# THE ANALYSIS OF THE FINANCIAL PERFORMANCE OF LOCAL AUTHORITIES IN THE CONTEXT OF BUDGETARY CONSTRAINTS

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**Abstract.** *Drawing on a set of financial and budget specific indicators, the paper examines the financial activities of local authorities, aiming at diagnosing local public financial management. In the context of the increasing decentralization of public finance, local authorities must demonstrate the ability to manage local resources as efficiently as possible, adopting decisions (including financial ones) to respond promptly to citizen needs. For this reason, we set out to present an analysis model aimed at accustoming local decision-makers with the specific tools and methods and assisting them in gaining awareness of the benefits of such analyses. Empirical research shows that local authorities, due to the low income generation capacity, face a shortage of own resources, creating dependency on the state budget. Moreover, it has been demonstrated that that lack of resources limits both the investment capacity and the decision-making autonomy of local authorities in prioritizing spending. The analysis conducted in terms of performance indicators has revealed low level of local government involvement in stimulating economic activity in the community under examination.*

**Keywords:** financial decisions, financial and fiscal indicators, financial autonomy, budgetary constraints, local performance, local public financial management.

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## 1. Introduction

The financial and budgetary reality of Romania nowadays is challenging, being marked not only by the extended economic and financial crisis, but also by aspects related to the specific development and implementation of public management. These aspects are also reflected implicitly in the local public financial management, which has experienced unprecedented developments and transformations. The budgetary austerity measures required to overcome the current situation demand a greater involvement on the part of local public financial management to ensure both the effectiveness of resource utilization and the efficiency of the performance of local public authorities.

The difficulties which the local authorities are facing have led to major transformations in public finance, prompting its reorganization and restructuring accompanied by decentralization and increased autonomy. These shifts are seeking to link the duties and responsibilities of local public authorities with the potential to collect resources in the local area. The unanimous view is that an optimal local public financial management is a pivot that can sustain real local autonomy (by means of a balanced budget). Furthermore, outlining a quantifiable image of the effects of the financial management practiced at local authority level also contributes to bringing public authority closer to the citizen, who thus has access to the necessary standards to judge the activity of local government.

Performance is the objective of any entity because “only through performance can organizations grow and progress” (Gavrea et al., 2011). The financial performance of local authorities, directly influenced by the quality of the decision-making specific to the financial management of local government, must be assessed by using a coherent and consistent set of indicators, thus ensuring the grounds for a comparison on the same terms of the evolution of the various administrative-territorial authorities, situated at the same administrative level, at different levels, in the same state or in different states.

A uniform basis for comparison is useful both to the local financial manager, who can “measure” his/her own performance in relation to that of other authorities, to public decision-makers at other levels or to private decision-makers. Faced with the need to make decisions aimed at designing or promoting specific public (financial) policies, by setting, for example, the criteria for awarding amounts to balance budgets to the local levels and by making decisions about the limits within which local authorities may guarantee loans, public decision-makers have a realistic basis to ground their decision, which allows value judgments whose main benchmark is the effort or involvement of local decision-makers. On the other hand, private agents who are in a position to ground their decisions engaging various relationships with local governments (a bank's decision to grant a loan locally, a firm’s decision to enter a public-private partnership with the local authority) have access to useful benchmarks, which diminishes the uncertainty of financial developments linked to the partner concerned.

Last but not least, the citizen himself (as taxpayer and beneficiary of public services) now has a useful tool to compare and control the financial performance of local government activities, especially for different terms of public officers (e.g. the performance of an authorizing officer compared with his predecessor) or for same-level communities.

## 2. Current insights into local public financial management

The analysis of the quality of financial decision as a premise for enhancing the financial performance of local authorities in the context of budget constraints has been and continues to be a concern for researchers and experts in the field (Smith, 1989; Boyne, 1997; Carmeli, 2002; Gutiérrez-Romero et al., 2010; Atan et al., 2010; Dogariu, 2010; Upton, 2013). The latter have taken an increasingly active interest in this issue amid the escalating budgetary constraints brought about by the crisis. As a result of the multiplication of risk factors, new research has explored the scientific grounding of decision-making, with the emphasis placed on quantitative and/or qualitative analysis and the assessment of the possible options determined by various influencing factors, premised on the fact that "the hallmark reform in the public sector concerns management, the quality of the management act exerting a direct impact on the performance of public organizations" (Onofrei, 2007, p. 20).

The review of Romanian literature in the field reveals that analyses of the quality of financial decision-making at local government level fall both within the scope of local public finance and of local public management. That is because, on the one hand, financial decisions are the expression of financial policies pursued by central or local public authorities (Văcărel, 2006), and on the other hand, decision-making matters define the sphere of public management focus (Androniceanu and Sandor, 2006). The development of these interdisciplinary lines of research has enabled the emergence of a new branch of management: public financial management. In the context of decentralization, local public financial management has staked out a key position in public financial management and focuses on two strategic objectives: to achieve a balanced, sustainable budget that will support the local authority in providing quality public services benefiting citizens and to enhance the financial solvency of local government in order to guarantee the optimal and balanced financing of sustainable development. Achieving the two strategic objectives depends unquestionably on the quality of financial decisions made by local authorities.

The relevant literature provides a wide range of indicators serving to assess financial (budgetary) performance at local level, with guidelines of financial performance indicators being drafted (e.g. the document drawn up by the Federation of local authorities in Romania). Nevertheless, one may notice that, in practice, local officials still limit themselves to drawing up regular and formal financial statements/reports required by law. For this reason, we set out to present an analysis model aimed at accustoming local decision-makers with the specific tools and methods and assisting them in gaining awareness of the benefits of such analyses.

