FINANCIAL EQUALIZATION TRANSFERS BETWEEN PUBLIC AUTHORITIES BUDGETS

Emilia Cornelia STOICA*

Abstract

This paper presents financial balancing mechanisms that it is applied by the most of the states with competitive market economy, in order to ensure equity between local authorities, as well as the stability of the entire national tax and budgetary system. In this regard, it is described the concept of financial equalization and its structure according to two fundamental criteria:

- equalization in accordance with the financial transfers orientation, distinguishing thus (1) horizontal equalization, which is carried out between local authorities and consists in assigning a part of the richest territorial collectivities resources to the disadvantaged ones; (2) vertical financial equalization, achieved through consolidated transfers the state / federal budget to the budgets by territorial administrative units, both for the operating budget section and for the development one;

- financial equalization according to the regional or local disparities observed as a result of territorial-level analyzes: (1) financial equalization based on balancing public revenues of the administrative-territorial units, which tries to correct the differences between the financial resources of each local authority and (2) the financial balancing based on the costs, which aims to reduce differences between standard costs of public services per capita.

Financial equalization mechanisms have as main objective the reduction as far as the total elimination of the regional or local disparities, which are also described in this article.

Keywords: *equalization, revenues, costs, horizontal, vertical.*

1. Introduction

Financial balancing territorial administrative units is a specific mechanism of public finances aiming to reduce the gap between local public income per capita registered or the inequalities between them. In this way, it is compensated the differences between the financial capacity of localities - measured either by tax revenue per capita, as in Romania, either by the cost of public services produced and/or distributed by the public authorities to the people.

The main purpose of financial balancing is to allow sub-national authorities to produce and/or distribute similar quality and the price/cost public services under similar budgetary expenditure, even if tax revenues vary from one community to another.

The financial balancing is considered a mechanism used by general government along with budgetary decentralization, insofar as it seeks to correct the potential imbalances resulting from the autonomy of local authorities.

The importance of financial balancing is underlined not only by its use in all countries with economy based on competition - either federal or unitary - but also because its objectives are defined in the Basic Law of the State, the Constitution, and is a pillar of fiscal and budgetarynational policy.

The role of balancing revenues and costs consists in reducing budgetary disparities between the communities, encouraging them also to increase their economic and administrative capacity, thus contributing to the macro-financial stability.

2. Regional Disparities

The own local resources category is not only reduced to the exclusive local taxes, but also includes other sources of funding that may be, and in some cases, extremely important. These are fees, charges and prices of use, but also of income from the property of land, businesses, financial assets, and the proceeds of public capital sales fixed, stocks, land, etc.

The concept of own resources does not mean that local authorities have necessarily complete control. Thus, regarding local taxes, it is generally the tax required whose elements are defined by law and the local authority have only to set tax rates, often within the limits established also by law.

Regarding the billing of local public services in general, rights, charges and usage prices may be fixed by the local authorities with some freedom. However, in most countries, limits are set at the national level.

The notion of regional budgetary disparities designate tax levy differences in capacity - or budgetary capacity - of collectivity that coexist in the same geographical area.

The flexibility of local authorities in regard to their own resources may be very large or very small. However, local authorities have an important real power, although defined by the law on their own resources, but it is different regarding the transferred resources, including shared taxes, endowments and grants.

Generally, the percentage of tax sharing amounts to a territorial level and terms of allocation to the

*Associate Professor PhD, Faculty of Economics, “Nicolae Titulescu” University of Bucharest (e-mail: **liastoica@gmail.com**).

different communities of a given level are set by national legislation and thereby, as part of a tax sharing system, the local government position is stronger than it is when it comes to other forms of transfers.

The endowments are, too, free allocation and local authorities can use these free amounts paid to them in the only limits under the scope of their skills and eventually the distinction between operating expenditures and investment.

As for grants, not just their total amount is set each year based on budgetary availability, but also their use is determined by the authority granting them and allocation takes place based on criteria that allow that authority a discretion important.

