

# **MONEY FOR OUR PEOPLE?**

**Decentralization and corruption in Romania:  
the cases of the equalization, infrastructure and pre-university  
education funds**

**Sorin Ioniță**

Research director, Romanian Academic Society (SAR)

15 Petofi Sandor, Bucharest 1, Romania

tel/fax (4021)222.1868

[sionita@sar.org.ro](mailto:sionita@sar.org.ro)

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## **SUMMARY**

In spite of the attempts to introduce simple, accountable and rule-based mechanisms governing the flows of funds for Romanian local governments (LGs) in the last years, anecdotal evidence suggest that deviations from the norms are still widespread and undermine the stated goals of many policies. This study aims to explore to what extent the political factor (party affiliation, i.e. local informal power networks) interfere with the allocation of public funds as far as three main areas of decentralized policy are concerned: (i) the general purpose equalization transfers; (ii) the Roads Fund grants; and (iii) the transfers for financing the pre-university education. These components represent a relatively large share of the total of local budgets and are illustrative for two important attributions Romanian local governments perform today: maintaining the local infrastructure; and providing essential social services. Through a set of variables measuring, on the one hand, the real pattern of resource allocation, and on the other hand, the intensity of politicization in the three areas, we tested the hypothesis that intergovernmental financial flows in Romania are to a large extent captured by rent-seeking groups. It turns out that this is indeed the case with the funds for infrastructure, and much less so with the transfers financing pre-university education. Some conclusions from these contrasting situations are drawn which reflect on the broader discussion about the link between decentralization and corruption.

## 1. Introduction

Key legislative reforms, dating back to the end of 1997, have fundamentally changed intergovernmental fiscal relations and the structure of the finances of the county and local councils in Romania<sup>1</sup>. In particular, the Law on Local Public Finance adopted in 1998 put local finances and the local budget process on an equal legislative basis with those of the national government. The law also introduced tax revenue sharing in Romania. The new legislation greatly simplified the transfer system. All dedicated transfers for operating subsidies of public service companies and investment subsidies to the local and county councils from the state budget were eliminated. The general transfer was replaced with an *equalization grant* that aims to correct for differences in expenditure responsibilities and fiscal capacity among the county and local councils. The reforms also made capital and operational (supplies) costs for primary and secondary education the responsibility of local governments. Subsequent reforms introduced in 2001-2 increased further the attributions of local governments, by reassigning to them the responsibility to pay teachers' salaries. The intent of this stream of decentralizing legislation was, first, to strengthen local fiscal autonomy by clarifying and expanding local control over revenues, expenditures and the budget process; and second, to place a number of public sector functions such as the provision of local services, welfare support and pre-university education where they belong – i.e. closer to citizens.

However, progress in meeting these objectives has been partial at best, as many problems occurred in the process of implementation. First, the rules governing the assignment of revenues by tier of government, especially the tax sharing, have gone through frequent amendments, while the simplification of the system of transfers did not last long. They have eroded some of the benefits of the new local finance legislation.

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<sup>1</sup> Romania has two tiers of local government: *local governments* proper, at the level of communities (each with an elected council and an elected mayor – about 3,000 units, urban and rural); and *counties* (each with an elected council – 41 in all). In theory there is no legal subordination between these two tiers, or between them and the central government.

Second, the budgetary process continues to have a substantial adverse impact on the autonomy of local governments, because it is long, complex and it subordinates de facto the local budgeting to the national one. As a result, it creates many points of intervention by the central government in the local budget process in general; and by the county councils in the budgetary process of localities. Third, the combination of decreasing central control over allocations and incomplete institutional reform at the grassroots level, which does not create the right incentives for local authorities to focus on output quality, is believed to skew the allocation of resources for social services in unpredictable ways. Anecdotal evidence says that the sums spent per capita of pupil in the education system vary widely across or within local jurisdictions, while the rules mandated from the centre are encouraging the “locking in” of the current misallocation of educational infrastructure. Finally, the volume and type of transfers, both general and earmarked (such as the one financing pre-university education) keep changing from one year to the next. Localities must wait for the county council to allocate to each one of them their corresponding share of the equalization grants received by the county council from the State budget. This allocation process usually follows different and unpredictable patterns in each of the 41 counties. The usual practice involves some quantitative criteria, but the process is far from being based purely on the formula which in theory is mandated by law. No local council knows for sure what amount they will receive from the county council. The process typically involves significant individual ‘communication’ between the local councils and the county council. Many domestic analysts point to these shortcomings to explain the *political migration* of mayors towards the party winning national elections (which is also the most likely to have majority in county councils), a tendency that has accelerated in the last years (IPP, 2001).

The problem with all these developments occurring in the area of local government finance is that they have not been proved with systematic data. So far they have remained largely at the stage of accepted knowledge based on anecdotal evidence.

*This material represents an attempt to test the hypothesis that when deviations from the*

*norm governing financial transfers to local governments occur, they correlate significantly with political factors (such as party affiliation).* In fact, the two variables – "deviant" patterns of financial allocations, and the intensity of political pressure on them (which we may call "political corruption") – are intertwined, forming a vicious circle where, though closely linked, none can be easily discerned as a clear cause of the other:

- a) The availability of funds governed by loose allocation rules encourage people in the local government system to rely on informal mechanisms in order to get them – and one such strong mechanism is party networking;
- b) And on the other hand the pre-existence of clientelistic groups at the local level makes it very difficult for any government to implement clean and transparent rules of distribution, because the expectations are high that "our people" should get the lion's share.