### 3. Data and methodology

Acknowledging the fact that the analysis based on specific financial and fiscal indicators involves certain risks (in case of inaccurate use, the analysis of the evolution of indicators does not match reality), we argue that it delivers a threefold utility, as it serves to determine *underlying trends* (the analysis enables the advance charting of indicators, providing opportunities to assess the quality of local performance and of financial and budgetary balance), to facilitate *comparative analyses* (by means of the assessment of the local authority's situation compared with other similar entities or relative to average domain values) and *statistical* ones (as it enables the analysis of the behaviour of one or several entities and facilitates forecasting).

The structure of the analysis model we aim to present can be rendered as follows: a) establishing the set of specific indicators used in conducting the analysis; b) deciding on the methodology to determine the indicators; c) computing the value of indicators and interpreting results; d) identifying influencing factors; e) making the diagnosis; f) identifying alternative solutions.

The sources of information available for use in the analysis include: revenue and expense budgets, as approved before the start of the financial year (also known as the initial budget); budget amendments, which reflect changes – either increases or decreases – in revenue and expenses; amended budgets (or budget variance reports); and annual accounts, which reflect the final budget results. To address the needs of commune-level authorities, we conducted the research based on data collected from the budgets and accounts of a medium-sized commune (or township) in Iaşi county. This aspect does not preclude the opportunity to extrapolate the model to the municipal/city levels, provided the specific features of the income sources and budget expenditure at the respective levels are factored in. Performing the analysis at this level mainly involves some limitations and reservations respectively, in the interpretation or generalization of findings, as it is virtually impossible to identify a "representative" commune for Romania, because often the particular elements have a defining impact on the attainable results. Ultimately, however, our undertaking is important not only in terms of the specific results of the analysis, but mainly in terms of establishing the useful indicators and laying out the potential directions of interpretation and use of the findings, in order to outline an appropriate set of tools, mainly made available to local agents, who must realize the need and usefulness of such analyses. For the sake of delivering accurate results, we considered as part of the income category only those financial resources over which the local authority has direct ability to handle in order to secure marginal revenue, although according to legal provisions the shares of income tax rates would also be in the same category.

## 4. Analysis of specific indicators and diagnosis of the quality of local public financial management

The most relevant financial and fiscal indicators specific to local public administration can be classified and analyzed in three groups: revenue indicators; expenditure indicators; and result/performance indicators. The analysis may not necessarily aim to determine all the possible indicators. The quality of the analysis does not lie in the number of the indicators under consideration, but rather in their relevance for the analyzed entity. Furthermore, the findings based on the determination of indicators must not be viewed as absolute; rather, they must be interpreted in close connection with other indicators and with the evolution of the variables typical of public operations in a local environment.

### 4.1. Analysis of revenue-based indicators

Within this group the focus is on indicators such as: the degree self-financing of local public government, local government revenue generation capacity, level of own revenue collection, income (total and own income, respectively) per capita, the extent of decision-making autonomy, the level of dependence of the local budget on the national budget (and hence the level of state dependence of the local authority in question), the capacity of the local public authority to access non-reimbursable financing (Table 1).

*The degree of self-financing of the local public authority* ($DSF_{LPA}$), was calculated as the ratio of own revenues generated by the examined commune and the total revenue (Table 1, row 3). The indicator values, 24.04% in year 2011 and 11.32% in year 2012, indicates that the level of funding of total expenditure by own revenues is extremely low; consequently, the degree of financial autonomy is very low. Although the indicator also enables the assessment of the quality of the financial management of the local public authority (i.e. the local government's interest in determining the taxable base and collecting own revenues), an appraisal based only on this indicator would be limited, as the indicator is influenced by other factors as well. For instance, without knowing the financial (and non-financial) details of the local authority under review, one must also carefully examine the evolution of total revenues and any changes on the structural level. By analyzing in correlation the evolution of own revenues (which increased only 1.6 times) and the evolution of total revenues (which grew 3.4 times), one can identify the premises underlying the significant year-on-year growth of revenue; these can include increased transfers from other authorities, additional debt or access to grants through various non-governmental financing programs. Concretely, the situation presented above is explained by the higher level of capital subsidies; for the year 2012 a further 7 million lei from the national budget were allocated to fund high-priority multi-annual environmental and water management programs.

*Table 1*

**Method of calculation of revenue-based indicators**

| | Information | 2011 | 2012 | Reference values |
|---|---|---|---|---|
| 1 | Total revenues (thousand lei) | 3460 | 11749 | - |
| 2 | Own revenues (thousand lei) | 832 | 1330 | |
| 3 | **Degree of self-financing of local public authority**: (line 2 / line 1)* 100 | **24.04%** | **11.32%** | **→100%*** |
| 4 | Shares of income tax (thousand lei) | 104 | 176 | - |
| 5 | **Revenue generation capacity of local public authority**: [(line 2 + line 4) / line 1]* 100 | **27.05%** | **12.81%** | **→ 100%** |
| 6 | Projected own revenues (thousand lei) | 983 | 1369 | - |
| 7 | **Degree of own revenue collection** (line 2 / line 6)* 100 | **84.63%** | **97.15%** | **→ 100%** |
| 8 | Number of inhabitants | 5222 | 5260 | **-** |
| 9 | **Income** (lei) **/ per capita** (line 1 / line 8) | **663** | **2234** | Average recorded for comparable local authorities |
| 10 | **Own revenues** (lei) **/ per capita** (line 2 / line 8) | **159** | **253** | |
| 11 | Tax revenues (thousand lei) | 3424 | 4486 | |
| 12 | **Tax revenues** (lei) **/ per capita** (line 11 / line 8) | **656** | **853** | |
| 13 | Revenues from property tax (thousand lei) | 17 | 18 | |
| 14 | **Property tax** (lei) **/ per capita** (line 13 / line 8) | **3** | **3** | |
| 15 | Revenue from management of public property (thousand lei) | 13 | 14 | |
| 16 | **Revenue from management of public property** (lei) **/ per capita** (line 15 / line 8) | **2** | **3** | |
| 17 | Subsidies received (thousand lei) | 35 | 7260 | - |
| 18 | **Degree of decision-making autonomy** [(line 1– line 17) / line 1] *100 | **98.98%** | **38.20%** | **→100%**** |
| 19 | Subsidies received by other government authorities | 3 | 40 | - |
| 20 | **Degree of dependence of the local budget on the national budget** [(line 1 – line 2 – line 19) / line 1] * 100 | **75.86%** | **88.33%** | **→ minimum** |
| 21 | Total subsidies (line 17 + line 19) (thousand lei) | 38 | 7300 | - |
| 22 | **Hunter index** [(line 1 – line 21) / line 1] | **0,98** | **0,38** | **→ 1** |
| 23 | Financing programs under way (non-reimbursable funds) | 0 | 0 | |
| 24 | **Capacity of local public authority agencies to access non-reimbursable financing** (line 21 / line 1) *100 | **0** | **0** | **→ maximum** |