Public grants to local budgets can be classified and examined according different criteria and as regards the origin of the inputs its are:

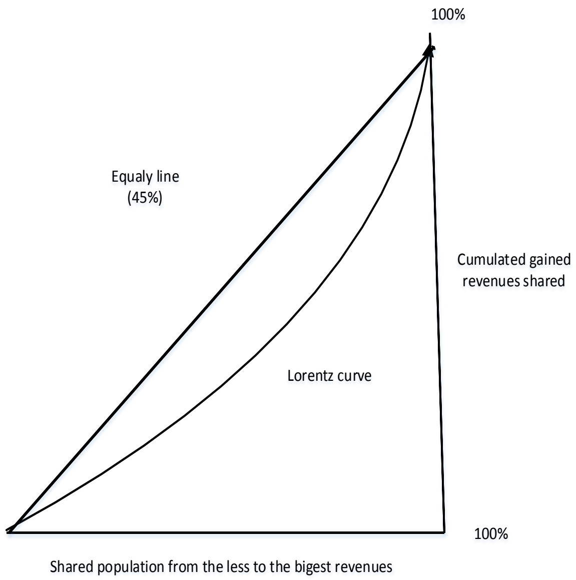
- the contributions of the central state, or the amounts charged to the central government budget;
- the contributions of communities in regional scale and the contributions of other intermediate authorities (provinces, departments, counties, etc.);
- the contributions of the same level of authorities, especially the amounts paid in framework of horizontal equalization mechanisms, or by groups of communities to their members;
- the contributions of international organizations (excluding loans) in particular funding from the European Community.

Local governments provide certain services traditional that might be subject to fees and royalties. Most of these services - garbage collection, road maintenance, building permits, etc. - Could be paid by users and, in theory, it is possible not to provide them at a loss. However, the situation is different when certain free services of the welfare state are decentralized. Given that users are not supposed to pay the cost of these services, they have to be financed by taxes. Thus a redistribution takes place, for example in favor of families with children through free schools, or that of people elderly and sick through free hospitals.

In the case of an important decentralization can result, in terms of horizontal equity, a considerable inequality between people from different communities and thereby it is advantageous to move from one municipality to another, even at the same level of service between the two cities.

The actions taken by public authorities to achieve a near constant level of public income per capita available in all communities shows as the main motivation existence and persistence of regional disparities between the same geographical region.

The differences presented by the GDP/capita, recorded between territorial-administrative units may serve as indicators for measuring regional disparities, especially in the general level of economic development, but along with this information should be found and someones about the life level, and a very significant indicator of this is the GINI index.



The Gini coefficient is a measure of inequality of income distribution in a society. The indicator was built by an Italian statistician, Corrado Gini.

The Gini coefficient varies between 0 and 1, 0 means a perfect equality, 1 total inequality. Representing the Gini coefficient of variation is the Lorenz curve, which shows the orderly revenue in ascending order, and the abscissa population broken down by revenue.

The Gini coefficient measures the area between the Lorenz curve and located right distribution of absolute equality, expressed as a percentage of the total area under the curve.

The Gini coefficient is used primarily to measure inequality of income distribution or heritage, but the economy is often combined with other information, such as democracy indicator (located between -2.5 weakest and +2.5 strongest) in order to analyze the impact of implementing the proposed policies.

(Source: Gini, C. variable is mutable (variability and Mutability, 1912; C. Cuppini, Bologna, 156 pages. Gini, C (1909) Concentration and dependency ratios, Rivista di Economic Policy, 87 (1997) 769-789. http://fr.wikipedia.org/wiki/Coefficient_de_Gini)

Public expenditure per capita for the provision of social services can also highlight, the spread between regions of the same State. Differences in geographical location, number of people, demographic, social protection, also the perceived impact of economic shocks - as recent economic and financial crisis - are responsible for the registration of differences between social costs of public services provided by public authorities of administrative-territorial units to the local population collectivities they run.

Currently, between Member States of the European Union there are significant differences with regard to each of the above indicators.

	GDP/cap -euro -	Total general government expenditure % of GDP	Gini coefficient of equivalised disposable income (source: SILC) Number
EU28	26600	48.5	30.5
Bulgaria	5600	38.3	35.4
Romania	7200	35.1	34.0
Poland	10300	42.2	30.7
Czech Rep.	15000	42.0	24.6
Italy	26500	50.5	32.5
UK	31500	45.5	30.2
France	32100	57.1	30.1
Germany	34200	44.3	29.7
Netherlands	38300	46.8	25.1
Denmark	45100	56.7	27.5
Sweden	45500	53.3	24.9

Thus, both compared to the European average of the 28 member states, as well as to developed countries, Romania and Bulgaria occupies the lowest places in terms of economic development and the public expenditure, showing poor state involvement in national economy. In that regards GINI coefficient, it is situated in the two countries at the highest rates.