If we now reformulate the hypothesis in a more operational way, point (b) says that we should expect that financial flows favor certain local governments, and these deviations from the norm on a specific tier should be associated with the affiliation to the party which controls access to resources from the upper tier of governance.

Point (a) says that, in time, we should notice a trend in political migration in the local administration towards that particular party which controls the resources, and as a result this too should be significantly associated with favoritism in the allocation of resources. Both trends are part of a larger phenomenon we may call "political corruption"<sup>2</sup>. This paper is a modest attempt to operationalize, measure it and contribute to the current debate about the link between decentralization and corruption by going beyond simplistic conclusions such as "decentralization is good (or bad)" for the fight against

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<sup>2</sup> By this term I mean primarily acts of "grand corruption" and "state capture", as opposed to the widespread "petty corruption" by small-time bureaucrats. More on these distinctions and their practical consequences in Schacter and Shah (2001).

corruption, by showing in what specific circumstances and under what kind of institutional arrangements this is more likely to happen.

## **2. Decentralization and political corruption**

There are many studies available which show that decentralization's promise to bring more accountability and transparency in the political process is hard to fulfill. If local officials come more frequently into contact with the citizens, this may lead to the personalization of interactions and, as a result, to less professionalism and neutrality in the public bureaucracy (Tanzi, 1995). Personalization of citizen-civil servant relationships creates fertile ground for corruption as the latter become increasingly more attentive to the needs of particular groups than the general interest. Prud'homme (1994) lists some reasons why this is likely to happen:

- Increased influence of local interest groups;
- It is empirically proved that locally elected officials tend to have longer tenure in office, being more often reelected, when the degree of decentralization is higher
- The stakes of the local political competition are higher when many resources are controlled locally
- The central supervision is looser
- There is less control by the public and the media, and less moral pressure from them, because the number of relevant political actors is much higher in decentralized systems, while the attention of the public is a limited resource

Treisman (1999) backs the conclusions above: he runs a statistical analysis on 85 states which shows that federal states are perceived as more corrupt than the average, because:

- They tend to be larger

- They tend to have supervisory and law enforcement agencies stratified on several tiers, so more easily targeted by "asymmetric pressures" from various levels of governance; moreover, overlapping jurisdictions in law enforcing, by local and federal agencies, create incentives for "overgrazing"<sup>3</sup> in extracting illicit payments
- They tend to have an upper house in the Parliament with veto powers on resource-allocation decisions, which is elected on a regional basis; this increases the probability that local politicians will develop "special relationships" with the central ones

According to some authors, political decentralization seems to be a source of corruption in the process of reforming the economy in Russia, but not in China (Blanchard and Shleifer, 2000). They contrast the role of local authorities in the two countries and conclude that while in China this was a positive one for industrial restructuring, while in Russia it was largely negative. Over-taxation and the abusive and uncoordinated regulations introduced through local initiatives in the second case would be, in their opinion, responsible for a large part of the deterioration of the business environment and the proliferation of corruption in Russia. The difference between the two situations is therefore attributed to the political component of decentralization, present in Russia but absent in China<sup>4</sup>.

Contradicting Treisman other comparative studies identify a negative correlation between the degree of decentralization and the perceived level of corruption in a particular country. Fisman and Gatti (2000) measure decentralization by the percentage of public funds spent at the local level, while for corruption employ three sets of data, all based on perceptions<sup>5</sup>. The authors interpret their results to the effect that decentralization in spending correlates significantly with a lower perceived corruption,

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<sup>3</sup> Process similar to the process of vandalizing a *common good* through over-exploitation.

<sup>4</sup> In technical terms, we can therefore say that in Russia a real decentralization has occurred (with transfer of decision-making power), while in China only some *deconcentration*.

<sup>5</sup> One on the general population and two on panels of experts.

even after controlling for the influence of factors mentioned by Treisman<sup>6</sup>. Huther and Shah (1998) have also run a cross-country comparative analysis and their results converge with those of Fisman and Gatti: fiscal decentralization seems to be associated with better governance, understood as greater citizen participation, more transparent institutions, social equity and lower perceived corruption. The resource allocation tends to be more optimal in the long run, especially in developing countries where excessive centralization had underfavored social sectors such as health and education (sectors in which corruption, when it exists, usually takes more "benign" forms).

In-depth case studies tend to confirm such findings: Wade (1997) shows that the irrigations administration, one of the most centralized in India, is also one with a very corrupt bureaucracy, and the perpetuation of centralism only magnifies misallocations, the cynicism of beneficiaries and, eventually, corruption<sup>7</sup>.

There are, therefore, at least as many counter-examples to the cases mentioned above which support the idea that the transfer of resources and decision-making power to local authorities increase transparency and make the political system more responsible towards citizens. The political competition stimulates innovation and the transfer of best-practices; and, at least in some areas of policy (though probably not in all) the citizens are really better informed as far as local issues are concerned. It is even possible that, what in the first instance looks like a proliferation of corruption triggered by decentralization, to be in fact only a by-product of increased local interest and scrutiny. Crook and Manor (2000) have studied closely the situation in India, Bangladesh and Ghana and concluded that the localization of decision has led to a greater preoccupation for public affairs, which increased the frequency of reporting corrupt practices, which in turn has distorted the data generated through perception surveys.

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<sup>6</sup> And others, such as the level of development: it has been often noted that a developed country can be in the same time more decentralized and less corrupt, without the two things being necessarily related.

<sup>7</sup> Wade, R (1997). "How Infrastructure Agencies Motivate Staff: Canal Irrigation in India and Korea", quoted in Fisman and Gatti (2000).

