

**THEORETICAL AND PRACTICAL
CONSIDERATIONS REGARDING
THE INSOLVENCY OF THE
ADMINISTRATIVE-TERRITORIAL UNIT
ANINOASA - PART II**

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ABSTRACT: *The main aim of our research was to present you the study case of the first Romanian town declared insolvent, namely Aninoasa town, from Hunedoara county. For the first time in our legislative history, the Romanian authorities considered opportune to regulate the situation of administrative insolvency of a town or village.*

For technical considerations we split our study into two parts. On the first part we have presented you some general considerations regarding the insolvency of administrative-territorial units regulated by the Romanian law and the premises for declaring the town of Aninoasa insolvent, i.e. the economic and social context and the analysis of this insolvency situation causes.

On this second part we will analyze the factors that caused the insolvency of the city of Aninoasa and the way the insolvency proceedings were closed by the Romanian authorities. Our study ends with some conclusions. Shortly, we consider that our government solution represents a palliative result and it can be accepted as a singular solution, motivated by the unique and unprecedented situation. The solution is that the Government should continue its work and find a way to solve the present-day Local Governments financial problems.

KEY WORDS: *Romanian Local Government, austerity, fiscal stress, insolvency, municipal bankruptcy, council bankruptcy, local budget.*

JEL CLASIFICATION: K23.

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1. FACTORS THAT CAUSED THE CITY OF ANINOASA TO BECOME INSOLVENT

From the analysis of all information gathered in connection with the research for this paper, we assume that the state of insolvency of the city of Aninoasa has been caused by several factors, which we will be further analyzed.

1. First, we believe that it is the loan for investments of 2,783,992.98 lei raised by the public authority in 2006 and the lack of necessary resources to cover equity rates, interest and commissions.

In this respect, we must add that on 10th October, 2006 a credit agreement was signed with a commercial bank, granting the City Hall of Aninoasa a repayable funding in the form of investment credit worth 3,000,000.00 lei for a period of 10 years, thereafter on 22nd October, 2007, an addendum to the original contract would reduce the loan for investment to 2,783,992.98 lei.

The motive for accessing this credit for investment was the need to achieve the following objectives: modernizing the administrative headquarters, mechanical school workshop rehabilitation, church renovation, major repairs on Sports Centers, sports field rehabilitation, natural gas supply, redesigning a building, overhaul on dwelling houses, technical projects and feasibility studies, rejuvenation of Aninoasa creek/brook. These investments financed from the loan have been completed to a large extent, except for the natural gas supply.

We would like to clarify the following issues related to the above mentioned expenses that were made from the sum obtained as a result of accessing this credit. The Recommendation of the Committee of Ministers to Member States Rec (2005)1 on the financial resources of local and regional authorities provides as basic principle regarding the loans of local authorities, that this form of investment is applicable in the case of services, since the debt will be paid by users in the form of bills.

As such, we have come up with two questions. 1. Why none of the objectives in which this amount of money was to be invested does not represent a type of service that subsequently would produce cash to cover part of the rates for that loan? 2. To what extent the modernization and rehabilitation of those locations was necessary so that it be done at the risk of destabilizing the budget of Aninoasa administrative – territorial unit?

We hasten to add that we must stop dwelling on the answer to these two questions, since the objective of this study is not to examine the advantages of such expenditure. In addition, making a loan in compliance with the legislation in force makes this action of the public administration to be a legal one, whereas the latter has received a favourable opinion from the Commission for local loans approval.

2. The same year the credit had been contracted, Aninoasa Mining Company, the main contributor to the local budget was shut down, which generated many negative implications, such as:

- low incomes to the local budget, Aninoasa Mining Company being the most important contributor to the local budget revenue;
- increased unemployment rate because the majority of the working population in the area was employed in the mining sector;

- the low income of inhabitants determined a small extent of collecting taxes and duties from individuals, as well as a reduction in the amounts allocated by the County Council.

Determining these two prime causes of going into payment default of Aninoasa administrative-territorial unit - making a public loan, which has proved to be difficult to repay since the closing down of the most important contributor to the local budget of Aninoasa, we must emphasize another aspect as well.

Shutting down Aninoasa Mining Company in 2006 had been planned since the year 2000 both at the level of the Jiu Valley and at central level. As it had been expected, on 17th April, 2006, the last ton of coal was extracted from Aninoasa Mine, and by the year 2008 the mine would have gone through a closing and site clearance program. The credit agreement was concluded by the city of Aninoasa on 10th October, 2006, for a period of 10 years.

