Ways to Finance Investments within the Local Public Administration

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ABSTRACT
The aim of this study is to disclose several ways to finance investments within the local public administration. The study has revealed that the investments in local public administration may be made by establishing public-private partnerships, attracting and using grant funds and using loans to finance public services and investments in local infrastructure with governments' warranties or local authorities' warranties. This study provides a realistic background for finding solutions to the problems encountered by the local public administration in order not only to surmount the economic crisis, but to upturn the international investments in Romanian infrastructure.

KEYWORDS: *economic recovery, investments, local public administration.*

JEL CLASSIFICATION: *H54, H71, H72.*

INTRODUCTION

This study investigates the ways to finance investments within the local public administration. The manner in which the investments made by the local public administration are financed is a highly debated topic these days because of its imperative role and major implications for the Romanian public administration.

The local authorities have the difficult task of managing difficult and complex issues of the local communities. The public authority ensures the management of financial resources, but their use is established on account of the electoral programs and surveys, so as to meet the strategic objectives to satisfy the immediate or future needs of the local communities.

The local communities in Romania and in the EU countries are called upon now to ensure local public services which meet the needs of permanent and temporary residents, whose character has proved, over time, to be unlimited. Human needs are many and varied and are amplified by the development of the society and country. Therefore, the development and diversification of public services were generally encouraged by the progress of the society, which has determined new necessities for the population. The local authority was tempted to satisfy these needs for reasons related to the general interest.

There is a confrontation between the financial resources which are typically deep limited, and the needs for public services, whose character is unlimited. Thus, the local communities are often put in a position to look for financial resources, using loans, when necessary, as an alternative to financing public services and local development.

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Firstly, this study reveals the European macroeconomic context in which the Romanian local public administration has to develop its activity, taking into account the economic growth, the contribution to GVA growth and also the anticipated growth in the EU10 countries.

Secondly, the paper proposes several ways of financing investments within the Romanian local public administration. Improving the management of the local public administration must be made by taking into account the macroeconomic context of Romania as the budget estimates for the years 2012-2014 are established based on the forecast of the macroeconomic indicators. The Romanian State Budget is facing nowadays growing constraints and therefore, the tendency to reduce the funding of public services and investments from this source is more and more evident and other sources have to be found. The study has revealed that there are three ways of attracting capital to finance the local public services, and these are other sources of local budget revenues that may be used in order to develop the Romanian infrastructure.

1. THE MACROECONOMIC CONTEXT

In early 2011, about two and a half years after the global financial crisis broke, economic output in the EU10 (i.e. Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia) had returned to the pre-crisis level. Helped by aligned business cycles and close trade and production linkages, economic activity in the EU10 rebounded in parallel with the EU15. Growth strengthened in the second half of 2010 (Figure 1), supported by restocking, a double-digit expansion of industry, and a rebound in consumption (The World Bank, 2011).

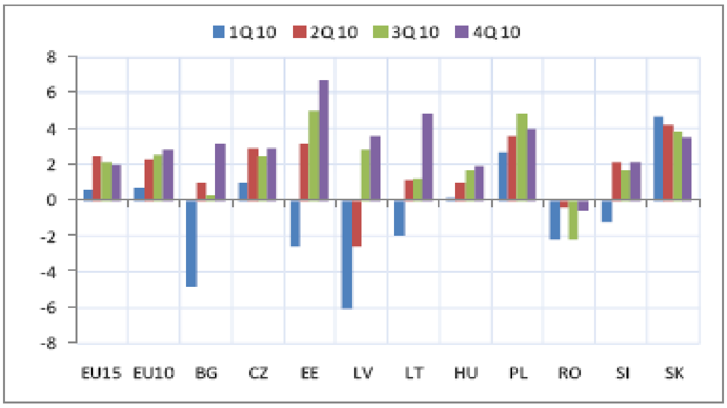

Figure 1. Quarterly growth rates in the EU10 countries
Source: The World Bank (2011), p. 4

The pace of the recovery differs across the EU10, reflecting, among other factors, the overheating prior to the crisis, trade openness and competitiveness. While the annual growth numbers are similar, the growth dynamics differed between the EU10 and EU15. Year-on-year growth in the EU15 peaked in the second quarter of 2010 at 2.8 percent. The growth has been reduced to 2.0 percent in the fourth quarter of 2010 due to volatile financial markets, the end of the restocking cycle and an unwinding of fiscal stimulus, even though net exports continued to support the expansion (The World Bank, 2011).