* desirable level; according to the processing of the consolidated data provided by the INS, the maximum level ever reached 36.38% in the year 2000 (Dogariu, 2010); ** desirable level – can be achieved only by eliminating transfers to fund the subsidies undertaken in the state budget.

Although the interpretation of the indicator $DSF_{LPA}$, as calculated in the Table 1, remains valid, we believe that a revised indicator can be determined, which should exclude temporary influences (such as the capital subsidy allocated after the revision of the budget). In the new calculation approach, the degree of self-financing of the local government (for the year 2012) shall be 28.00% – the resultant new calculation formula being: *[own revenues / (total revenues – capital subsidies)]*100*. We observe therefore an increase of the analyzed indicator (signifying a positive development), which may be attributed either to the local government's improved capacity to generate its own revenues or to changes in tax legislation.

To sum up, we estimate that the indicator $DSF_{LPA}$ must be analyzed and interpreted in correlation with the following influencers: structural changes at income level; the capacity of the local public authority to generate own revenues (i.e. the local government's interest in determining the taxable base and collecting own revenues); tax legislation; decisions intended to ensure the decentralization of responsibilities, the allocation of financial resources, and the accurate determination of the tax base and the full and timely collection of own revenues; tax legislation and its amendments, decisions to decentralize the administrative responsibilities along with decisions to allocate financial resources or assign new revenue sources.

The low self-financing rate, correlated with the negative trend, is not an atypical case. The vast majority of local (especially rural) authorities evidence the same characteristic. Moreover, studies have shown that, against the backdrop of the crisis, the share of own revenues in the total generated revenues has declined considerably (Dogariu, 2010).

With respect to the share of own revenues in the local budgets, the literature in the field (Moşteanu and Lăcătuş, 2008) recommends calculating the Hunter index, which determines the revenues controlled by the local public government as a share of the total local public revenues. As regards the benchmark index values, it has been argued that a Hunter index (which quantifies the level of local decentralization) close to 1 should be the goal of fiscal decentralization in Romania (Dincă et al., 2009). In the case of the examined administrative-territorial unit, the Hunter index (Table 1, row 22), determined by the relationship [(total revenues/(total revenues - capital subsidies)]*100) reveals a sharp decline precisely because of the rise in the share of revenues that cannot be controlled by local governments (since subsidies are assigned for specific ends, allocations cannot be diverted to other purposes).

*The local public authority's revenue generation capacity* was determined using the relationship: [(own revenues + shares on income tax)/total revenues]. Compared to the previous indicator (the degree of self-financing of the local public authority), is a rather more complex indicator used in assessing the financial standing of the local authority (including its financial autonomy), as it also factors in the amounts from the share of income tax collected at local level. Although the local authorities cannot influence directly the collection from this source (by modifying the tax base or level) and cannot control rigorously this source of revenue (as monitoring in this area is the remit of decentralized agencies), they can contribute to expanding the tax base by deliberate actions by virtue of their administrative autonomy, as a first step towards increasing the resources derived from this source.

In this case also the analysis of the progress of the indicator may be conducted globally or analytically, depending on the structure of own revenues and of the revenues from income tax shares (including or excluding the influences of temporary factors). According to the information in the Table 1 (line 5), one must not label the evolution of the indicator as negative (simply because it declined from 27.05% to 12.81%) since, if we eliminate the influence of temporary factors, a positive trend emerges (a rise from 27.05% to 31.71%), which entails a positive assessment of the evolution of the financial standing of the local authority.

While the assessment of the evolution of the indicator is more important, one must not neglect the interpretation of its value; compared to the maximum admitted level (100% - a level considered desirable yet extremely difficult to achieve for local authorities in Romania), the capacity of local government to generate income is modest. However, this aspect cannot be ascribed solely to local management, as it is also dependent on a range of collateral factors such as: the income tax rate, the share of the income tax attributable to the local level (both regulated by the central government), the per capita income, etc. From another perspective, the sterile interpretation of this indicator is not relevant for all rural communities, especially given the particular conditions in Romania, where economic activity often occurs on the very small-scale, a phenomenon explained primarily by the lack of attractiveness of the local environment for the conduct of business. As a result, for stakeholders (citizens, creditors, investors, etc.) the relevant analysis concerns not so much the value of the indicator in a fiscal year, but rather its evolution over a certain period of time, which is particularized in the context of the manifestation of various influencing factors (legislative changes, local economic outlook, etc.).

