

FINANCIAL ASPECTS OF DECENTRALISATION

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Abstract

The objective of the decentralization process is better targeting of the financial resources, which translates into a lower tax price to financial cover the decentralized public services. In the current period, also in the European Union and in relations with other developed countries, there is an increasing mobility of people and economic activities. Wealthy individuals and firms are inclined to place their wealth or relocate their activities to lower taxation centers, while lower income people tend to move into communities benefiting more generous social transfers.

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Introduction. The event functions in the process of decentralization of public finances

In modern theories of public finance, they are considered a basic factor for macroeconomic development. Thus, according to Musgrave's theory, the public sector performs three essential functions for the good of the state:

- affected function of resources
- redistribution function
- macroeconomic stabilization function of the activity.

At the national level, macroeconomic stability and growth targets imply the need for sustained fiscal consolidation, and discipline in public spending, at all levels of government, which is public or private, central or local.

The three functions of public finances is manifested differently in terms of administrative and financial decentralization.

There are a great variety of administrative and financial systems adopted both in the European Union and in the most developed contries in the world. Thus, although many countries present three levels of administration – France (regions, departements and municipalities), Germany (federal, landers, local), Italy (regions, provinces, communes), Spain (autonomous communities, provinces, municipalities), Sweden (federal, län, kommuner), United Kingdom (different for each hystorical region: England, Northern Ireland, Scotland and Wales) etc., there are several countries, like Romania, where administrative organisation comprise only two levels.

This paper discusses the relationship between central and local administrative level, both regarding their responsibilities and public financial - revenues and expenditures – correlation, taking account by the type of decentralisation the country heve adopted.

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1. The public finance functions

The affected function

The affected function represents State intervention as producers of goods and services, it ensures satisfying public needs and the necessary adjustments in the allocation of resources that forms on the market. This action must be performed by the economic authority because no private operator would not accept to fulfill it, because of the too high economic and financial risk arising from development and exploitation of certain products and services at those prices and tariffs acceptable to all social categories. But in this case, the question arises - the very difficult problem - of The State efficiency as an economic agent producer of goods and services

The redistribution function

By their very nature, liberalism and market economy creates inequality in society. When this inequality is excessive, the state must intervene to reduce, by performing duties of redistribution. To this end, the State acts in two ways:

- collects, in the form of taxes, a newly created part of the national income;
- redistributes what has been taken through the economic and social transfer:
- overall objective of economic transfers.-. materialized in the most part., into the subsidies made to certain economic sectors and capital gains for the achievement of investments regarded as national priority - is to support the financial situation of the agents whom they are intended, either public or private;
- social transfers are carried out as a national solidarity action. Through such transfers is realised the vertical income redistribution, respectively from those with higher incomes to those with lower incomes, etc.

Stabilization function of the economic activity.

The state sets as an essential target the economic climate stabilization, that is the keeping of global demand at the desired level. This relatively new function of the State requires appropriate means, which are mainly monetary, budgetary and industrial policies.

- in a period characterized by an unfavorable conjuncture, State injects revenues in the economic cycle through the budget or a flexible monetary policy¹, to support the demand and the relaunch of the economy;
- in a period characterized by favorable juncture, The state controls the wealth creation.-. for example by limiting the level of domestic credit.-. to hamper the expansion of global demand. The economy, which often tends to move away from its equilibrium state, is restored - or regulated - in this state through direct and / or indirect State intervention.

Resource allocation function

The decentralization process is aimed at improving financial resource allocation, which translates into a fiscal price as low as possible for the financial coverage of decentralized public services.

In this respect, decentralization is considered proper (devolution), one that gives the largest autonomy to the local communities, which best enable the correlations of public services linking local preferences / needs of citizens and, also, with businesses that are located within those communities.

¹ Fiscal and monetary policy interact each other in vary ways and they affect both macroeconomic performance and the living conditions. Change in fiscal policy has a direct impact on demand. Thus, if the tax level is modified, are affected companies profits and disposable revenues of individuals. Using these fiscal instruments, central authorities influence the labor market and the investmental process, both privat and public. On the other hand, monetary policy credibility is a very important factor for fiscal stability. In every stance of an economic cycle, fiscal and monetary policies have to be correlated. That means, in an expansionary period, when the fiscal policy is relax and contribute to the economic growth, the monetary policy has to maintain a stability of prices.