One can easily observe that the closure of Aninoasa Mining Company preceded the date of the credit agreement. This means that, at the time of signing the credit agreement it was obvious that the most important contributor to the local budget of the city of Aninoasa had disappeared from the list of taxpayers.

Then the following question arises: how could anyone approve a public credit based on a forecasting of income depending on the revenues of the past years, as long as it was obvious that by closing down Aninoasa Mine, the most important taxpayer would disappear, and the forecasts would no longer reflect the reality.

At this point of our analysis we are entitled to doubt the good faith of those who drafted and signed the credit application authorization, taking into account the income from the previous years, when the contribution of Aninoasa Mining Company was significant, without highlighting the fact that the closing of Aninoasa Mine would determine a significant reduction in revenue to the local budget beginning with the year 2006.

3. The negative effect upon the revenue of the local budget was doubled by major implications of the tough economic situation within the area, because of the fact that many companies from the town, other than the Mining Company - the main taxpayer, had significantly reduced their activities or had entered insolvency proceedings, while the chances to recover outstanding debts from them seemed very poor; the share of these outstanding debts within the total revenue amounts to 66.95% by March 31st, 2013.

4. Moreover, the amounts allocated from the budget of the County Council were reduced in order to balance local budgets, because of the difficult economic situation at national level.

5. The last cause and, incidentally, the one that resulted in an immediate onset of the state of insolvency was the implementation of article 1 from GEO No. 3/2013 on measures regulating the reduction of some arrears from economy and other financial measures, as well as the amendments to some legislative acts, which stipulated the obligation to reduce the volume of arrears with at least 85% by March 31st, 2013, otherwise the local budget would stop being supplied with amounts from broken shares.

As it has been pointed out, the town of Aninoasa, had already been facing a series of financial problems as a result of contracting that weighted credit and because it had lost much of its own sources to the local budget, due to the closure of Aninoasa Mining Company - the main taxpayer, but also because of the limitation/shutting down of other companies within the area. Under these conditions, the town of Aninoasa has not had any chance to reduce the volume of arrears in the period required by law, immediate consequence being the cessation of granting broken shares.

Considering the role of broken shares in ensuring the operation of local administrations, it is notorious that within local public administrations, the funds coming from the broken shares if income tax and the amounts deducted from some revenues of the State budget in order to balance local budgets, often represent the most important local budget revenues, in many cases exceeding 90% of the institution's income share. This was the case of the City Hall in Aninoasa in 2013; therefore, such income ensured the functioning of the institution, covering operating expenses, salaries and providing essential public services.

By the year 2013, even though an administrative-territorial unit registered arrears that could not be reduced, salaries and running costs had been covered, while the payment of debts played second. The only way a creditor could exercise pressure on an institution was to force the foreclosure and freeze the accounts of the institution.

However, as it has already been pointed out, by implementing GEO No. 3/2013 on measures regulating the reduction of some arrears from economy, the state requires territorial-administrative units to reduce the volume of arrears with at least 85% by March 31st, 2013, otherwise local budgets would not have supplied with amounts from broken shares anymore, which was the case of the City Hall of Aninoasa.

Therefore, the big problem of Aninoasa has been the impossibility to cover the debt from its own budgetary revenues, which on 31st March, 2013 reached 4.28%, in conjunction with the low degree of collecting taxes and fees.

Correlating the last two causes: decreasing the amounts distributed by the County Council in order to balance local budgets, due to the difficult economic situation at national level and the adoption of a normative act by which authorities were to reduce the arrears of administrative-territorial units, we are able to consider the occurrence of insolvency of administrative-territorial units from Romania as a direct consequence of austerity measures, which have been taken not only in our country but also worldwide amid the global economic crisis.

Although the Romanian doctrine does not have studies on the effects of austerity policies over the local government, they have already been the subject of research in American (Downhill, 2014, p. 93) and British (Dunleavy, Rainford, Tinkler, 2011, pp. 1-20) literature.

In our opinion, the emergence of normative acts containing regulations regarding measures for the reduction of arrears in economy and the financial crisis and the state of insolvency of administrative territorial units are concrete evidence of the application of an austerity policy in Romania as well, which have directly affected local administration.

Moreover, as shown in a recent study on the effects of the economic crisis in the Balkans, one of the main consequences of the global financial and economic crisis is the deterioration of public finances (Rădulescu, 2012, pp. 27-29).

In our turn, we consider that Romanian administrative-territorial units have already been facing financial problems, while the onset of the global economic crisis, which has affected all world economies and public finances implicitly, can only aggravate the financial problems of local authorities.