In view of the fact that there is a positive correlation between the level of economic development of the local administrative division and its revenue generation capacity, local authorities must take advantage of all the available leverage in order to: expand the taxable base present at local level; enhance the determination and collection of own revenues (and adjusting local fiscal and budget policies accordingly); effectively manage public and private property; boosting employment locally, etc. Moreover, appraisals of the financial standing of a local community must also focus on the characteristics of the various revenue sources and determine the probability of the availability of those sources in subsequent years. Considering this overview of the multitude of correlations between the analyzed indicator and its related influencing factors, it is readily apparent why an isolated interpretation of the indicator is not advisable.

*The degree of own revenue collection* – determined as a ratio of own revenue and projected own revenues – matches up the level of own revenue collection with the budget provisions for the period under consideration. The values of the indicator (84.63% and 97.15%, respectively) reflect the local government’s capacity to properly forecast and subsequently collect own revenues. The calculation of the indicator proves useful both in planning budgets and in examining budget execution, becoming established as a conditioner of local expenditure levels (current regulations condition the forecasts of own revenues on the degree of own revenue generation over the previous two years). Current regulations (Government Emergency Ordinance no. 63/2010 modifying and completing Law no. 273/2006 on Local public finance and on certain financial measures, published in the Official Journal of Romania no.

450/2.07.2010, art. (10) binds the planning of own revenues to the actual revenue generated over the previous two years. In concrete terms, in case the actual level of own revenues generated is below 97% of the planned local budget amounts, the authorizing officers shall determine own revenue levels for the current year at no more the level of revenues collected in the previous year

Approaching the 100% target rate is indicative of an optimal revenue collection rate and highlights effective financial management at the level of managing local fiscal revenue and is dependent upon on the proper establishment of the taxable base, the use of appropriate methods to fine-tune revenues and, last but not least, upon sound budget execution; the latter is dependent on the extent to which financial officers (not limited to authorizing officers) possess the professional skills and knowledge required for the optimal implementation of identification, establishment, monitoring and collection of budget revenues.

On the contrary, the declining evolution of the indicator denotes either deficient (unrealistic) budget planning or the inability of local public officials to meet the initial budget targets. The potential causes for such an evolution can be variously ascribed to the overestimation of budget revenues, lack of officials' interest in collecting revenues, declining tax-paying capacity of natural and legal persons. Although rare, there may be cases where the indicator exceeds the optimal level (100%), and such cases may be interpreted as being positive or negative depending on the assessment of specific influencing factors.

The analysis of indicators calculated as a ratio of the different categories of revenues in a community and the number of inhabitants in the respective area enables the assessment of the financial capacity of the community under consideration. These indicators can facilitate comparisons between administrative units both at county level and between several counties, with their performance potentially serving to simultaneously support both the opinion of the public or other key stakeholders and to properly adjust inter-administrative transfers, by integrating them into a complex index of local effort, as suggested in specialist literature.

To ensure an accurate assessment, the analysis of the overall trend of total revenue per capita must be conducted by taking into account the evolution of each revenue category. Highly useful in this respect are the indicators calculated based on own revenues, global and distinct entity revenues. For instance, the indicator *own per capita revenues*, by its record low levels, denotes low tax paying capacity, which may be explained by: low volumes or the absence of taxable bases; tax rates; local tax policies; low level of economic development of the authority under review; the value of public and private equity of the local authority; the inability to capitalize on certain privately-owned assets or the lack of such assets; the inability to set up revenue-generating legal entities; the failure to support private entrepreneurship in order to boost local development, etc.

The analysis can be continued by factoring in the structure of own revenues, while relating the income subdivisions to the number of inhabitants yields primary data that enables comparative (quantitative and qualitative) analyses, among same-level local communities.

*The degree of decision-making autonomy*, although calculated as the share of revenues, except subsidies, out of the total revenues, reflects the extent to which the local public authority is able to make its own decisions regarding the distribution of expenditure (i.e. establishing the priority of expenses for specific targets); the higher the degree, the lower the dependence of the local public authority on the national government. Subsidies play a decisive role in quantifying this particular indicator, as they have a defined use and may not be used for other purposes. In the case under review, the declining trend of the indicator is attributed to: a) the increase of capital subsidies (for the year 2012, 7 million lei were allocated from the state budget to finance high-priority multi-annual environment and water management programs); b) the rise in current subsidies, with the main increase being due to the household heating subsidies.

*The degree of dependence of the local budget on the national budget* is determined as follows: [(total revenues – own revenues – subsidies received by other government authorities)/total revenues]*100. Considering the recorded values (75.86% in year 2011 and 88.33% in year 2012), shows the extent to which the support for local government expenditure is conditional upon resources transferred from other public budgets, primarily the central government budget.

The value of the indicator is influenced by: the volume of revenues provided by the state budget (including the break-downs of local budget adjustment allocations, special-purpose revenues, adjustment allocations from county councils, transfers and subsidies in addition to special funds); the value of own revenues and the related collection level; the share of revenues from income tax in the overall revenues; local taxable base; the structure of local budget revenue sources as provided by law; the criteria for the assignment of budget balancing financial funds received from central government. This indicator (also known the degree of financial dependence) can be analyzed in conjunction with the degree of decision-making autonomy; naturally, a decline in the degree of decision-making autonomy entails a growing dependence of the local budget on the national budget.

*The capacity of the local public authority to access non-reimbursable financing nerambursabile*, assessed in terms of the ratio of non-reimbursable funding received and the total revenue, reflects the level of interest of local public agencies in attracting alternative funding to invest in local development and public services, in order to meet the objectives of the local community. Given that in the case in focus such alternative financial funds were not accessed, one might anticipate the conclusion that, in this case, there is zero capacity of the local government authorities to obtain non-reimbursable financing. The interpretation of this indicator must be conducted very prudently, as there are multiple factors influence such as: statutory and financial (the possibility to provide cofinancing or the existence of financing axis for which the authority is eligible); institutional factors (organizational structure); human resource factors (professional capacity); technical factors (access to specific information); and political factors (political backing). According to views expressed in the relevant literature (Oprea, 2011), one motive often invoked (mainly by local officials) in the context of the very low degree of absorption of European funds is the lack of co-financing capacity, which may also serve in principle to conceal lack of interest or actual capacity to attract these funds. Under these circumstances, it appears reasonable that public budgets should earmark a limit amount (e.g. 10% of revenues) for cofinancing projects receiving nonreimbursable funding, such earmarks not being transferable to other purposes.