The direct estimates made by the authors show that the total stock of resources controlled through obscure mechanisms by a small number of local officials has in fact decreased. Just that they became more visible after decentralization, which made the population more aware of what is going on. Wildasin (1995), moreover, concludes that decentralization in general may reduce corruption – while *deconcentration* may work in the opposite direction<sup>8</sup>.

Briefly put, there is a long list of factors which may interfere in the relationship between decentralization and corruption, skewing it in unpredictable directions (Treisman, 2002). The fundamental problem raised by devolution is therefore that a level of governance too close to the citizen can in some circumstances be easily confiscated by illegitimate influences. More than two centuries ago James Madison clearly expressed this idea:

*The smaller the society, the fewer probably will be the distinct parties and interests composing it; the fewer the distinct parties and interests, the more frequently will a majority be found of the same party; and the smaller the number of individuals composing a majority, and the smaller the compass within which they are placed, the more easily will they concert and execute their plans of oppression. Extend the sphere, and you take in a greater variety of parties and interests; you make it less probable that a majority of the whole will have a common motive to invade the rights of other citizens... As each representative will be chosen by a greater number of citizens in the large than in the small republic, it will be more difficult for unworthy candidates to practice with success the vicious arts by which elections are too often carried. (Federalist Papers, No. 10)*

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<sup>8</sup> Simply put, *decentralization* proper (devolution) passes not only resources, but also the power to make fundamental decisions down to the elected local governments. By contrast, *deconcentration* simply relocates away from the capital agencies which remain under central subordination, or at best creates strict national mandates to be implemented by local governments.

Verifying Madison's ideas, recent studies show, for example, how the passing down to local communities more attributions and resources has only reinforced the traditional power structure of an incompletely modernized society (Bardhan and Mockerjee, 2002). Local elites have thus acquired a formal instrument through which to institutionalize a social domination that had been informal until that moment, and additional resources to be used in the process of creating local patronage networks. Nevertheless, these tendencies have to be balanced with the opposite propensity, equally damaging, of the central bureaucracy to create convoluted structures in order to siphon off public resources to the benefit of well-connected individuals or groups. Probably the worst case scenario is when the two phenomena coexist alongside, instead of canceling off each other. The interesting thing in such situations is how and why this may happen. Bardhan and Mockerjee are concerned precisely with the complex interaction of these opposite tendencies in particular circumstances (i.e. various Indian states). The correlation they find overall between decentralization and corruption is ambiguous.

Today, the debate on the effects of decentralization on corruption is going on, and no side in this dispute seems to have gained the upper hand. What we need probably to do is go beyond cross-country statistical studies which attempt to prove once for all a clear directional effect. As mentioned before, it is possible that such influence may differ according to local institutional designs or areas of policy investigated – and it is exactly such narrow studies which could shed light on the broader theory. With the advantages of decentralization on the one hand, and the danger of institutions being captured by the local elites as they receive more attributions and resources on the other, how the balance tilts may depend entirely on local circumstances and institutional setting.

However, some conclusions may still be more general in nature and applicable in other cases too. The case of Romania discussed below represents such an attempt to discern those particular elements that create a positive association between decentralization and corruption, the environment in which such association is more likely to occur, and discuss how such unwanted development could be prevented.

### 3. Methodology: the variables

The concepts of decentralization and corruption must be clearly operationalized in the case of Romania discussed below. For the purpose of this analysis the first one does not raise particular problems. Fig. 1 shows convincingly that a substantial amount of decentralization has taken place in Romania in the last years<sup>9</sup>. The space of local autonomy has expanded and more resources are passed down to local governments almost every year, so we can assume safely that the developments described below take place against the background of advancing decentralization.

We were actually interested to see if there is more or less corruption associated with this process of decentralization. The interesting aspects considered here are those related to "great corruption" and state capture, not petty corruption<sup>10</sup>. Therefore we are going to focus on the political effects of fund allocations, related to the party membership of decision makers. The petty corruption, though important, can be regarded as subordinated to the other two types both in importance and as far as the causal mechanisms are concerned: they are the ones which define the institutional culture in a society or organization, and create an environment where petty corruption either proliferates or is fought against.

#### *Fig. 1. Size of local government expenditure in Romania*

A number of variables were constructed based on data available from all 41 counties of Romania. Details regarding the significance of each indicator, the way they were generated and aggregated, and the exact values are presented in Annex 1 and 2.

Basically, there are two flows of funds we are looking into:

