis, and measures were taken with great delay and often had large legal gaps. On the other hand, the main focus was, surprisingly for an unconsolidated system, on reducing public expenditure, mainly transfer ones and not investments (as it would have been easier, for political and electoral considerations). However, beyond the good intentions materialized in the strategy, legal difficulties forced public authorities to increase taxes, while the intended consistent growth of investment allocations cannot be identified within the officially reported data (on the contrary, the data provided by Eurostat show a reduction of general government gross fixed capital formation of more than 10% from 2008 to 2010).

As Romanian economy, strongly afflicted by the crisis, generated decreasing public revenues both at central and local budgets, and as an increase of structural funds absorption level, by the way very low, was not registered, the investment core of the strategy should have generated, as naturally expected, an increase of public debt. The data in Table 1 indicate a fast increase of central government debt, correlated with an opposite situation at local level, while investment subsidies from the state budget to local budgets have not changed significantly. Also, a substantial share of the resources borrowed by the Romanian Government was directed to supporting state social insurance budget, which was very close to collapse. Under such circumstances, it is indisputable that local indebtedness for investment purposes should have been taken into account as a complementary way of action to cope with the crisis.

Tab. 1: Romanian local and general government debt before and during the crisis (2007-2011)

Indicators	2007	2008	2009	2010	2011
General government debt (million RON)	82324.3	109795.1	147329.0	194459.2	222768.7
General government debt (% of GDP)	19.79	21.33	29.40	37.21	38.50
Annual general government debt growth rate (%)	29.97	33.37	34.19	31.99	14.56
Local government debt (million RON)	6174.7	9238.7	10835.2	11948.9	12533.7
Local government debt (% of GDP)	1.48	1.79	2.16	2.29	2.17
Annual local government debt growth rate (%)	77.83	49.62	17.28	10.28	4.89

Source: computed by the authors, data from the Ministry of Public Finance

The developments highlighted in Table 1 lead to the conclusion that the vision of anti-crisis program was a poor one. Instead of seeking to heal the real economic processes generating economic growth, thus dealing with the causes of the problem, the main concern was to fall within the 3% of GDP budget deficit target (thus aiming at the effects). The formal and obviously unproductive orientation towards respecting the conventional deficit target implicitly became a conditioning factor for local investments, mainly through administratively reducing local indebtedness ceilings. A paradox is the fact that reductions are also planned for the next two years to come.²

Under these circumstances, the authorizations for contracting or guaranteeing local loans shrunk consistently, the strongest effect being registered at lower administrative levels - villages and towns (Table 2).

Tab.2 : Number of administrative-territorial units that have received authorization from the Commission for Local Loans Authorization (CLLA) for contracting or guaranteeing of local loans (2008-2011)

Number of administrative-territorial units	2008	2009	2010	2011
Counties	12	6	12	11
Municipalities	32	40	46	31
Towns	30	22	38	19
Villages	145	70	108	150
Bucharest Sectors	1	4	2	3
Total	220	142	208	214

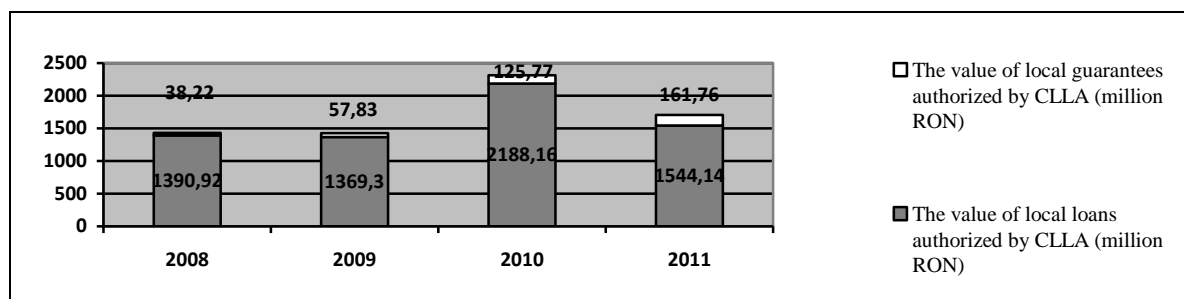
Source: computed by the authors, data from the Ministry of Public Finance

Also in formal terms, there are some signs of recovery, direct loans and authorized guarantees recording a trend of growth (Figure 2). However, we consider this situation disputable as long as the effective indebtedness capacity of Romanian local governments is, as previous studies demonstrate (Bilan and Oprea, 2011) questionable. An incontestable

² according to the Fiscal-Budgetary Strategy for 2012-2014, local governments' ceiling for contracting loans will be reduced from 900 million lei in 2012 to 800 million lei in 2013 and 2014 while the withdrawals ceiling will be reduced from 1400 million lei in 2012 to 1200 million lei in 2013 and 2014

argument in this respect is the evolution of local indebtedness indicators in Table 1, which shows a decrease of local government debt as % of GDP in 2011 compared to 2010.