3. Financial balancing

Financial balancing is mainly aimed at reducing the gap until cancellation of the differences recorded between local budgetary benefit to the same region.

Financial balancing is not intended flattening financial differences between individually household incomes, but the geographical differences in access to public services. Although both issues relate to the function of redistribution of public finances in each country - that highlights national tax progressivity and/or scope of public social protection programs - financial balancing objective is not identical in each country, as individual redistribution and/or space mechanisms varies considerably from state to state.

Fiscal and budgetary policy distinguishe three missions to the financial stability: equity of the public income distribution between local governments of the country; effectiveness of their use to finance public services necessary to implement a sustainable developments; the stability of public finances which ensures macroeconomic equilibrium of the nation.

Fiscal balance is achieved by financial transfers of the budgetary resources between levels of government, such transfers manifested in various forms, depending on budgetary and fiscal system of each country.

Equity refers to the distribution of public revenues an essential for the proper functioning of the public sector at territorial level, respectively equity between local communities residents, according to which all natural or legal persons from a country have access to comparable public services under similar tax conditions.

Due to financial balancing it can be corrected efficacy spreads between different public services distributed in the community, but also it can reduce the mobility of active people, because there is no financial reason to move from one place to another.

Also, by balancing financial it can be guaranteed the territorial administrative units possibility to respond asymmetric economic shocks, which ensures financial stability not only regionally, but nationally.

4. Taxonomy financial balancing

There are several criteria to classify financial balancing methods implemented in democratic countries. Thus, according to the balance transfers orientation, they can be classified as horizontal or vertical, and according to the disparities type that tries to diminish, we can talk about balance and balancing public revenues per capita costs of public services distributed by local authorities.

As regards the distinction between horizontal and vertical balancing, where the first is observed that transfers occur between sub-national public authorities, while balancing upright - that is to cover the financial deficits recorded at the end of a fiscal year in an administrative-territorial unit - the central government transfers funds to the local authorities.

Such balancing mechanisms are applied practically in all democratic states, some opting for the horizontal, others for the vertical and the third category of states implementing both mechanisms. For example, the European Union countries such as Austria, Denmark, Finland, Sweden apply horizontal balance, taking into account the fiscal capacity / contributor to local communities, while countries such as Italy, Greece, Poland, Portugal use vertical balancing mechanisms of sub-national public finances. Some European countries such as Germany, France and Romania, implements balancing mechanisms both horizontally and vertically. Formulas balancing changes with a frequency of a few years, according to the legal framework on public finances in each country, to adapt their respective mechanisms to the macroeconomic reality and to the evolution of the state administrative organization, the majority of the European Union Member States pursue a sustained trend decentralization[1].

The distribution scheme of public revenues to balance the different categories of financial territorial communities depends on the level and structure of financial resources available to these communities, on the typology of public services delivered and on the balancing formula / formulas imposed by the state.

Unlike balance income, which is mainly focused on reducing differences in financial capacity - which exhibit the authorities ability to collect revenues tax per capita - financial balance by costs seeks to register in all collectivities of a State about the same costs of public services provided by local authorities, possibly even in accordance with the rules applied consistently across the country.

In practice, there is rarely "pure" systems and, today, most countries use all equalization categories.

The revenue sharing is intended to compensate for differences in revenue raising capacity between sub-national governments. Also, there are a wide variety of models and existing equalization schemes in different countries.

Most transfers are of a fixed amount that is to say, the total amount of subsidies is capped, or the total amount paid is determined using tax-sharing formulas. The "marginal rate of equalization" (or "levy equalization", "tax refund" or "replacement rate"), that is to say, the amount of equalization grants a sub-national government if it loses increase its own tax revenue varies considerably between countries.

Balancing the budget with revenue presented in some cases important perverse effects, because it can cause distortions of taxation in areas that receive equalization transfers, by the proportion that is granted and while their management.