In addition, decentralization is accompanied by democratic participation in decision-making, which is done only through the operation of a stable and effective institutional framework. In addition, involving the citizen in a political decision, decentralization allows it to control the cost of local public services, which leads to improving allocative efficiency, and efficacy of public funds.

But, there are cases, where a too deep decentralization is not beneficial, for example:

- when the production of collective goods and services is obtained with incremental returns to scale², to have lowered average costs as it is possible, is recommended, as this to be done on an administrative level that is most convenient, generally at a supra-municipal (regional, county, etc.).

- If a public good is consumed by several communities (so-called *spill-over effect*), when the supra-national level does not assume its performance, the solution is cooperation / association of local stakeholders, in a legal or contractual contract. For example, in this regard are the provisions introduced by Law no.273/2006, local public finance law³, regarding the local specific

² Economy of scale, which records the returns to scale, is a microeconomic process characterized by increasing production and decreasing the cost of long-term average.

Economies of scale can be technical or financial.

Economies of scale are determined by technical factors and economic factors:

Technical factors refer mainly to:

- better specialization within the company, which becomes possible through an increase in its size;
- the increased division of labor, increase production capacity requirements;
- unable to divide the plant and other major endowments, the volume of production is higher;

Economic factors include, among others:

- facilities offered by a larger firm in terms of supply, storage, etc.;
- bonuses to big orders, guarantees quality products purchased, rate of delivery as required;
- conditions of funding - through trade credit or bank loan - best

Economies of scale can be internal (company) or external (outside it). The internal occurring particularly with increasing size of business, when fixed costs per unit of output and marginal costs are significantly reduced.

External economies of scale refers to the possibility of undertaking corporate to have access to a market whose inputs are well organized and accessible to a road infrastructure, telecommunications, power engineering, etc. well-developed and affordable cost.

(Nita Dobrota, Coordinator - Dictionary of Economics, Economic Publishing House, Bucharest, 1999)

³ The Law no.273/2006, local public finance law, provided (Art. 35): Collaboration, cooperation, association, twinning, accession (a) The deliberative authorities may agree to conduct cooperation or association of local public works and services. The cooperation or association agreements are made on the basis of association, which provide funding sources representing the contribution of each local government authorities involved. The association agreements concluded by the principal budgetary officer, under mandates approved by each local council or association involved in collaboration. (2) The deliberative authorities may decide on the capital or assets participation on behalf or in the interests of local communities they represent, at the companies setting up or establishment of local public services, or county, as appropriate, in terms of legal provisions. The deliberative authorities may decide to purchase, on behalf or in the interests of local communities they represent, the shares in the companies in whose establishment was attended by the capital contribution in kind and may increase or decrease their capital, under the law. (3) Deliberative authorities may decide on the capital or assets participation, in the name for the interests of local communities they represent, at the the establishment of development community associations, within the limits of the law and for carrying out joint projects for development of regional and local interest or joint provision of public services. (4) The community development associations are financed by contributions from local budgets of administrative-territorial units, from other sources on a project basis, loans and public-private partnerships, in terms of legal provisions. (5) The government develops development national programs to stimulate the association of administrative-territorial and to increase their administrative capacity, funded from the annual budget, through the Ministry of Administration and Interior budget. (6) The financial obligations arising from cooperation, twinning or accession agreements of the administrative-territorial membership in national associations organized at the national or international organizations with legal personality, determined by the deliberative, under the law, is covered from local budgets thereof.

principles, and the European Union policies aiming to foster local cooperation regardless of their geographical location within the Union.

Redistribution function

In the current period, in the European Union, but also in relations with other developed countries, there is registered an increasing mobility of people and economic activities due to the operating pillars of the Union. Wealthy individuals and firms are inclined to place their wealth or relocate their activities to the centers with lower taxation, while lower income people tend to move the community to benefit from more generous social transfers.