As some authors have revealed (Isărescu, 2009; Popa, 2009), the effects of the global financial crisis have expanded into the Romanian economy on five important channels:

1. The commercial channel (slow down or even reduction of the exports amount);
2. The financial channel (limited access to external financing, credit amount reduction, difficulties related to the private external debts service);
3. The exchange rate channel (reduced external financing, which materialized in depreciation of the national currency);
4. The trust channel (withdrawal of foreign investors from the Eastern-European countries, panic and speculative attacks on the monetary market);
5. The wealth and balance sheet effects channel (deterioration of the people' and companies' net assets, due to the high share of foreign currency credits correlated with the depreciation of the national currency and the decrease of speculative, unsustainable prices for movable and immovable assets).

In Romania, the effects of the economic crisis are visible in all areas of economic activity. Romania's economy has been hit hard by the global economic downturn. For instance, the gross domestic product, the financial markets, the fiscal deficit, the exchange rate and the government public debt are all affected by the world economic crisis (Zamfir & Ioniţă, 2009).

The contribution to GVA growth in the EU10 countries (Figure 2) shows that the accelerating growth in the EU10 during 2010 came with a broadening of growth across sectors.

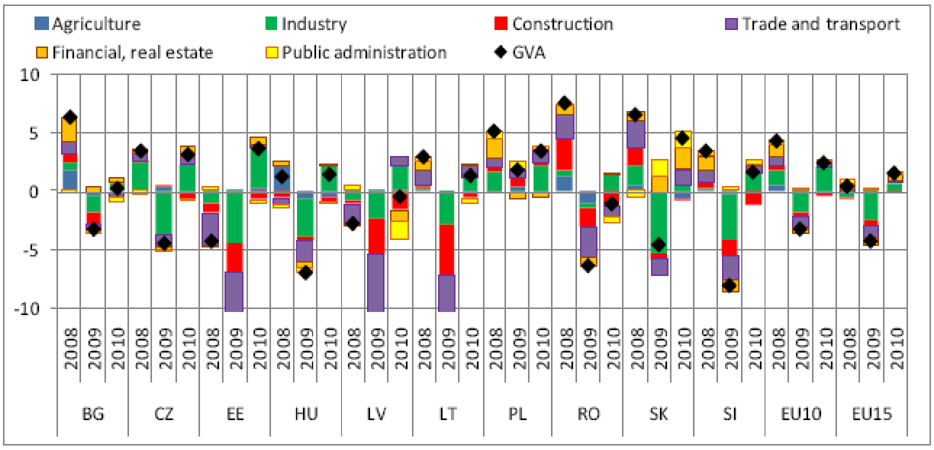

Figure 2. Contribution to GVA growth in the EU10 countries
Source: The World Bank (2011), p. 5

There was in the EU10 countries a double-digits growth of industry, reflecting the rebound in global demand for capital goods and durables and the deep integration with European production chains. In Estonia, industrial output, mainly manufacturing of radio, TV and communication equipment, reached record highs, as year-on-year growth accelerated from 4.2 percent the first quarter of 2010 to close to 30 percent in the fourth quarter of 2010. Growth in some EU10 countries spread to finance and real estate and strengthened trade, hotels and restaurants, and transport in the second half of the year. Public administration and community services remained subdued in light of fiscal pressures across the region (The World Bank, 2011).

The pace of the recovery in the EU10 is set to accelerate in 2011 and 2012 (Figure 3). The performance of Slovakia and Poland is set to remain solid thanks to limited pre-crisis imbalances, strong integration in European production networks, EU funds, and, in the case of Poland, stable consumption. Estonia, Lithuania and Latvia are likely to build on the export-led upswing, and growth could improve to about 4 percent by 2012 as domestic demand continues to recover. Growth in Slovenia, the Czech Republic and Hungary could increase to about 2.5 percent to 3 percent by 2012. This is somewhat less than elsewhere in the region, in part because these countries have already converged more to EU income levels. Romania and Bulgaria, where the crisis hit later than elsewhere, are set to see the biggest improvements in growth in 2011, aside from Latvia and Lithuania (The World Bank, 2011).