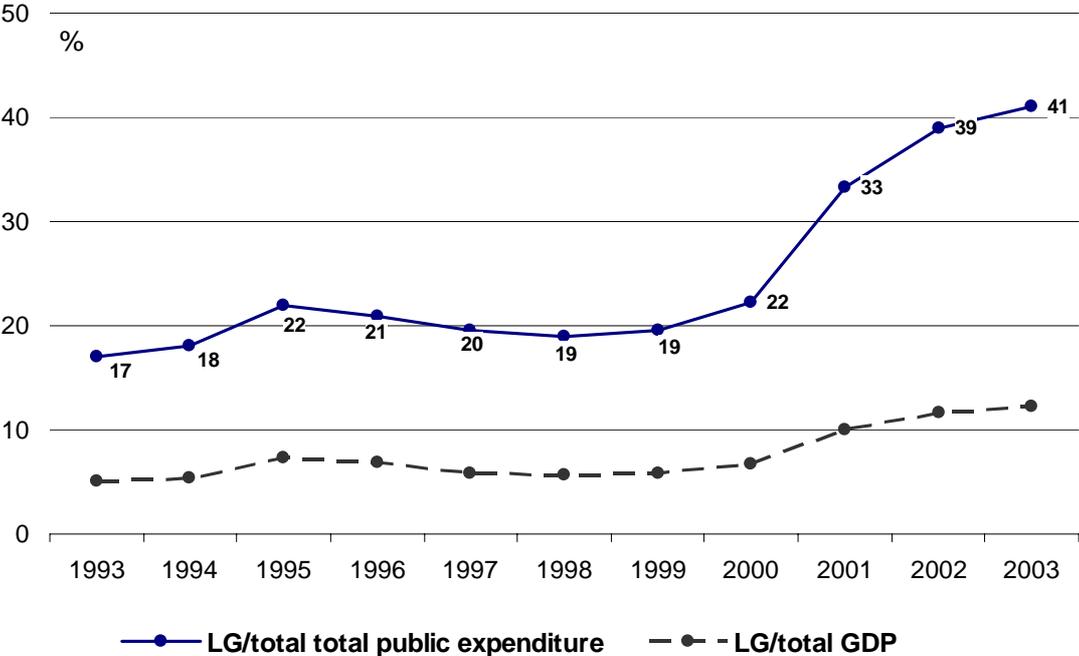
- The general-purpose *equalization grant*, which is meant to compensate the disparities in local revenue-generating capacity, and functions based on the Robin

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<sup>9</sup> What the chart does not tell is how much this was decentralization proper (devolution) and how much creation of mandates by the central government. In fact, it can be argued that there was a good deal of both.

<sup>10</sup> Distinction that follows Schacter and Shah (2001).

**Fig. 1. Size of LG expenditure**



Hood principle and: richer communities receive less money, poor communities more.

The distribution is made in two steps: first from the Ministry of Finance to County Councils, which withhold part of the funds from themselves and redistribute the rest to Local Councils in their respective jurisdictions following the same logic.

- The *Special Roads Fund*, collected centrally and distributed 35% to County Councils, which have the responsibility to maintain the districtual and communal roads.

Both flows of funds are in principle governed by allocations rules based on technical criteria mandated by law, both at the county and sub-county level. However, as it happens in many other cases in Romania, these rules are not consistently enforced, either because there is no interest in doing this, or because they are poorly written and change so often that people in the local government can plausibly claim the legal framework is not clear. One way or another, the opacity of allocations and the lack of criteria – or their deliberate ignorance when they do exist – constitute a fertile ground for clientelism at the local level. We can construct now a number of variables in order to test the link between these financial allocations and political developments in local government (details and data in Annex 1-2).

**(v<sub>1</sub>) The deviation from the theoretical distribution** to counties of the **equalization grants**. These funds are sent to each County Council by the Ministry of Finance, in principle following the mathematical formula mandated by law. The problem is, the local own fiscal capacity (proxy used for the "wealth" of the LG unit) is something estimated by each county council itself, and as a result there are strong incentives at the local level to underestimate this capacity in order to get more money in the equalization process. They all face the same incentives, but not all have the same political clout at the center to get away with this kind of behavior. In other words, the center tolerates rent-seeking to variable degree: more in the case of some LGs, less in the case of others. After the planned budgets are approved and the budgetary cycle is under way, each LG unit

attempts to extract as much resources as they can from their tax base. Naturally, the larger the tolerated underestimation of local fiscal capacity, the more significant the difference will be between the actual and projected "wealth" of the unit. And, by implication, the wider will be the deviation from the Robin Hood principle of equalization, since the grants are distributed based on projected, not actual strength of local resources. This deviation can be therefore used as a measure of the relative rent-seeking power of each county. Variable  $v_1$  is actually defined as the rank of each county according to their rent-seeking power in this respect, based on the financial data from 2001-2003.

**( $v_2$ ) The share of the Special Roads Fund** received by each County Council. Here things are simpler: 35% of the total fund collected centrally must, according to the law, be distributed to counties so that they maintain the districtual and communal roads (the rest is used centrally for maintaining the national roads). The law also specifies a formula based on technical criteria which should be used for determining how much of the pool of funds should go to each county. In reality the provisions of the law are simply ignored and the distribution performed in a discretionary manner by the Ministry of Transportation. Deviations from the theoretical pattern are wide: variable  $v_2$  measures this deviation for each county, corresponding to the period 2001-2003.

Among themselves these two variables offer therefore a good measure of the rent-seeking power of each county in relationship with the central government. In theory, it is possible that deviations from the criteria specified in the laws governing money allocations to be determined by objective local situations (such as a need for extra cash in one particular unit in order to finalize an investment project); or by a presumed tendency of upper-level tiers to privilege poorer local governments, beyond the provisions of the law<sup>11</sup>. While the first is more difficult to test – and would in fact represent nothing else but an admission that rent-seeking and preferential treatment do

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<sup>11</sup> This is the explanation given most often by public officials when questioned about the reasons why they do not enforce the laws fully.

in fact take place – the second claim is easy to verify. Fig. A and B in Annex 3 offer a first hint that there is no correlation between the degree of favoritism ( $v_1$  and  $v_2$ ) and the poverty of a particular county. In other words preferential treatment occurs independently of local needs. We will come back to this issue when we discuss the results of the analysis.

While  $v_1$  and  $v_2$  refers to the flow of funds between the central government and the 41 County Councils, estimating the degree of favoritism in the relationship between the national and intermediary tiers of government, it is also interesting to see what happens at the local level proper once the money get there. Part of the equalization grant<sup>12</sup> is passed down to Local Councils, in theory following the same allocation principle (more funds to poorer localities); the money for roads is used by the County Council directly. A measure of "accuracy" in spending can be devised for each of these funds.