In these circumstances it is recommended a centralization of redistribution policy, which refers both to public services and public funds relating to:

- as regards public services, those redistribution in kind or form of cash benefits, its shall be done in accordance with standards and rules applicable throughout the country. Also, the general trend - and negotiations accordingly - is to extend these rules throughout the entire European Union. Classical examples in this regard are education and basic health services;

- public funds financing these services will be affected, therefore, centralized. However, the redistribution will be performed with good results if it would be used procedures aimed at efficiency and effectiveness, that lead, for most public social services, to implement some form of decentralization as devolution and delegation.

If the redistribution function, which lean towards centralization, there are many contrary examples, especially in developing countries. Rural population in these countries face major drawbacks and risks (famine, pestilence, wars, etc..) and many individuals are moving towards the periphery of cities to find a job and / or protection, social services that they could benefit being considered by them in second background.

Stabilization function

Taking account by the macroeconomic stabilization, the traditional view is considering that it should be assumed by central government authorities. In favor of centralization are several reasons, among which the most important being:

- tax revenues of the territorial-administrative units must be as stable as possible, which means that the tax bases of local taxes should be as inelastic as its could. This requirement implies, however, that such taxes can not be used as instruments of macro-stabilization policy;

- economy of a local community is an open economy, with multiple economic and social relations with other communities, which means that fiscal-budgetary policy implemented by a local community will produce effects in a more different geographic area than that of the organization concerned.

Conversely, local public authorities of a territorial-administrative unit may adopt a tactic

An equally important problem is the management of local public deficit and, consequently, the local government borrowing, which may be very different, depending not only on the financial abilities of local authorities concerned, but also the degree of market development financial institutions in which they have access.

2. The system of government versus the typology of decentralization

The public sector modernization implies, on the one hand, adopting a system of decentralization appropriate socio-economic conditions and, on the other hand, it equally important, linking this system with a set of principles and procedures for fiscal and budgetary system that would can support decentralized governance.

In the economic analysis undertaken for the implementation of a decentralization process, it is standing out, in terms of public finances, two aspects:

- when decentralization is downward, fiscal decentralization need, i.e. passing the responsibility of collection of certain taxes and duties which are sub-budget financial sources.

Conversely, if decentralization upward, to develop a constitutional procedure by which tax revenues are transferred from a local to a regional or central office. For example, in Switzerland, to transfer the powers of a tax or a fiscal fee charge at the cantonal level of confederation, it is cantonal voting population or a special provision inserted in the state constitution.

- if the public revenues collected by local authorities are not sufficient to cover the full financial costs of decentralized public services - and this is the general case - should be developed and adopted by law mechanisms to ensure the funds necessary to balance local budgets, and these mechanisms should be applied throughout the country - for fairness - and that would be clearly stipulated in national legislation.

In countries with federal structure, downward financial relationships - vertically from the central authority by sub-national authorities - are more limited, first in order to preserve their autonomy and then for those ones to assume tax consequences of budgetary expenditure policy of their own budgets.

In fact, the main objective of applying balancing mechanisms in public finances of decentralized systems vary depending on the system of government, as follows:

- in the states with unitary tendency, the core objective of balancing is to give local authorities the opportunity to benefit from comparable social services, without being obliged to bear a greater fiscal press;

- in countries with federal features, by balancing mechanisms is aiming to reduce the disparities between sub-national communities to an acceptable level.

3. Benefits of decentralization:

Clearly, decentralization proves its usefulness, regardless of the administrative organization of the state. There are many benefits associated with of devolution and local public services delivered: a better utilization of resources and, consequently, an greater operational efficiency compared with a centralized system, and the increased allocational efficacy⁴, meaning that devolution increases the fit between people's wants and what they get.

It may be mentioned at least two important ways in which decentralization produces beneficial effects for the population:

- the possibility of community control and to exercise the power to participate in decisions about managing public activities. In this way, it is limited the discretionary behavior of local public authorities and economic agents, individuals or legal entities that are resident in those municipalities area can compare their elected officials performance with results from other local elected officials and impose measures to improve local public services.

In addition, the population entitled in a democratic state, to change residence that is to relocate - housing and / or business - in one place more convenient in terms of taxation. In this way, it is preferred a locality benefiting of a lower fiscal pressure exerted by local taxes and fees or where the local public services are better and more numerous, or both.