Equalization marginal rates are extremely difficult to calculate and their value must be considered carefully. Statutory rates and equalization numbers may vary to a considerable extent the fact that there are interactions between the tax bases and the equalization formulas fail completely or partially certain tax bases. Often, the effective rate is endogenously defined as the total amount to be paid is decided in the first place before it is calculated the equalization rate for each local authority. The marginal rate of equalization must be clearly distinguished from the average long-term reduction of fiscal disparities sub-national governments. These two indicators can vary in considerable proportions.

Equalization revenue is mostly horizontal while the cost is usually vertical.

Cost equalization covers two types of cost difference. The first is the unit cost of providing a service - eg, maintenance of a kilometer of road is more expensive than plain mountain - and the second focuses on the needs - such needs health care for the elderly are more important in a local authority where the population is older. Both cost difference sources are sometimes difficult to distinguish because ultimately they translate both by differences in the per capita cost of providing services. Most countries have implemented cost indicator systems that take into account both the differences in unit costs and differences in needs, distinguishing general "geographical indicators" - which reflect differences in unit costs due topography - and the "socio-economic indicators" which reflect the different needs due to the social structure of sub-national government.

Unlike revenue sharing, it is vertical in most countries, which means that the unit headquarters often sub-national benefit utilities. While most countries use equalization formulas standardized type of costs in several of them that equalization is based on the amount of expenses recorded in the past or current expenses.

While equalization revenue leaves little room for special interests - because is determined on a basis of assessment and equalization rate - the margin of error and interpretation is more important in the equalization of costs: it is necessary choose criteria explaining the differences in costs, determine their weight and collect relevant data.

The dispersion of the population and its density may impact on the unit cost of providing public services. Small municipalities are more expensive to manage because as schools, hospitals and other public facilities show fixed costs. However, services such as security and the fight against fire result in higher spending per head in urban areas.

5. The role of financial equalization to reduce budgetary disparities

Subsequent fiscal equalization disparities are less than the economic disparities measured by regional GDP, which means that public services are distributed more equitably between local authorities that economic heritage.

Redistributive structure of financial equalization between the various categories of local authorities depends on the sources of sub-national revenues, characteristics of decentralized public services and the equalization formula. Equalization revenues typically results in a redistribution of urban to rural areas due to the lower tax-raising capacity of the latter. The

[1] Magali Caumon, Romain Le Borgne, Erwan Hetet, Olivier Wolf et Manuel Zamora, “La réforme de la péréquation:un nouveau souffle pour la réduction des inégalités territoriales ?”, Institut national des études territoriales, Centre national de la fonction publique territoriale, Promotion Salvador Allende, Mars 2012.

equalization of costs based on geographical indicators strengthens redistribution towards rural areas. The equalization of costs based on socio-economic needs indicators reduces this redistributive aspect, but in general the urban areas are net contributors to the extent that the highest indicators of tax levy capacity and lowest.

6. Conclusions

Equalization significantly reduces disparities. Most devices used in different countries have an equalizing effect somewhat similar, but in a few countries the disparities are reduced to virtually zero. The horizontal fiscal equalization has an equalizing effect slightly stronger as a percentage of GDP, the vertical equalization.

Their goal is to allow sub-national governments to provide their citizens similar ranges utility for a similar tax burden. Financial equalization is an explicit program of redistribution and, as such, it may conflict with goals such as efficiency of sub-national spending or sub-national tax effort. Financial equalization devices are very specific to different countries and are often an essential part of their institutional framework, so any comparative analysis must be considered very carefully.

Financial equalization is more transparent if it is institutionally separate statistically or other transfer mechanisms.

References

- Boutayeb Chahira (dir.), La solidarité dans l'Union européenne. Pierre angulaire d'un
- système juridique, Dalloz, coll. Thèmes et commentaires, 2010;
- Börzel T., States and regions in the European Union. Institutional adaptation in Germany
- and Spain, Cambridge, Cambridge University Press, 2002, pp.105-113;
- Hooghe L. Marks Gary, Multi level governance and European integration, Lanham (MD), Rowman & Littlefields Publishers, 2001, 256p;
- Law no. 273/2006, Law on Local Public Finance, as subsequently amended;
- http://www.epp.eurostat.ec.europa.eu;
- http://www.mfinante.ro;