***(v<sub>3</sub>) Price/km of county-level road repaired.*** Once they get their share of the Roads Fund, County Councils can proceed and contract out services with local operators in order to perform this task. It has been noticed that the price for what is a fairly standardized service – rehabilitation of 1 km of two-lane road – varies widely from one county to another. The general tendency is for them to sign contracts in which this cost is higher than the one reported by the National Roads Agency on similar projects.

Disproportionate costs for such infrastructure works without obvious reasons (special roads, difficult terrain, etc) point to a preferential relationship between the public administration and the private contractors who perform these works.  $V_3$  estimates this cost for 29 of the 41 counties where data were available, as a percentage of the average cost for the same type of work performed by the National Agency of Roads.

***(v<sub>4</sub>) The deviation from the theoretical distribution of the equalization grants in the second stage*** (from counties to localities). In the same way we did for  $v_1$ , an indicator can be constructed now to measure the degree of favoritism in the relationship between

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<sup>12</sup> Until 2002, an unspecified amount; since 2003, 75%.

each County Council and the Local Councils in the respective jurisdiction. This favoritism occurs by the leadership of the county deciding to depart from the allocation formula specified by the law and deal case by case with "local situations".

Finally, a variable measuring the political dimension of relationships at the local level must be devised, since the ultimate goal of this material is to infer to what extent all the deviations from the norm described above are politically motivated.

**(V<sub>c</sub>) *The intensity of political clientelism in each county*** can be estimated indirectly using the data on political migration after the 2000 local elections (IPP, 2002). Romania is unique in the region in that that displays a high propensity of locally elected people to change parties after being elected in office<sup>13</sup>. Typically this migration occurs either towards the national ruling party, or the one controlling the leadership of the respective County Council. Between 2000 and 2004, which are electoral years in Romania both at the local and national level, these coincided to a large extent: the ruling Social Democrats (PSD) also had the presidency of 36 of the 41 counties. Over the same period of time, to which the present analysis is confined, around one third of the Romanian mayors<sup>14</sup> elected in June 2000 have migrated to PSD. As most political analysts agree, this massive shift of allegiance has little to do with ideology, and more with the systemic flaws of the Romanian public administration. A high rate of migration indicates an increased political pressure on local officials exerted through informal means (because formally there is no subordination among tiers of government). Or, in other words, a high degree of political clientelism at the local level. We can therefore approximate the intensity of this phenomenon by the rate of political migration of mayors towards the national ruling party. The scores presented in Annex 1 range from 1 (low migration) to 5 (high migration).

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<sup>13</sup> The same is true for members of parliament, though to a lesser extent. A full explanation for this phenomenon is beyond the scope of this paper.

<sup>14</sup> They are about 3,000 in total.

The data presented above on funds allocation and political migration (variables  $v_1 - v_4$  and  $V_c$ ) describe the situation in all Romanian local governments. Additional data regarding the same phenomena in the education sector can be also included in the analysis, but due to the complexity of the task they could only be collected from a sample of schools from three counties – see Annex 2. School financing is a shared responsibility for all the three levels of governance in Romania: Local or County Councils (depending on the level of education) take care of facilities and operating costs; the central government finances staff salaries and various national programs (such as textbooks or free meals, where applicable). To complicate matters even more, the whole arrangement is in flux, education being a policy area in full process of being decentralized, with all the uncertainties and hesitant steps involved in such a process.

**( $V_{e1}$ ,  $V_{e2}$ ) *The clientelism at the school level.*** Rumors abound that "politicized" schools – that is, those where headmasters have good relations with the local governments overseeing them – receive preferential treatment in the allocation of funds. Therefore we can use the two variables in presented Annex 2 –  $V_{e1}$ , measuring the total resources per pupil available in one particular school; and  $V_{e2}$ , measuring the party affiliation of the headmaster – in order to test this hypothesis on the selected sample of schools.

#### **4. Results: the case of "influential" counties**

We can now proceed to test the extent to which the political factors explain deviations from the norms of funds allocation when they occur. If the hypothesis is verified, than we will have a more precise view of the mechanisms and magnitude of "political corruption" in local government in the sense defined above. And we will be able to provide an input into the debate on the link between decentralization and corruption summarized in the second section.

Two models can be now constructed and tested against the data available.

**Model A** attempts to explain what are the factors which determine the favoritism (i.e. the deviations from the established rules) in the allocation of funds by counties to the localities on their territory. Therefore the dependent variable is V4, and the independent variables selected are:

- The degree to which the respective county was itself privileged by the center in receiving equalization grants (V1)
- and Transfers from the Roads Fund (V2);
- Intensity of local political clientelism (proxy: the political migration of mayors towards the ruling party in that county, Vc).

A number of other variables were introduced in order to capture "objective local conditions" that may force county decision makers to deviate from the established rules. For example, if a county is on average poorer and with higher discrepancies among localities, the case may be stronger to deviate from the allocation rules in order to solve particularly acute problems. Also, such situations are more likely to occur in larger and more sparsely populated areas. In order to test the influence of such factors, we have introduced:

- Local "wealth" of communities: own revenues per capita of local governments (V01)
- County area (in kmp, V02)
- County population (V04)

Briefly, model A tries to show what determines the way County Councils use their resources in relationship with the Local Councils in their jurisdiction. We thus explore an inter-administrative pattern of behavior.