⁴ Efficacy is the capacity to produce an effect. It is these conditions that distinguish efficacy from the related concept of effectiveness, which relates to change under real-life conditions. -- Wikipedia: "efficacy" http://wiki.answers.com/Q/Difference_between_efficacy_and_effectiveness#ixzz1Eb757oX1

Actually, however, mobility is quite limited, in many personal reasons for individuals and in order of management for businesses - they must have in its new location, the necessary resources: human, material and financial.

Also, the exercise of public pressure, in terms of tax, over the local authorities may have adverse effects for the entire population. Thus, for dealing with tax competition, local governments would be tempted to reduce the pressing produced by local taxes.

- either by lowering rates, either through tax relief - or to engage in increased public expenditure to finance local public services. If, however, the trim⁵ is not sufficiently elastic, i.e. the general tax base is not expanding sufficiently, due to the increase of economic growth and living standards, mainly, the total amount of local government revenues from local taxes and fees will diminish considerably, which will drastically reduce their maneuver margin for the financial management of local public services.

- local public authorities can implement best practices experimented by other local authorities, with the approval of their citizens, without considering the opinion of the higher public authorities - than if those ones participate to the extent of local resources in the implementation of those measures.

This advantage depends on the type of decentralization applied to that activity. If decentralization is done by delegation, the performed model is passed even by the upper hierarchy authority, which reduces the risk ..

When decentralization is a deconcentration, i.e. the agency responsible for local public service is part of the organizational structure of a territorial public authority, the leaders of this sub-national public institution are tempted to show that the benefit is greater than the cost of the experiment, the information received by the central public authority being thus distorted.

In conclusion, the behavior of public decision makers at the local level depends largely on the type of decentralization adopted by national law and for each category of local public service, also on the specific socio-economic, cultural, historical, etc. of localities. When the population, not only in the area analyzed, but all nations, is poor, the satisfaction of vital needs prevail, which means that public services requirement is nearly homogeneous.

As society evolves, the localities are diversified in terms of citizens' preferences, decentralization being necessary to meet these preferences.

Conclusion

Public financial revenues come from different sources: from taxes and fiscal fees collected at central level and various sub-national levels, from non-fiscal revenues, from the pricing of public services, loans etc..

Public expenditure financing public services are covered from various sources, which in a modern democratic state, are not centralized under a single public authorities. Therefore, the allocation of responsibilities in the management of public money, also public revenue collection should be done taking into account the specific requirements of the local population. If this goal is not met, central public authority exercising a discretionary power in budgetary planning, economic and social development capacity will be affected by not only in certain localities, but also by the contagion effect at national level.

A breakdown of the budget and fiscal powers clear and transparent, conducted in accordance with the principle of responsibility (*accountability*) produce the most efficient and

⁵ Trim are all measures are taken by tax authorities in connection with each subject taxable, to taxable object identification and determination of tax due (Economic and Financial Dictionary, <http://www.contabilizat.ro>)

effective results for producing and distributing public services, removing the possibility of public authorities to take advantage of so-called X-inefficiency⁶.

The division of competences is based on administrative-territorial organization of the country and, in the administrative-territorial units are created public institutions to which will be given the tasks of producing and distributing local public services.

Sharing administrative districts do not always take into account the economic specificity of a public service, so in order to benefit from economies of scale⁷, the local authority concerned will have to be associated, under the law, with other local communities⁸.

An alternative is the decentralization of public service up to higher administrative level - for example, county, city or common face - so that of the respective service can benefit the population that lives in a wider geographic area, but the management and finance to be the responsibility of an administrative higher level.

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⁶ X-inefficiency occurs when an economic agent that produces goods and / or services is subject to little or no control. Being the only good customer execution of production and not having to answer to any higher institution - what is called information asymmetry - the operator does not pay attention to the requirements of the efficiency of production, and this inefficiency is named X, because no one knows who takes advantage from this situation, because the production process involved more economic operators. (Wikipedia, the free encyclopedia)

⁷ Economy of scale - reducing the unit cost of a public service with the increase in its production volume and, consequently, the number of beneficiaries (Article 2, lit.o, no.195/2006 Law, Law of decentralization, OG. 453/2006).

⁸ Art.13 of Law No.195/2006, Law of decentralization, states: "In order to exercise powers in terms of efficiency, administrative-territorial units may be organized in intercommunity development associations, under the provisions of the Law no. 215/2001, as amended and supplemented.