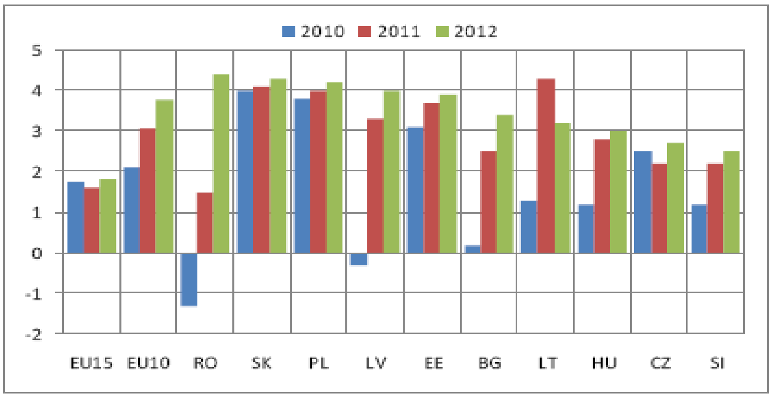

Figure 3. Anticipated growth in the EU10 countries
Source: The World Bank (2011), p. 22

Firms are expected to raise investment with higher capacity utilization and strong global demand for capital goods and durables, and households to step up consumption with improving confidence about future prospects (The World Bank, 2011). However, Romanian economy recovery may last more than expected. The Government of Romania is confronted with the difficult challenge of reconciling three objectives: to protect priority programs for economic and social development in order to enhance growth prospects and to mitigate the social costs of the economic crisis; to exit from anti-crisis policies and ensure fiscal consolidation once the recovery is under way in order to make room for a private sector led recovery; and to improve policies, regulations and coordination in order to prevent such crises in future. Further structural reforms can help to boost potential growth and facilitate the large fiscal consolidation (The World Bank, 2009). The main challenges for fighting the economic crisis are to find the solutions aimed at gaining investors' and customers' trust and to stimulate investments in infrastructure. The Government of Romania may use new foreign financing for infrastructure development, as a solution for the economic recovery (Zamfir & Ioniţă, 2009). Sustained growth and job creation require stable financial markets, sustainable fiscal balances, structural reforms, and the modernization of the public administration.

2. WAYS OF FINANCING INVESTMENTS WITHIN THE ROMANIAN LOCAL PUBLIC ADMINISTRATION

The Romanian State Budget is facing nowadays growing constraints and therefore, the tendency to reduce the funding of public services and investments from this source is more and more evident. Moreover, since the entry into force of the Law on local public finances (Romanian Parliament, 2006), the state budget participates with resources only to financing the obligations established through its commitments with the international financial institutions. On the other hand, local authorities do not yet have sufficient own resources to meet those needs. Therefore, may be considered three ways of attracting capital to finance these local public services:

- Increasing the involvement of private capital (public-private partnership);
- Attracting and using grant funds;
- Using loans to finance public services and investments in local infrastructure with governments' warranties or local authorities' warranties.

In Romania, balancing local budgets is a current topic and subject of numerous debates. There is a strong fight between the local communities who earn own revenues and those who do not earn sufficient revenues for maintenance costs of any settlement. Local communities who earn sufficient own revenues are proposing some measures (such as the elimination of the procedure of balancing local budgets), and those with insufficient funds are lobbying to get as many financial resources this way. This dispute is taking place on two levels of government: from central administration to county level and from county to local level.

The local budgets consist of two main sections: revenues and expenditure of localities. The local budgets are mainly formed of local revenues and of revenues from the central level. In addition, another important source of income that can increase the local revenue is that of loans.

The own revenues of the local budget are the revenues carried out locally by the local authorities. The level and sources of income are controlled and decided by local authorities, taking into account the legal limits prescribed. In Romania the main laws governing the own revenues of the local authorities are the Law on local public finances and the Tax Code.

The Law on local public finances, in light of the most recent changes, introduces a new grouping of payments and redefines the accounting concept of residual payments which means amounts owed and overdue payments stipulated by the legislation or by the contract or invoice. For the unpaid payments rescheduled with the agreement of the parties, the payment deadline is amended accordingly.

Regarding the operating revenue section of the budget, the own revenues have been redefined, namely those specified by the law, excluding the revenues from the sale of goods, the amounts of depreciation of fixed assets and amounts for special deposits for house construction. As a general overview, the revenues of the local budget consist of:

- Own revenues, consisting of: taxes, fees, contributions, other payments, other income and allowances deducted from income tax;
- Amounts deducted from certain income of the state budget;
- Subsidies from the state budget and other budgets;
- Donations and sponsorships;

- Amounts received from the European Union and/or other donors on account of payments made in advance.