By contrast, **Model B** analyzes the other way in which the County Councils can use their resources, i.e. by contracting out services with private partners. Irregularities can occur in this relationship too, which, when associated with corruption, tend to reflect in a higher than average cost of the service contracted. In this case the dependent variable

is the unit price of road rehabilitation as a ratio of the national average price (V3). In addition to the independent variables described above, another one was introduced in order to describe the "objective environment" in which each county operates:

- Length of county and communal roads (V03)

#### **A. Determinants of favoritism in distributing equalization funds to localities (V4)**

<i>Dependent variable</i>	<b>Favoritism in distributing funds to localities (V4)</b>	
Independent variables	Standardized beta	p-value
Own local revenues level, \$/cap (V01)	- 0.192	(0.162)
County area, kmp (V02)	0.022	(0.821)
County population (V04)	0.015	(0.897)
Favoritism in distributing equalization grants to counties (V1)	0.205*	(0.075)
Favoritism in distributing roads fund grants to counties (V2)	0.294***	(0.009)
Political migration towards the ruling party (Vc)	0.561***	(0.000)
(Constant)		(0.298)
N of cases	41	
R square	0.75	

**B. Determinants of high price of local infrastructure – roads (V3)**

<i>Dependent variable</i> <b>Price of road rehabilitation, ratio to national average (V3)</b>		
Independent variables	Standardized beta	p-value
Own local revenues level, \$/cap (V01)	– 0.131	(0.233)
County area, kmp (V02)	0.202	(0.162)
Length of county & communal roads (V03)	– 0.290*	(0.083)
County population (V04)	– 0.107	(0.453)
Favoritism in distributing equalization grants to counties (V1)	0.279*	(0.076)
Favoritism in distributing roads fund grants to counties (V2)	0.243*	(0.071)
Political migration towards the ruling party (Vc)	0.596***	(0.000)
(Constant)		(0.000)
N of cases	29	
R square	0.80	

In both models it turns out that  $V_c$  (political migration of mayors) is the strongest predictor. In other words, favoritism in distributing general-purpose equalization grants or Road Fund transfers does indeed go hand in hand with intense local political clientelism. No "objective situations" can explain this pattern of allocation:  $V_{01-04}$  are insignificant in both models, with just one exception (model B, where counties with a smaller roads network tend to get higher prices for their maintenance, which may reflect lower economies of scale). The preferential treatment from the center is also a significant factor in both models.

In other words, those counties where political pressures on the local governments is higher tend also to have a better informal link with the center, which they are able to exploit in order to benefit from transfer allocation. They get more funds from the center, and then use them in order to build clientelistic networks (i) among the local councils from their jurisdiction; and (ii) among private agents who contract services with the public administration. The clientelism built in relationship with the center is thus reproduced at the sub-county level. It is always the same group of 10-12 "influential" counties which score high on all dimensions of financial allocation favoritism and political clientelism. This group reproduces quite accurately the development described by the Romanian media in the last years as the "rise of local barons" in some parts of the country.

A clear direction of causality here is difficult to discern – whether political clientelism (migration) is an effect or a cause of preferential financial allocations. Both directions of causation are plausible: mayors migrate towards the ruling party in order to be rewarded with more resources (and an easier life in managing them), so the allocation patterns may be a result of migration. On the other hand it is the existing system of loose and discretionary practices which create in local officials the expectation they will be rewarded with extra funds if they switch sides. Most probably, both phenomena are caught in a vicious circle as two sides of the same coin: poor and clientelistic governance.

### C. Significance of party affiliation ( $V_{e2}$ ) in distributing education funds ( $V_{e1}$ )

#### ANOVA

VAR00003

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	2.421	1	2.421	.169	.682
Within Groups	842.922	59	14.287		
Total	845.343	60			

The education system, a sector which has only recently begun to be decentralized, does not seem to display the same tendencies (yet?): the analysis presented above based on data from Annex 2 shows that there is no significant impact on the level of resources available at the school level by the headmaster's affiliation to the ruling party. The disparities in funds per capita of pupil are very high, but they are probably due to the initial misallocation of assets and staff inherited from the previous regime. The historical-based budgeting, still prevalent in most of the Romanian administration, plus the political sensitivity of the education sector, makes it very difficult to change the situation. However, since we rely here only on a sample of schools from three counties, this conclusion should be taken with a pinch of salt until more extended research corroborates it.

#### 5. Conclusions and lessons

The empirical data presented above confirm that the decentralization process in Romania, consisting in transfer of resources and decision-making power to local governments, leads to the emergence of privileged relations among some categories of political actors. They form the basis for significant "informal interaction", clientelistic networks and rent-seeking when local government units (localities or counties) deal with upper-level authorities. If the Romanian example is anything to go by, it casts doubts on the allegations that the process of decentralization alone can always and everywhere reduce corruption and generate better governance. On the contrary, in circumstances like these it can probably only

increase the stakes of the political competition for the appropriation of resources, and as a result make the situation worse.

More concretely, some local government units, especially at the intermediary level (counties), have managed to secure preferential treatment from the centre, sometimes by exploiting legislative gaps, sometimes openly breaking the law. They tend to encourage the reproducing of this type of behavior one level below them. All these administrative irregularities, which can be documented with financial data, go hand in hand with a strong politicization of the public administration, reflected in the high rate of political migration of local officials towards the party controlling the governing unit immediately superior. A detailed analysis on the social power networks would explain how such arrangements appear and perpetuate. And in-depth case studies on each of the financial flows used in this study as variables could document the intense lobby by the interested parties for things to stay as they are, reports on budgetary allocations to remain as much as possible obscure, lacking comparable data and benchmarks, and kept away from the public's eye (as they are nowadays). But such endeavors are beyond the purpose of this study.