Additionally, the level of funds attracted could be considered as a performance indicator included in an aggregate index of local effort when making adjustments to allocate budget balancing funds. As a result, a system of penalties (a proportional decline in the amounts transferred for budget balancing) and rewards (conditional allocation of budgetary loans assigned to the cofinancing fund for external nonreimbursable grants), which would essentially force authorities to attract nonreimbursable funds, by setting up favourable conditions to this end. Even if the increase in the size of nonreimbursable financial assistance will not reach the expected level for all administrative and territorial units, the positive effect will be to set a proper benchmark for reporting the capacity of local authorities to attract nonreimbursable funding and to reveal the administrative capacity of elected officials or local technocrats, who will thus be judged more accurately by the members of the local community.

### 4.2. The analysis of expenditure-based indicators

At this level particular attention is paid to the analysis of the following indicators: expenditure rigidity; investment capacity; per capita investment levels; current and forecast (statutory) debt-carrying capacity; the ratio of per-capita debt to per capita income; the share of the various expense categories in total expenditure. The role of these indicators is to determine the extent of flexibility or rigidity of the various expenses of a local public authority, and respectively to deliver a realistic basis for estimates regarding the development potential of a local community and "local budgetary policy".

The first calculated indicators in Table 2 (line 2), i.e. *expenditure rigidity*, reflects the limits of the decision-making authority of local public administration in prioritizing expenditure. Usually, a reduction in the share of staff expenses in the total expenditure leads to optimized management only if it is accompanied by rising own revenues (resulting from local development, increased efficiency in determining and collecting revenue), changes in the allocation policy and savings in staff-related expenses. In the case under consideration, the declining share of staff expenses in the overall expenses has resulted mostly from capital expenditure made using the subsidies received by the local authority. By eliminating this influence (viewing it as temporary), the revised indicator stands at 52.29%. Although it is on a declining path, the indicator is still at a relatively high level.

*Table 2*

**Method of calculation of expense-based indicators**

| | Information | 2011 | 2012 | Reference values |
|---|---|---|---|---|
| 1 | Total expenditure (thousand lei) | 3375 | 11748 | - |
| 2 | Staff expenses (thousand lei) | 2289 | 2483 | - |
| 3 | **Expenditure rigidity** (line 2 / line 1) *100 | **67.82%** | **21.13%** | **→ minimum** |
| 4 | Capital expenditure (thousand lei) | 495 | 7633 | - |
| 5 | **Investment capacity** (line 4/ line 1) *100 | **14.66%** | **64.97%** | **→ maximum** |
| 6 | Number of inhabitants | 5222 | 5260 | |
| 7 | **Capital expenditure/per capita** (lei) (line 4 / line 6) lei | **94.79** | **1451.14** | **→ maximum** |
| 8 | Debt service, interest, fees and other expenses | 0 | 0 | - |
| 9 | Total revenue (thousand lei) | 3460 | 11748 | - |
| 10 | **Current and forecast debt-carrying capacity** (line 8 / line 9) *100 | - | - | **within the statutory limits** |

Naturally, a priority and indispensable expenditure category for the territorial administrative consists of the remuneration of the human resources involved in providing various public services of local interest. For this reason, the analysis must focus not only on the actual expenditure but also on its effect, as public services have "a major impact on the quality of life" (Dimian and Barbu, 2012). In respect, we would argue that this prioritization must not be viewed in exclusive terms, but rather within the framework of minimum staffing and optimal compensation requirements.

The indicator must not be appraised only in terms of the large volume of funds allocated to labour compensation for performing the duties that are the remit of the local government authority but also in terms of the low level of financing of the community. Keeping staff expenses within certain limits must constitute an element of budget policy. The factors which influence the size of these particular expenses are not confined to local circumstances (the specific responsibilities of the local government, level of professional training, extent of implementation of computer-based local-government information systems, support for staff development, etc.) but also include central government-related factors (pay scales, compensation adjustments in the context of the public finance crisis, imposing procedures and guidelines on quality).

The use of economic classification (which structures expenditure into two large groups – current and investment expenses) facilitates the analysis of the indicator both globally, at budget level and at the level of an individual budget chapter.

A pertinent analysis of local expenditure rigidity should also take into account the specific decisions on personnel costs, eliminating amounts earmarked for mandatory spending such as salary payments for secondary school education. The indicator thus obtained provides a clearer picture of the flexibility of local expenditure, in that it avoids the distortions induced by financing personnel costs for secondary-school, which are not under the control of local governments, but are covered exclusively through a special-purpose transfer. A similar situation occurs for subsidies covering the differences in the price and charges for heating and social welfare, which are imposed and incurred through special-purpose transfers.

As an additional element along the lines of prioritizing expenditure, the analysis of the *investment capacity* (an indicator determined as the ratio of capital expenditure and total expenditure) reflects the extent of local government involvement in promoting local development. However, unlike the previous indicator, this one is essential for planning medium and long-term budget policy.

The indicator allows two alternative interpretation approaches, based on whether the model considers own resources allocated to investments or the overall resources assigned for investments (including other raised financing). The second approach is relevant for the purpose of appraising the quality of local administration management.

