

**INSOLVENCY OF ADMINISTRATIVE TERRITORIAL UNITS -
ARE THE PRINCIPLES OF PUBLIC LAW FULLY COMPATIBLE
WITH THE REQUIREMENTS
OF AN EFFECTIVE MANAGEMENT?**

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ABSTRACT: *The European states have introduced the mechanism of administrative territorial units (ATU) insolvency due to the influence of American law, US being the first state that recognized in 1934 the cities insolvency by Bankruptcy Act, as an answer to the financial crisis of the 1930s. Romania introduced it in two steps. Firstly, by the Law no. 273/2006 regarding local public finances. The procedure described by this law made it practically impossible to apply it, as the public law doctrine emphasized it. Secondly, by the Government Emergency Ordinance (GOU) no. 46/2013 that changed the previous law. Even if many authors emphasized the necessity of such a regulation, the results of its application are rather modest. Many ATU does not want to declare to be in financial crisis, even if the GOU no. 46/2013 describes sanctions that may be applied for non-declaring. The atomization of the local public administration - by the emergence of an impressive number of ATU without an impact study - aggravated the functioning of the administration at the local level. This atomization has not been remedied by the introduction of the TAU insolvency mechanism.*

KEYWORDS: *financial crisis; insolvency; local administration; management; territorial administrative units*

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Public institutions have long been excluded in Romania and in comparative law from the application of the insolvency procedure.

Romanian Commercial Code of 1887, partly in effect, provided in art. 8 (repealed now) that the state and public institutions cannot be assimilated to traders, therefore they cannot be subject to insolvency or bankruptcy procedures.

The current trend in commercial law and administrative law is to abandon this concept.

The European States have introduced this mechanism due to the influence of American law, the USA being the first country which recognized in 1934 the insolvency

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of the cities with the Bankruptcy Act, in response to the financial crisis of 1930s. This law was amended to include also the municipalities in the category of legal entities subject to insolvency, by introducing specific regulations (Chapter 9).

A well-known case is that of Orange County, California. In 1994 this district lost money due to the amounts allocated for investment funds that did not pay off.

Another case is that of Vallejo city, also in California. Municipality employees could not receive their wages that had risen unreasonably. In 2008 Vallejo became the most populous city in California that requested the application of Chapter 9.

So far, around 500 ATU were declared bankrupt and cities such as San Diego, Miami and Cleveland were very close to this situation.

In 2013, Detroit became the most populated city in the USA that requested insolvency. A federal judge later approved a plan for recovery of the debt that had reached 7 million dollars.

Yet, the insolvency of municipalities / districts is rather a rare phenomenon.

From 2008 to 2012 (throughout the financial crisis), the ratio between ATU which requested insolvency and their total number was 1668: 1, which means 0.06% (Mike MACIAG).

Romania has introduced this legal mechanism in two phases.

In the first stage, by Law no. 273/2006 on local public finances (Official Journal no. 618, 2006) a reference to the insolvency of the administrative - territorial unit (ATU) was introduced.

Article 74 of the Law no. 273/2006 mentions the state of "financial crisis" that can be overcome through a recovery plan and art. 75 regulates a procedure of insolvency *sui generis* of the ATU.

Insolvency is defined as "the inability of the ATU to pay the outstanding and liquid payment obligations except those who under contractual disputes" (art. 2), and in art. 75 it is stated that the ATU is insolvent if: a) it failed to pay the outstanding and liquid payment obligations, older than 120 days and which exceed 50% of the annual budget, without taking into account those under contractual disputes; b) it did not pay the remuneration provided in the revenue and expenditure budget, for a period longer than 120 days from the due date.

Obviously, there is a contradiction between the two provisions.

This procedure established by this law made practically impossible its application, a fact that was criticized in the doctrine (Gheorghe PIPEREA).

In the second stage, the OUG no. 46/2013 on the financial crisis and the insolvency of AUT (Official Journal no. 299, 2013) was issued, which substantially modified the mechanism described by Law no. 273/2006.

The law defines the financial crisis of the patrimony of ATU confronted with financial difficulties, due to lack of availabilities, which leads to non-payment of the payment obligations older than 90 days and exceeding 15% of the AUT's budget, as well as non-payment of wages provided in the budget, for more than 90 days after the due date.

Insolvency is defined as a state of the patrimony of ATU confronted with financial difficulties, by lack of availabilities, which leads to non-payment of liabilities. Non-payment refers to 120 days and is referred to 50% of ATU budget.

The difference between financial crisis and insolvency refers, therefore, to the number of days of non-payment of liabilities and their weight in the ATU budget.

