

Municipal Pooled Financing in Romania

- An initial study of the possibilities to introduce pooled financing for local authorities in Romania

- Executive Summary -



June 2015

Lars M Andersson

Executive summary

Municipal Pooled Financing Mechanisms (PFMs) can be broadly defined as a cooperation between local authorities with a focus on local infrastructure investments' financing through market-based borrowing. PFMs can be an efficient tool to address financing challenges at municipal level in developing/emerging countries, where financial markets and municipalities are sufficiently sophisticated. A wide international experience shows that pooled financing has been very successful in enabling market-based funding of local infrastructure investments, reducing costs of borrowing and supporting decentralisation. The implementation of PFMs has been adjusted to political and public sector circumstances in many developed countries and in some developing countries. It can range from the execution of a single bond issue (club-deal) by several municipalities, to the creation of a platform for repeated club-deals and, further, to the creation of a municipal funding agency.

This is a first study of the possibilities to introduce PFMs in Romania. It is focused upon

- Local authorities' financing needs, capacity and creditworthiness,
- Legal options and restraints to apply PFMs.

The need for local infrastructure investments is substantial. Public utilities' infrastructure needs to be further developed in Romania. For example, in some part of the country, less than half of the housing units are connected to running water and sewage.

Romanian local authorities have so far had problems with absorbing EU grants due to weak capacity to prepare and implement projects. On top of this there has been a lack of resources for co-financing, although Romanian local authorities have low levels of debt, estimated at around 2 percent of GDP, which can be compared to an EU local authority average that amounts to more than 15 percent. One reason for this is the borrowing restriction that the Romanian central government has imposed on local authorities for all debt and guarantees, except for co-financing of projects supported by EU grants.

Romanian local authorities were hit hard by the effects of the recent financial crises and, according to the Ministry of Development, most local authorities still have low capacity to borrow, except for the 20 biggest cities. Many have poor creditworthiness and a lack of capacity that sometimes even prevents the use of grants. Creditworthiness seems to be diverse, with big differences in different parts of the country, but it is likely that a sufficient number of local authorities have the required financial solvency to participate in a PFM project. Furthermore, it should be the aim of this project to assist local authorities in reaching the required creditworthiness level.

The legal framework allows for cooperation between these public entities and it seems likely that such a cooperation scheme can include financing, provided that all local borrowing is done in accordance with the existing legal limits.

There is an obvious need for new funding mechanisms for Romanian local authorities and the basic requirements for PFM are deemed to be present, which leads to the conclusion that this question should be further investigated. Among the suggested next steps (see further in the section VIII. Recommendations – next steps) are to primarily target the Ministry of Development and local government organisations, like the Association of Mayors, to further refine the view of possibilities and challenges to introduce PFM in Romania and to investigate if central stakeholders could be committed to examine PFM. It is, furthermore, important to have

discussions with major players in the domestic capital market, where the commercial banks obviously play important roles.

It is also recommended to do two further studies:

- A legal study of the possibilities to form a PFM agency, including types of guarantees that the local government (or any other stakeholder) can issue to support this agency. The study should address the questions concerning the possible legal status of a PFM agency.
- A study of the creditworthiness of local authorities in order to determine which local authorities have sufficient financial standings to be part of a possible PFM scheme.