The factors that may impact this indicator are not limited to the local level (the development strategy of the administrative division; the local fiscal and budget policy; the capacity of the administrative unit to raise alternative financings to fund investments; capacity to co-finance projects; institutional capacity; institutional management) but are also related to the upper levels of government (sectorial/national development strategy). Based on this grouping of influencing factors, the evolution of the indicator can be explained for the particular authority being examined, for which the increase in the investment capacity was shown to be the result of capital subsidies granted in year 2012.

The indicator *capital expenditures per capita* shows the amount of expenditure by the local government on investments, i.e. local development; this indicator is used as a basis for comparisons between similar administrative units. In the year 2012, due to the allocation of capital subsidies from the national budget, capital expenditure increased significantly. The value of the indicator is dependent on investment policy, the local development strategy, financing alternatives (own resources, transfers from the national budget or other authorities, financing programs, loans), opportunities/capacities to conclude public-private partnerships.

Given that the local authority in focus did not contract any loans, the *current and forecast debt-carrying capacity* (determined as the ratio of debts and related items, on the one hand, and total revenues, on the other) remains at the maximum statutory level; this indicator does not overlap with the *real* debt-carrying capacity of the local authority, which depends, as shown in specialist literature, on influence factors such as the financial credibility of the local community, the potential to provide loan guarantees, the interest of potential creditors, legal authorization, the global debt ceiling, etc. (Oprea and Bilan, 2011). Nevertheless, we believe it is worth highlighting the new legislative provisions in the field. Thus, the legislation in force, namely the Emergency Government Ordinance 63/2010, stipulates that the administrative units shall be prevented from contracting any loans or providing loan guarantees, if total annual debt levels (including instalments on loans or on loans for which they serve as guarantors, and related interest and fee payments, including of any loans that are to be contracted and/or guaranteed during the current year) exceed 30% of the arithmetic mean of own revenues, less the gains from disposal of assets, over the previous 3 years of the year for which authorization is sought for the intended reimbursable contracted and/or guaranteed loan. Moreover, the administrative units which had outstanding payments as of the 31 December of the previous year, unpaid by the date of applying for the approval of the Authorizing commission for local loans or which posted a deficit of the administrative expenses budget section are prohibited from contracting or providing guarantees on any loans. The administrative units in financial distress or in insolvency proceedings are exempt from these provisions and can apply for loans or guarantees to refinance local public debt, under the terms of the financial recovery or insolvency proceedings. In case of local debt refinancing loans, the total annual debt level, including instalment repayments, interest payments and fees related to refinanced loans, is excluded when calculating the 30% ceiling of the arithmetic mean of own revenues.

Due to the fact that the legislation regulating local public finances (Law no. 273/2006 regarding local public finances, published in the Official Journal no. 618/ 18.07.2006), article 62, provides that the repayment of contracted loans must be funded by own revenues, there is a certain reluctance to resorting to this source of financing; this behaviour is also explained by the low tax-paying capacity of the local community.

Where the authorities have contracted loans the indicator must be calculated and examined to avoid the over-leveraging of local authorities. Considering that the share of local public debt in total public debt has increased (from 0.01%, in the year 2000, to 7.36% by the end of 2009), some authors have argued that highly leveraged local authorities should set up a special department to deal with the issue and cooperate with the competent national agency – the Directorate General for the Treasury and Public Debt, part of the Romanian Ministry of Finance (Câmpeanu et al., 2009). Furthermore, the same authors have recommended that two indicators must also be considered in such cases, i.e. debt per capita and income per capita, in order to focus on ensuring accurate and balanced financial management.

The access to loan financing is conditional upon: regulations on the leverage levels of local government; current interest rates; the structure of local budget revenues; the degree of revenue collection; the administration's financial management; the public's attitude to public debt; the current and prospective fiscal policy (during the repayment of the loan), etc.

Based on the information in the Table 3, one can observe that – in year 2011 – expenses on social and cultural programs had the largest share of the budget (67.46%). In year 2012, the largest share went to public development, housing, environment and water expenditures (65.56%). In relation to this finding, we must emphasize that expenses on social and cultural activities normally predominate in the budget of the authority under review.

In the year 2012 the ranking changed due to a budget revision, which allocated a capital subsidy totalling 7,000 thousand lei; yet due to their nature, subsidies have a defined purpose being allocated to finance a temporary need (and will not therefore continue to affect the structure of expenditure over the following years). By eliminating this influence, the shares of the various expenditure categories in the overall budget are on a declining path (with one exception). This development is due to the budgetary constraints induced by the current crisis.

*Table 3*

**Method of calculation of the share of distinct expense categories in total expenses**

| | Information | 2011 | 2012 | Comparison benchmark |
|---|---|---|---|---|
| 1 | Total expenditure (thousand lei), of which: | 3375 | 11748 | Average recorded for comparable local authorities |
| 2 | General public service expenditure (thousand lei) | 681 | 687 | |
| **3** | **Share of total expenses** (line 2 / line 1) * 100 | **20.17%** | **5.84%** | |
| 4 | Expenditure on social and cultural programs (thousand lei) | 2277 | 3083 | |
| **5** | **Share of total expenses** (line 4 / line 1) * 100 | **67.46%** | **26.24%** | |
| 6 | Education expenditure (thousand lei) | 1284 | 2005 | |
| **7** | **Share of total expenses** (line 6 / line 1) * 100 | **38.04%** | **17.06%** | |
| 8 | Healthcare expenditure (thousand lei) | 0 | 0 | |
| **9** | **Share of total expenses** (line 8 / line 1) * 100 | **0** | **0** | |
| 10 | Expenditures on cultural, leisure and religious events (thousand lei) | 84 | 140 | |
| **11** | **Share of total expenses** (line 10 / line 1) * 100 | **2.48%** | **1.19%** | |
| 12 | Insurance and welfare expenditures (thousand lei) | 902 | 938 | |
| **13** | **Share of total expenses** (line 12 / line 1) * 100 | **26.72%** | **7.98%** | |
| 14 | Public development, housing, environment, and water expenditures (thousand lei) | 64 | 7703 | |
| **15** | **Share of total expenses** (line 14 / line 1) * 100 | **1.89%** | **65.56%** | |
| 16 | Expenditure on economic initiatives (thousand lei) | 172 | 275 | |
| **17** | **Share of total expenses** (line 16 / line 1) * 100 | **7.51%** | **2.34%** | |

The obligation to pass balanced budgets requires local authorities to either identify new sources of funding or cut expenses. The economic and social climate, severely affected by crises, makes it difficult or even impossible to identify new sources of funding. The only viable option remains to restrict expenses; such restriction ought to be based on a spending priorities plan that takes into account the impact on the local community (accepting only a curb in the volume of public services while not reducing their quality).