On the other hand, we should not conclude that decentralization is always bad or useless in combating situations like the one described here. On the contrary, such cases should help us acquire a nuanced and realistic view about the potential costs and benefits of decentralization. A number of conclusions and lessons for the process of decentralization can be therefore drawn.

- If implemented mechanically, decentralization seems to reinforce the existing institutional culture and administrative practices in the public sector, with only marginal immediate changes. Where these are reasonably effective and clean, there are good chances they will become even more so. But in countries where the institutions of horizontal accountability (financial comptrollers, administrative justice, ombudsman, etc) are weak, and those of vertical accountability (administrative hierarchy) are vitiated by political patronage, the opposite may be true. When the costs of civic

information and action by the public are high and the enforcement of regulations loose, we cannot expect decentralization alone to solve the problems of poor governance and corruption. Strong political signals, steady interest and involvement from the top cabinet level, and exemplary action against wrongdoers are necessary in order to change expectations of people in the local government, make local innovation and effort pay more than rent-seeking, and make decentralization eventually successful.

- Intermediary tiers of government (where they exist) should not be allowed to invade and capture the newly-created space of local autonomy, because in most cases they will tend to do this at the expense of lower tiers. The institutional design of decentralization should include safeguards against local clientelism, based on transparency and clear lines of responsibility: a clear separation of attributions and sources of revenues; minimal involvement of intermediary tiers in financial transfers for functions that are purely local; relevant and timely reports based on cost benchmarks and the final pattern of financial allocations.
- Social sectors are probably less affected by political clientelism in money allocation than the investments in infrastructure or the general-purpose grants (the general-purpose transfers being in many cases used also to co-finance local infrastructure). It may be that headmasters are not (yet?) important political assets in a community, since they do not have much decision-making power or visibility in community. Or, as it has been noted before, it may be that in a public bureaucracy the possibility to extract side-payments is much higher in big infrastructure projects than in labor-intensive social sectors (Hirschman, 1967), with the effect that there is a tendency in the bureaucracy to produce over-investment in the former and under-investment in the latter. We should not be surprised therefore when we find the same correlation with political clientelism in the first case but not in the second.
- However, when a social sector like education is being substantially decentralized, as is the case now in Romania, special attention must be paid to the way the financial

mechanisms are designed, incentives structured, and local managing capacity and accountability bolstered. All the more so since more modern, automatic formulas of transferring money per capita of pupil will increase the scope of local decision, allowing for the first time LGs to make reallocations among budgetary categories (investments / current / staff salaries). It is possible that, as the scope for local decision increases, especially in the domains of strategizing and prioritizing expenditure, bad practices from the other areas of fiscal decentralization contaminate the education sector too, and as a result political clientelism may rise.

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## ANNEX 1 – Data on distribution of funds by county, the costs of infrastructure and political migration

<i>County</i>	Own revenues, \$/cap, 2002	County area (kmp)	Length of local roads (km)	County population	Favoritism – equaliz grants higher = more favored	Favoritism – roads grants higher = more favored	Price/km county road, % national average*	Favoritism: sub-county distribution of equaliz. grants	Local clientelism (migration of mayors) 1=min 5=max
	V01	V02	V03	V04	V <sub>1</sub>	V <sub>2</sub>	V <sub>3</sub>	V <sub>4</sub>	V <sub>c</sub>
Alba	39.6	6242	2174	399591	29	123	182	4.23	4.0
Arad	52.7	7754	1835	474868	30	98	122	.66	2.0
Argeş	44.8	6826	2422	675383	2	167	134	2.34	3.0
Bacău	51.6	6621	2023	756782	35	528	201	6.69	4.0
Bihor	47.9	7544	2079	621826	3	113	110	2.18	1.0
Bistriţa	30.6	5355	1195	329028	13	91	150	1.20	1.0
Botoşani	28.7	4986	1699	470018	37	179	171	4.42	3.5
Brăila	36.0	4766	978	389751	5	105	145	1.03	1.5
Braşov	55.9	5363	1096	623543	14	117	135	.83	2.0
Buzău	29.6	6103	2024	509430	15	148	165	5.10	4.0
Călăraşi	31.6	5088	793	332492	38	138	162	2.14	3.0
Caraş	31.9	8520	1380	352932	31	107	193	1.60	2.5
Cluj	57.1	6674	2296	708440	1	202	.	.63	1.0
Constanţa	88.8	7071	1842	745333	20	205	.	.86	1.0
Covasna	38.2	3710	652	230812	25	96	140	.46	1.0
Dâmboviţa	34.3	4054	1415	554049	16	181	139	1.03	2.5
Dolj	40.0	7414	1767	743059	4	144	120	.32	2.0
Galaţi	61.6	4466	1241	643872	26	108	158	3.86	3.0