2. CLOSING INSOLVENCY PROCEEDINGS IN THE CASE OF ANINOASA

In order to cover the financial blockage some administrative-territorial units have been dealing with, throughout September 2014, the Romanian Government has approved the resolution to financially unblock 11 municipalities facing insolvency, enforcement or the impossibility of payment, a decision which granted RON 25.584 million from the budgetary reserve fund. Aninoasa was among the 11 towns and villages mentioned in that Resolution, so it received the RON 3,707,000 and as a consequence insolvency proceedings were closed.

Table 1. Information from the local records regarding insolvent administrative-territorial units

Registration number	Name of city/village	Identification Code	Court Decision number	Date of opening the insolvency proceedings
31233/ 10.07.2013	Aninoasa	4468994	868/F/2013	17.06.2013

Registration number	Name of city/village	Total expenses	Total debts	The ratio of debts on total expenses	Date of closing the insolvency proceedings
23365/ 05.12.2014	Aninoasa	4.297.650	3.377.629	78,59	14.11.2014

Source: <http://discutii.mfinante.ro/static/10/Mfp/buget/sitebuget/hunedoara11122014.pdf>, accessed on 12 January 2020

The act in question is Resolution no. 804/2014 regarding the supplementation of the budget of the Ministry of Regional Development and Public Administration in 2014 from the Budgetary Reserve Fund at the disposal of the Government, stipulated within the State budget for 2014 and the Ordinance of the Ministry of Regional Development and Public Administration No. 1719/25.09.2014 with regards to allocating RON 3.707 thousands to the local budget of the town of Aninoasa within Hunedoara County for 2014, article 1 and the following ones, according to which the local budget revenues for Aninoasa have been supplemented by RON 3,707,000.

Under the circumstances, on October 24th 2014, the Department of Civil, Contentious Administrative and Fiscal Service within the Court, according to Decision 918/2014 acknowledges the Chief authorizing officer's and the Mayor's request, with regard to terminating insolvency procedures.

On the website of the Romanian Ministry of Public Finance we can find the information regarding the situation of Aninoasa's insolvency (table 1).

3. CONCLUSIONS

From the analysis undertaken, we can conclude that the state of insolvency of Aninoasa has occurred because of the mismanagement of local authorities by contracting that weighted credit, which we consider unsubstantiated in terms of its advantages and by not taking measures to capitalize on the entire potential used to attract, increase and collect own resources in time; all this happened amid the closure of Aninoasa Mining Company, the main taxpayer in the area. Besides all these, there are also the consequences of the global financial crisis which, according to economic analysts, have affected our country as well since 2008.

As for how authorities have solved the issue of termination of insolvency proceedings of territorial-administrative units, including Aninoasa, we consider it fair to some extent. Thus, the only argument for allocating resources from the Reserve Fund of the State budget is that the Government is faced with an unprecedented situation at legislative level, which really needs to be solved.

However, we are of the opinion that the allocation of resources from the Reserve Fund of the State budget in order to cover the debts of insolvent administrative territorial units must not become a habit or a general way of dealing with such situations; on the contrary it must represent a particular if not, a special case.

Therefore, we believe that the efforts of authorities to solve issues regarding the insolvency of administrative-territorial units should not confine to this first step, which consists in transferring the necessary financial resources from the Reserve Fund of the State budget, because this is only a temporary solution of financial problems of local authorities. In the future, in order to optimize the management of local public administration and to avoid the bankruptcy of administrative-territorial units, the Government should take measures in three main directions.

First of all, the legal framework should be improved in the direction of adopting a more restrictive policy with regard to the possibility of contracting public loans by local public administration authorities.

On analyzing the context in which the loan was contracted by Aninoasa City Hall, and the fact that reimbursement has resulted in serious financial problems at the level of the local budget, finally becoming insolvent, we have found some shortcomings of the legal regulations in force regarding the access to public loans.

We must note that these regulations compel administrative- territorial units to present documentation indicating that they will have the financial resources to cover loan rates, but it lays emphasis on revenue forecasting.

This was the case of the town of Aninoasa, as I have already pointed out, since forecasts presented accounting data which met legal conditions and, as such,

determined a favourable loan notice, while actual data would reflect a different reality because of the closing of one of the taxpayers, Aninoasa Mining Company.

We must admit that in any economic forecast errors or risks can occur. But in this particular case, we have found that it was obvious that local authorities from Aninoasa had been aware of the fact that these forecasts were basically incorrect in the context of closing down Aninoasa Mining Company, the main contributor to the local budget, yet they decided to ignore this issue and did not include this information in that certain documentation.