The deliberative authority (the local council, the county council) determines the financial crisis and mandates the authorizing officer (mayor, county council president) to draft a financial recovery plan. This authorizing officer requests the registration of the decision in the Local Register of financial crises situation of the ATU.

In five days from the adoption of the decision, the Committee for financial crises is established. Composition: mayor, chief of the financial - accounting department, a representative of the local council or county council, a representative of the General Directorate of Public Finance (GDPF - devolved service of the Ministry of Finance) and a representative of the structure the unit is part of.

The financial recovery plan includes:

- A presentation of the financial situation of the ATU;
- Measures to ensure essential services for the duration of the plan;
- Measures to improve financial management and to efficiently deliver essential public services;
- Measures to reduce costs;
- Budget planning;
- Establishing tasks to implement the plan, objectives, persons in charge and deadlines.

The implementation of the financial recovery plan is mandatory for ATU.

The financial crisis ceases:

- If the conditions that led to the finding of the financial crisis no longer exists for a period 180 days;
- If the criteria of insolvency are fulfilled.

Insolvency begins with filing the application to the court by the creditors or by the main authorizing officer. The application must be accompanied by:

- ATU budget;
- List of goods in patrimony;
- List of creditors;
- List of payments and patrimonial transfers made during a previous period of 120 days;
- List of key public services that ATU will provide during insolvency

The insolvency judge gives a judgment opening the insolvency procedure and appoints a judicial administrator.

The latter sends notifications to ATU creditors and draws up a table of claims. Along with the authorizing officer, he develops a recovery plan, submitted for approval to GDPF and subject to approval by local or county council.

The Recovery Plan includes the means and deadlines for the discharge of debts to each creditor.

The execution of the recovery plan may not last more than 3 years from the date of approval.

The insolvency procedure is declared closed if the claims contained in the final table of claims have been completely settled.

If the conditions that led to the finding of insolvency are no longer fulfilled, the procedure is declared closed, even if not all debts have been paid.

Not declaring the state of financial crisis represents a contravention and the penalty is a fine of 10,000 to 50,000 lei.

Failure to declare or declaration of the insolvency with a delay larger than 6 months by the authorizing officer is an offence, and the penalty is imprisonment from 3 months to 1 year or a fine.

In case of ATU insolvency, sanctions do not concern ATU or the local community. The penalties concern the authorizing officer - the mayor or the president of the county council.

What happens if the insolvency and the taking over of the attributions of the authorizing officer by the judicial administrator is extended after the election date? Will the person who wins the election not be able to take office? Does the sanction apply therefore also to the newly elected person? From the wording of the law, which refers to "authorizing officer" as a function rather than a person, the penalty is not *intuitu personae*, but also extends to the newly elected.

This situation may however raise controversies, because in this way the will of the electorate cannot be applied.

The financial problem of ATU can be solved by the new procedure, but the public law issue is disregarded by it. If the length of the term in office of a local elected official were to be considered, the financial problem could be solved only in certain situations.

This shows that sometimes the specific management exigencies of ATU are not fully compatible with the time limitation of the mandates of local elected officials and, in general, with the public law rules.

Although the necessity of such a regulation has often been pointed out in the doctrine, the results of the implementation of this legal mechanism are modest. Many ATU do not want to declare a state of financial crisis, even if GEO no. 46/2013 establishes penalties for failure to declare it. The atomization of local public administration, through the emergence of an impressive number of ATU without any impact study, which hampers the functioning of the administration at local level, could not be remedied by this regulation, at least for the time being.

The motivation for introducing the ATU insolvency mechanism was to solve the inability of such establishments to self-manage the revenues they have. Expert Forum remarked in a study published in 2013 that only 650 communes out of a total of 2,860 can fully cover salary expenses from the revenues plus a share - part of personal income tax (PIT) which are remitted monthly to them, these sources accounting for 48% of local budgets. More worrying is that 24% of these communes (685) have wage costs more than twice as much as their revenues. Under these circumstances, most ATU are in a constant state of de facto insolvency. The solution of allocating additional funds from national funds for investment projects has proved to be generating political clientelism, while generating a greater dependency of the ATU from the centre, thus being an obstacle to decentralization. Expert Forum believes that the only reason of existence of these ATU "designed from the start to be technically bankrupt" is "preserving the territorial base of political clientelism." Since the solution of merging ATU was not and is not feasible because of local identity egos, the solution of regulating the insolvency of ATU was found, so that those facing major problems in ensuring minimal expenses are no longer forced to seek funding from the centre based exclusively on political criteria. Unfortunately, this solution proved not to be applied, which recalls the need for real decentralization through which ATU can have more own revenues, while finding mechanisms to encourage mergers of ATU, with the aim to create ATU capable to

perform better financially and to apply more efficiently, thanks to this feature, the principles of good governance.

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