The revenues of the development section consist of:

- Payments from the operating section;
- Subsidies for capital expenditures;
- Amounts deducted from certain revenues of the state budget to finance capital expenditures;
- Amounts received from the European Union and/or other donors on account of payments made in advance;
- Amounts from the sale of goods and amounts representing depreciation of fixed assets and amounts for special deposits for house construction, according to the law approving OUG no.63/2010 (Romanian Government, 2010).

The expenditures of the development section were completed, so as to include:

- ✓ Capital expenditures;
- ✓ Projects funded by external grants post-accession;
- ✓ Transfers for capital expenditures;
- ✓ Other internal transfers for capital expenditures;
- ✓ Reimbursement of loans contracted for the implementation of the projects financed with external grants post-accession, scheduled to be made through the reimbursed amounts.

The special taxes are collected only from individuals and legal persons who use local public services for which the taxes were established and, according to the supplement to the regulatory document, are revenues for the local budget.

The amounts of depreciation for fixed assets related to the economic activities of local public services are completely revenues of local budgets, which are included in the development section, are used exclusively for investment and stand out distinctly in the investment program as its funding source. There may be some exceptions which are stipulated in the loan or warranty agreements with the international financial institutions.

The local communities in Romania should ensure local public services which meet the needs of permanent and temporary residents, whose character has proved, over time, to be unlimited. Human needs are many and varied and are amplified by the development of the society and country. Therefore, the development and diversification of public services were generally encouraged by the progress of the society, which has determined new necessities for the population. The local authority was tempted to satisfy these needs for reasons related to the general interest. There is a confrontation between the financial resources which are typically deep limited, and the needs for public services, whose character is unlimited. Thus, the local communities are often put in a position to look for financial resources, using loans, when necessary, as an alternative to financing public services and local development.

As mentioned before, in addition may be considered three **ways of attracting capital to finance the local public services**, and these are other sources of local budget revenues:

- **Encouraging the involvement of private capital (public-private partnership)**. In order to improve the effectiveness and efficiency of public services is important for the local public administration to create a favourable climate for private enterprises' development and to promote the public-private-social partnerships so as to stimulate the investment and provision of services of general interest. The private capital has to be involved in the local public services' sector through the public-private partnership due to various reasons, such as:

- The private interest disciplines the local authority from the point of view of the budget and leads to an increase of the economic efficiency of the operator;
- It involves the capital in the sphere of public services on long-term;
- It introduces the elements of competition in an area generally characterized as a monopoly, and that competition increases the quality of the public services provided.

- **Attracting and using grants**. The scenarios of financing urban infrastructure investment in Romania should consider as sources grants from the European Union or from other European countries or outside the European continent. Romania is part of the European eco-system as polluter and in the same time, as a receiver of pollution, and is a country that has acceded to most environmental and sustainable development conventions.
- **Using credits to finance public services and investments in local infrastructure**. Financing infrastructure through bank loans should be extended because:

- State budget allocations are becoming increasingly limited, due to budgetary constraints and the economic crisis;
- Private companies interest for investment is still small compared to the investment needs of this sector;
- Economic efficiency requires credits and financial discipline, which are features most needed by this sector of the local public administration;
- Credits allow sharing the urgent investments in infrastructure (generating long-term benefits), on several generations of future beneficiaries.

CONCLUSIONS

The study has revealed that in early 2011, about two and a half years after the global financial crisis broke, economic output in the EU10 had returned to the pre-crisis level. The pace of the recovery differs across the EU10, reflecting, among other factors, the overheating prior to the crisis, trade openness and competitiveness. There was in the EU10 countries a double-digits growth of industry, reflecting the rebound in global demand for capital goods and durables and the deep integration with European production chains. In Romania, the effects of the economic crisis are visible in all areas of economic activity. Romania's economy has been hit hard by the global economic downturn. However, Romania, where the crisis hit later than elsewhere, is set to see the biggest improvements in growth in 2011.

Another conclusion of this study is that the local authorities do not yet have sufficient own resources to meet the needs of developing the urban and rural areas. This is because the Romanian State Budget is facing nowadays growing constraints and thus, the tendency to reduce the funding of public services and investments from this source is more and more evident Therefore, may be considered three ways of attracting capital to finance the local public services: increasing the involvement of private capital (public-private partnership), attracting and using grant funds, and using loans to finance public services and investments in local infrastructure with governments' warranties or local authorities' warranties.

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