As such, we believe that *de lege ferenda* is compulsory to complete the legal framework for accessing public loans, while authorities who sign it must be held responsible in case they prove to have acted in bad faith, meaning they did not declare important issues that would affect the future of the local budget revenues as well as the closure or relocation of some economic agents, taxpayers in the area, if it is found that they have been aware of this information.

In addition, as I have already pointed out, we are of the opinion that we should take into consideration the recommendation made by the Committee of Ministers of the European Council to call upon public credits for providing services that will later generate revenue through bills paid by customers; this money will then be used for paying loan rates.

Secondly, from our point of view, we support a theory that has already been presented in a previous study, according to which we must take into consideration a far-reaching reform relating to the abolition of communes and small towns by merging them with neighbouring towns, municipalities, respectively, because small administrative-territorial units with low resources can only function with funds allocated from the State budget. (Cenușe, 2012, p. 5)

Moreover, this tendency to create larger, more efficient and financially autonomous administrative territorial units has developed throughout Europe since 1060 (Swianiewicz, 2010, pp. 1-25). At present, the trend of fusion, of merger has increased again at EU level, many states encouraging the policy of eliminating local municipalities, because a large number of local administrative-territorial units generate greater expenses.

Thirdly, measures should be taken to strengthen the autonomy of administrative-territorial units in the financial field in particular, measures which aim to increase the financial capacity of administrative-territorial units.

Thus, in order to achieve a real financial independence of administrative-territorial units and to obtain an equitable distribution of financial resources from the State budget to local budgets, we believe that measures must be taken in the following two directions.

First of all, steps should be taken in order to strengthen the independence of administrative-territorial units through their own efforts. Therefore, appropriate legal measures should impose certain conditions on administrative-territorial units in order to benefit from transfers from the State budget.

In practice, it is found that the majority of administrative-territorial units have a very low degree of collecting local taxes and duties, which represent their own

resources. We believe that there are two reasons for such a situation: on the one hand, local authorities do not initiate enforcement actions against debtors most likely for political reasons, because such unpopular actions would attract the loss of confidence of the electorate and, on the other hand, local authorities rely on transfers from the State budget.

These are the reasons why we believe that in order to obtain financial autonomy, the State has an essential role, which must, however, be completed by the effort of administrative-territorial units. Therefore, we consider that a minimum threshold for raising own resources should be enforced by law upon administrative territorial units, for example a rate of 75%, otherwise transfers from the State budget should be blocked and local authorities will be directly involved in collecting funds, thus avoiding the situation existing at present.

In addition, a legal system should motivate administrative-territorial units to identify and capitalize on all sources of income to the local budget, and then to collect them as we have shown above.

In case it is not possible to identify new sources of revenue in local budgets, there should be a concern from local public administration authorities to achieve an optimum ratio between the income level and the local budgetary expenses.

Secondly, in order to eliminate political influences from the circuit of financial resources transferred from the State budget to local budgets, the power of county authorities regarding financial transfers from the State budget should be overturned first, and then the State must find an appropriate solution to cover through budget transfers, the necessary difference in resources, solving at the same time the delicate problems of ensuring equal opportunities for all administrative-territorial units for the purposes of establishing a minimum and a maximum amount for budgetary transfers, so that poor administrative-territorial units be helped to survive.

At the same time, this kind of action must not be carried out at the expense of rich administrative-territorial units, which would be able to fulfill all the tasks using their own resources and they should be limited to a certain amount of financial resources transferred from the State budget, because otherwise, instead of being encouraged and appreciated for their financial independence, they will be determined as a result of frustration, to stop being so interested in covering all the resources they need and they can provide for themselves.

Moreover, we should make clear that we support the abolition of power of county authorities regarding the allocation of financial resources which are transferred from the State budget, because, unfortunately, they often make arbitrary decisions as far as financial resources are concerned, thus eliminating this link from the circuit of financial transfers from the State budget.

The final conclusion is that the local public administration is faced with difficult financial problems, thus challenging the Romanian Government. The solution is that they understand the acute need for measures at many levels (restricting access to public loans, strengthening the financial capacity of territorial-administrative units at the basic level, both by increasing their sizes and by obliging them to correctly identify all the opportunities to earn income and to collect them) because the mere transfer of funds from the Reserve Fund of the State budget is only a stopgap that does not help

local public authorities to avoid a financial crisis or even the state of insolvency. Solving the actual financial issues at the level of local administrative-territorial units can be possible as soon as the Government will have embarked on a reform which would include measures of the kind described in the paper.

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