Fig. 2: Local loans and guarantees authorized by CLLA (2008-2011)



* loans and guarantees authorized in EUR and USD have been converted in RON at the exchange rate at the date of authorization

Source: computed by the authors, data from the Ministry of Public Finance

The identified developments, in connection with the objective assumed by public authorities of reducing general government deficit to 3% could suggest, to a careful analyst, a useful complementary solution: granting guarantees to viable local economic entities, guarantees that do not increase direct local government debt and do not engaging explicit local government financial commitments, thus affecting their overall financial situation. Moreover, such a solution could have been viable, allowing for the injection of capital to be precisely directed to real economic processes and thus, being more easy to avoid investments just “on paper” (for which expenditures are made only for studies, projects or documentations, eventually provided by foreign companies). This solution should have been complemented by orienting local guarantees towards private loans for co-financing projects benefiting from non-reimbursable financial assistance, under the condition of economic subjects’ viability and eligibility, thus supplementing the potential of local and national resources.³

3 Analysis of Romanian local governments’ indebtedness capacity – was there scope for any more debt?

The assessments on local indebtedness and its correlations with local investment requirements must also be verified from the perspective of Romanian local communities’ indebtedness capacity. For this we distinguish between the legal/theoretical indebtedness capacity and the

³ according to the legal framework in force, the loans for co-financing projects benefiting from EU financial assistance are not taken into account when establishing the ceilings for contracting local loans, making withdrawals or granting guarantees for private loans

effective one, according to the demarcation proposed in our previous research (Bilan and Oprea, 2011).

In Table 3 are presented summarized data on the overall legal indebtedness capacity of Romanian local authorities, prior to the crisis.⁴

Tab. 3: Overall share of local public debt service in local budgets' own revenues

Indicators/Year	2007	2008	2009
Own revenues of local budgets (million RON)	17317.4	20587.7	21117.6
Local public debt service (million RON)	769.2	1290.6	1732.3
Local public debt service/own revenues of local budgets (%)	4.44	6.27	8.20

Source: computed by the authors, data from the Ministry of Public Finance

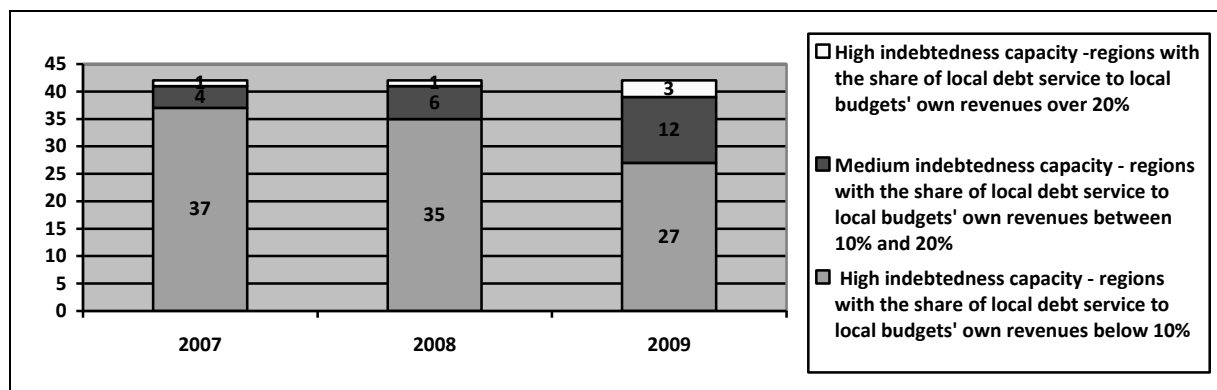
The data suggest that, in contradiction with the need for local resources and local investments, absolutely necessary especially in the field of infrastructure, Romania local authorities could not exploit in full the legal indebtedness limit (exploited only 27.33%), due to multiple explaining factors (the excessive prudence of local governments, the lack of experience, the underdeveloped capital market, the lack of guarantees etc..). Some of these factors (such as the access to capital markets and bank credit availability) were even potentiated during the crisis, exacerbating the situation. This deterioration is transmitted to the legal indebtedness capacity which, although still of 30%, is now reported to decreasing own revenues, thus meaning diminished effective rights to incur debt. This aspect was partially offset by the recent legal framework reconsideration establishing, as reference, the last 3 years average value of own revenues and not just the one of the year prior to the contracting, as in the initial version. Also, although rationally justified, the removal in determining the reporting base of capital revenues, donations and sponsorships, has further narrowed the possibilities of debt incurring.