### 4.3. The analysis of result indicators (serving to assess performance)

The main indicators used to assess the performance of local public administration are the following: a) the financial management capacity; b) the budget burden of the local administrative unit; c) operational reserve funds; d) primary deficit. The analysis of these indicators provides an overview of the extent and the quality of the involvement of local public government in boosting the economic activity of the community under consideration.

*Table 4*

**Method of calculating performance indicators**

| | Information | 2011 | 2012 | Comparison benchmark |
|---|---|---|---|---|
| 1 | Current revenues (thousand lei) | 3426 | 4488 | Average recorded for comparable local authorities |
| 2 | Current expenditure (thousand lei) | 3279 | 4115 | |
| 3 | Revenues – (thousand lei) | 3460 | 11749 | |
| 4 | *Financial management capacity* [(line 1 – line 2) / line 3)] * 100 | **4.24%** | **3.17% (7.85%)*** | |
| 5 | Own tax revenues (thousand lei) | 256 | 293 | |
| 6 | Shares of income tax (thousand lei) | 104 | 176 | |
| 7 | Total tax revenues collected locally (thousand lei) | 3500** | 3700** | |
| 8 | *Fiscal burden of the local administrative unit* [(line 5 + line 6) / line 7] * 100 | **10.28%** | **12.67%** | |
| 9 | Operational revenues (thousand lei) | 3460 | 4500 | |
| 10 | Operational expenditure (thousand lei) | 3455 | 4424 | |
| 11 | *Operational reserve fund* (line 9 – line 10)*100 (thousand lei) | 5 | 76 | |
| 12 | Own revenues, locally generated (thousand lei) | 261 | 297 | |
| 13 | Shares of income tax (thousand lei) | 104 | 179 | |
| 14 | Administrative expenditure (thousand lei) | 3002 | 3283 | |
| 15 | *Primary deficit* (line 12 + line 13 – line 14) (thousand lei) | - 2637 | -2807 | |

*excluding the capital subsidy, ** reference values.

The indicator *financial management capacity* was determined as the ratio of the surplus of current revenue to current expenses, on the one hand, and revenues, on the other. According to the determination methodology, this indicator demands the simultaneous analysis of local budget revenues and expenses. The value of the indicator and its progress over the course of time enables the quantification of the quality of financial management adopted by the authorizing officer. The financial management capacity must be examined and assessed in the context of the budget evolution during a determined period of time.

Local authorities demonstrate their financial management capacity when they do not use all the available resources on current expenditure, but instead channel a significant share of resources into investment projects. In the case considered here, beyond the upward trend which can be interpreted as positive, one can observe that the majority of resources is earmarked to fund current expenditures (as the authority's possibilities to commit its own revenues to capital expenses are extremely limited).

The influencing factors of this indicators include: the local authority's forecasting capacity; the expertise of staff employed in the financial department; the local fiscal and budget policy; the structure of local budget revenues (highly relevant being the origin of resources and their end use); the degree of decision-making autonomy; local public policies that the authority is committed to.

To ensure a more accurate assessment of financial management capacity, the indicator may also be determined using a range of other approaches including: operational revenues minus current expenses as a share of total revenues; local taxes as a percentage of total revenues; the share of operational reserves in total expenses etc.

*The fiscal burden of the local authority* balances the local authority's own generated revenues (own tax revenues and break-downs of income tax) and the total revenues collected locally (both for the local budget and for other public budgets). In view of how it is determined, the indicator reflects the efforts of the local community in terms of aiming to provide quality local services and to support the funding and development of public services overall (not just at local level but for the whole society). The specific influencing factors include: fiscal policy (central and local); the community's financial capacity; the capacity to collect projected revenues; the capacity of local elected officials to efficiently capitalize on the assets under their administration.

According to information in Table 4 (row 8), the fiscal burden of the local authority under review allows the following interpretation: out of the total fiscal resources collected locally, only 10.28% (and 12.67% respectively) is allocated to the local budget (the remaining share represents sources of income for other budgets).

*Operational reserves*, determined as the difference between the operational revenues and the operational expenses, refer to the amount of available resources at the disposal of the local authority after it has provided all the public services that fall within its remit. They can enable it to provide (additional) funding for local development (providing that the value of the indicator is not distorted by unpaid commitments). In the case under review, although one notes an upward trend, the operational reserve fund is minuscule compared with the local development needs; for the year 2012 this shortcoming was compensated by securing the capital subvention from the national budget (following a budget revision).

In addition to the size of operational revenues and expenses, the indicator is influenced by: the financial capacity of the local public administration to pay for the operational expenditure committed for the current year; the legal framework; transfers of responsibilities from the central public administration to the local public administration; efficiency/effectiveness of financial management.