Sorin Ionita

Giurgiu	24.3	3526	817	295192	11	89	125	1.51	2.0
Gorj	49.5	5602	1556	396836	18	203	178	5.08	5.0
Harghita	34.8	6639	1231	342123	24	182	.	1.77	1.0
Hunedoar	42.5	7063	2747	525426	10	178	125	2.52	3.0
Ialomița	33.1	4453	803	306535	28	87	169	5.45	3.0
Iași	37.8	5476	2030	824231	23	168	.	3.30	3.0
Ifov	97.3	1583	647	275260	32	268	169	2.88	3.5
Maramure	32.9	6304	1266	536096	21	122	.	3.01	2.5
Mehedinți	33.8	4933	1482	324579	17	168	.	4.33	3.5
Mureș	43.6	6714	1583	603169	8	173	144	1.28	2.0
Neamț	29.2	5896	1403	593446	19	154	168	7.26	4.5
Olt	31.5	5498	1736	514531	0	137	.	.71	2.5
Prahova	52.0	4716	1904	860599	7	161	.	.74	2.0
Sălaj	32.8	3864	1304	258978	27	90	.	1.69	2.0
Satu Mare	32.8	4418	1336	392184	22	133	.	3.63	3.5
Sibiu	55.1	5432	1342	440987	12	163	135	.81	2.5
Suceava	32.6	8553	1636	719935	36	161	194	6.51	5.0
Teleorma	30.4	5790	1167	461940	33	156	173	5.65	3.0
Timiș	61.9	8697	2368	675172	6	122	.	.93	1.0
Tulcea	52.9	8499	888	264114	40	191	158	2.13	1.5
Vâlcea	37.2	5765	1677	435444	9	128	.	1.88	2.0
Vaslui	23.1	5318	1562	473906	34	145	170	4.00	3.5
Vrancea	37.9	4857	1374	394053	39	400	185	9.80	4.0

\* Data available only in 29 counties

### Explanatory note:

- V01: Represents the own revenues of the County Council and Local Councils on its territory, plus the automatic shares of personal income tax; this is the best available indicator of local development
- V02: Area of each county, in kmp
- V03: Length of districtual and communal roads (km); County Councils are responsible for their maintenance
- V04: Population of each county
- V1: Deviation (+/-) in equalization grants received by each county (2001-2003), against the formula mandated by law
- V2: Sums from the Roads Fund received by each county (2001-2003); the RF is one of the most important sources of transfers for the local governments
- V3: An estimate of the average cost per km of county road repaired by County Councils in 2001-2002, as a percentage of the average cost per km paid for similar works by the National Roads Agency
- V4: Coefficient of deviation from the formula of distributing the equalization funds at sub-county level (from County Council to localities); it is calculated as the ratio standard deviation / mean of differences from the theoretical distribution of funds to localities in each county; this is a measure of the scope for discretionary decision-making by each county leadership in distributing these general-purpose grants
- Vc: The score of political migration of mayors towards the national ruling party (which in 4/5 of cases also holds the presidency of the County Councils: 1= minim, 5= maxim). The data reflect the period 2000-02 and are adapted from *Migrația Politică în Administrația Locală*, 2001. IPP and ProDemocrația. The indicator is used as a proxy for clientelism at the local level.

School	Total Costs / Pupil, mil Rol V <sub>e1</sub>	PSD membership of headmaster V <sub>e2</sub>
Baneasa	4.1	0
Bolintin Deal	5	1
Bolintin Vale	10.9	0
Crucea de Piatra Calugareni	6.3	1
Dumitru Patrascu Crevedia	5.4	0
Gheorghe Crevedia Mare	4.7	1
Ghimpati I-IV	4	1
Ghimpati I-VIII	3.9	1
Grupul Scoala Naval	8.3	1
Grupul Scolar Agricol Calugareni	26.8	1
Joita	4.6	0
Mihai Bravu	7.2	1
Mihai Eminisecu Giurgiu	4.3	0
Nicolae Crevedia	9	0
Nr. 1 OGREZENI	11	1
Nr. 1 SF Gheorghe	7.4	1
Nr. 2 OGREZENI	8.7	0
Valea Plopilor Ghimpatu	4.2	1
Vedea	1.6	1
Lacu Sarat	4	1
Liceul Teoretic Cerna	7.8	1
No. 2 Viziru	5.8	0
No.1 Viziru	9.3	1
Scoala Al Cuza	5	0
Scoala Albina	3.3	1
Scoala Ciresu	17.4	1
Scoala Cotu Lung	4.2	0
Scoala Creanga	5	1
Scoala Eminescu	5.7	0

Scoala No. 8 Braila	6.5	1
Silistrau	7.2	0
Surdila Gaiseanca	5	1
Surdila Greci *	9.2	0
Traian	9.5	0
Victoria	6.4	1
Anghel Saligny	5.4	0
Balcani 1	6.3	1
Balcani 2	5.1	1
Botesti	6.5	0
Contesti	10.2	0
Ferastrau Oituz	11	0
Fintinele	5.2	1
Frumoasa	5.3	0
Gh Avramescu	4.8	1
Ghe Vranceanu	8.5	0
Gr Sc Ion Borcea	8.5	0
Gr Tabacaru	5.4	1
Hemeius	5.5	1
Hertioana	14.5	0
Ion Luca Bacau	6.3	0
Mihai Dragan	4.5	1
Oituz 2	7.1	1
Oituz 3	7.4	1
Pancesti I-IV	6.9	0
Sascut I-VIII	6.9	1
Sch 1 Buhusi	4.2	1
Sch 17 Bacau	2.9	1
Sch 2 Buhusi	5.5	0
Traian I-VIII	6.4	0
Zemes	4.7	0

**ANNEX 3 – Deviations from mandated distributions and the local wealth of counties**

*Values on the vertical axes correspond to Columns 1 and 2 in Annex 1. Own revenues/cap in 2002 (Column 0 in Annex 1) is the best measurement for the local financial strength of a LG unit. There is no significant correlation between these indicators in either case, in other words the deviations from mandated allocation formulas cannot be explained by a desire of central authorities to help poorer LGs beyond the provisions of the law.*

(here Fig. A and B)