Looking at the analytical indebtedness capacity of different administrative-territorial units, we can see that most sub-national collectivities had in 2007-2009 a high legal indebtedness capacity and less than 10% recorded a low capacity (Figure 3). This situation reveals that a more direct orientation of local authorities to support local investments via

⁴ we define the legal indebtedness capacity, in accordance with Romanian legal framework, as the result of the difference between the legal limit of the share of the local debt service in local own revenues, of 30%, and its actual level

borrowing, as part of the anti-crisis strategy, would have found fertile ground and could have been considered a viable alternative.

Fig. 3: Number of NUTS 3 regions by their indebtedness capacity*



Source: computed by the authors, data from the Ministry of Public Finance

Beyond the anti-crisis strategy's lack of vision, the allocation of resources for local investments still relies on a system that supports complaints and conflicts that lead to the counterproductive use of local actors' energy and resources. Thus, the distribution of transferred amounts from the state budget to balance local budgets is made in two steps, first to counties and then from there to other local communities. In the second stage, 20% of the amounts are allocated only for investment projects "on the basis of the decisions of the County Council". It is obvious that the lack of objective criteria for ranking investment projects and for correlating them with the real needs of the local community may allow for political affinities, the source of conflict being present even if sometimes the effects are dissimulated.

Another important issue extensively studied in some of our previous works and extremely relevant for the correlation with local investments, is the "procrustean approach" of the indebtedness capacity. Basically, we are dealing simultaneously with local communities with potential and effective indebtedness capacity over the legal limit, which in these cases acts as an inhibitor, and local communities with potential and effective indebtedness capacity below the legal limit, for which the mere legal provisions cannot act as an incentive to borrow. The logical solution would be to proceed to establishing personalized indebtedness thresholds for Romanian local communities, following the Portuguese model, at least for different types of administrative units, if not even individually. Another viable option could be stimulating municipal associations by differentiating inter-administrative transfers for individual subjects and associations, thus bringing together agents with potential and common

interests. Provided that the legal framework in force also allows taking into consideration the overall financial capacity of the association members when authorizing new loans, the more developed local actors, with potential, will become, as led by an invisible hand, engines for the less involved ones.

4 Conclusions and policy recommendations

The main conclusion of the paper is that the Romanian anti-crisis strategy was a poor one, not taking into account the viable alternative of creating the support for local investments, although such an approach would not have been an absolute novelty (the experience of other countries could have served as initial landmark). Analyzing the evolution of local public debt in Romania, we found an obvious discrepancy between its growth pace of that of central government debt, concluding that the orientation towards the effect and not causes, by formally seeking to fall into the budget deficit target, operated in a counterproductive manner.

We also highlighted as an objectionable aspect with consistent negative impact, the poor orientation towards granting loan guarantees to local economic entities viable or eligible for non-reimbursable financial assistance. We propose, in this respect, to establish a separate ceiling for the guarantees granted by local authorities (under the current legal framework, the public guarantees ceiling is treated globally, not distinguishing between local and central authorities), thus opening another valve for collectivities with high potential.

Regarding the correlation with Romanian authorities' financial capacity, we highlighted the shortcomings of the current system, where the legal capacity appears to be independent to the effective one and economic realities, and proposed to personalize this legal capacity, at list for major types of collectivities.

Finding a gap between the effective and legal financial capacity of different local communities, we proposed as solution to stimulate municipal associations by differentiating inter-administrative transfers for individual subjects and associations and taking into consideration the overall financial capacity of the associative structure when authorizing new loans. The immediate effect of bringing into the scene communities with reduced potential on the account of those with high potential will automatically be reflected, over the medium and long term, in increased investments (due to the above mentioned legal condition), with direct relevance for exiting the crisis and the development of national economy.

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Contact

Irina Bilan

“Al. I. Cuza” University of Iasi

Bd. Carol I no. 22, Iasi, 700505 Romania

irina.bilan@uaic.ro

Florin Oprea, Elena Cigu

“Al. I. Cuza” University of Iasi

Bd. Carol I no. 22, Iasi, 700505 Romania

foprea@uaic.ro, elena28072001@yahoo.com