*Primary deficit,* as an indicator, enables the assessment of the capacity of local government to operate autonomously; based on how it is determined, the indicator serves to reflect the extent to which administrative expenditure are funded by own revenues, generated locally (including shares of income tax), and defines the parameters of local budget balancing (and serves as a reference in adopting budget balancing decisions). Its size provides an insight into the socio-economic situation of the community, serving as a barometer in establishing the actual budget balancing needs. Financing the deficit based on balancing transfers is supported by the fact that administrative units must operate regardless of the revenues they obtain, on condition that they adopt and deploy generally the cost standards for basic public services. The factors that exert an influence over this indicator include: the national standards (guidelines) on primary deficit; the local budget balancing policy; the quality of local government management; the level of local development of the community; the extent of involvement of the civil society in providing public services and in local economic development; the financial capacity of local government.

### 4.4. Diagnosis and identification of alternative solutions

By referring only to the most relevant indicators, we can draw up a list of positive and negative points with respect to the financial performance of the community under review.

Regarding the data provided in Table 5, we would like to emphasize that the appraisal of financial management must not be confined merely to identifying the positive and negative points and to sterile diagnosis. As we acknowledge that the situation cannot be ascribed solely to local decision-makers (but also to the organization and operation of public finance, the local development level, the centrally-coordinated public policies, the macroeconomic context, etc.) and transfer the interpretation of the indicators through the prism of averages recorded for similar authorities, the diagnosis can involve further connotations.

*Table 5*

**Summary of the evolution of financial and budgetary indicators**

| Interpretation | Indicators | 2011 | 2012 | | Benchmark |
|---|---|---|---|---|---|
| | | | Initial | Revised | |
| POSITIVE POINTS | Degree of own revenue collection | 84.63% | 97.15% | - | → 100% |
| | Degree of decision-making autonomy | 98.98% | - | 94.52% | →100% |
| | Expenditure rigidity | 67.82% | 21.13% | - | → minimum |
| | Investment capacity | 14.66% | 64.97% | - | → maximum |
| | Capital expenditure/per capita (lei) | 94.79 | 1451.14 | 120.34 | → maximum |
| NEGATIVE POINTS | Degree of self-financing of local public authorities | 24.04% | 11.32% | 28.00% | → 100% |
| | Revenue generation capacity of local public authorities | 27.05% | 12.81% | 31.71% | → 100% |
| | Degree of decision-making autonomy | 98.98% | 38.20% | 94.52% | →100% |
| | Degree of state dependence of the local authority budget | 75.86% | 88.33% | 71.15% | → minimum |
| | Capacity of local public authorities to access non-reimbursable financing | 0 | 0 | - | → maximum |
| | Expenditure rigidity | 67.82% | - | 52.29% | → minimum |
| | Investment capacity | 14.66% | - | 13.32% | → maximum |
| | Capital expenditure/per capita (lei/per capita) | 94.79 | - | 120.34 | → maximum |
| | Current and forecast debt-carrying capacity | - | - | - | → optimum |
| | Financial management capacity | 4.24% | 3.17% | 7.85% | → maximum |
| | Budget burden of the local public authority | 10.28% | 12.67% | - | → maximum |
| | Contingency fund (thousand lei) | 5 | 76 | - | → maximum |
| | Primary deficit (thousand lei) | - 2637 | -2807 | - | → minimum |

Starting from the list of acknowledged negative points, taking into account the whole set of influencing factors and thoroughly assessing the level of exploitation of available resources, one can identify a series of recommendations, including: a more active interest in mobilizing own resources (even in the current economic and financial context); a redefinition of local fiscal policy; a greater interest in raising funds through financing programs in order to increase the access to non-reimbursable funding; increasing the share of expenditure on investment (as a basis for local economic development); an increased focus on reducing the primary deficit.

## 5. Conclusions

This paper presents a model for assessing the quality of financial decisions made at local government level. For this purpose, we used a set of specific indicators, presented the determining methodology, interpreted the results, identified the influencing factors, diagnosed the situation and identified the required solutions to facilitate the enhancement of the performance of the management of local public financial resources.

The following are the main conclusions drawn from the context of the research:

- Although the specialist literature provides the grounding for a diverse range of indicators for assessing financial activity conducted in a local environment, empirical studies are rarer; moreover, in practice, financial decision-makers limit themselves to quantifying a restricted number of indicators (in this case, those included in regular financial reports);
- The main indicators enabling the appraisal of the quality of financial decision-making are based on variables such as: revenue, expenditure and results / performance;
- The findings from the determination of an indicator must not be taken in absolute form; rather, they must be interpreted in close connection with the evolution of other indicators and that of variables specific to public activity conducted in local sphere;
- The assessment of financial management should not be confined merely to an identification of positive and negative points and to sterile diagnostics; this is because the situation cannot be attributed exclusively to local decision-makers.

In view of the manner in which it was designed and developed, we consider that the present study delivers a threefold utility:

a) scientific, as it reflects the current state of knowledge in the field and contribute to enhancing the methods used in diagnosing the quality of local public financial management;

b) methodological, given that it provides a framework methodology on which to base the analysis of the quality of financial decisions made at the local government level;

c) practical, as it can serve as a tool (guide) for local public managers in increasing the quality of their financial decisions and boost performance.

As we have already argued, the research conducted involves certain limitations entailed by the generalization of results (given that the research factors in only information characterizing one administrative and territorial subdivision, and because often the particular elements have a defining impact on the attainable results). The study represents a starting point for further research aimed at the development of a coherent and consistent set of indicators that should serve as the basis for a comparison based on common terms of the evolution of the various administrative-territorial units, situated at the same level in state administration, at different levels. Such a pursuit is necessary because the analysis of indicators for assessing the financial performance of the local authorities (correlated with the analysis of other non-financial indicators) enables the implementation of more complex diagnostic investigations, and lays out the prerequisites for: high-performance financial management; providing scientific grounding for decision-making; improving financial policies; increasing the transparency of the local government processes, etc.

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