

FACTORS INFLUENCING LOCAL GOVERNMENTS' INVESTMENT DECISION

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Abstract

Local communities' sustainable development represents a key topic on public governments' agenda, thus raising the problem of social and economic growth determinants, which could be shaped throughout promoted public policies. In this context, public investment plays a crucial role, being considered as a main trigger of local development on medium and long term, in close connection with the quality of the associated decision-making process. Under democratic values as decentralization, local autonomy and selfgovernment, public investment decisions are configured by local authorities while facing particular constraints or influence factors, both related to endogenous sources (e.g. administrative capacity, legal collaborative partners 40 competence or legal constraints) or exogenous ones (as financial market conditions, corruption, institutional arrangements, politics etc.), which are affecting finally the quality of the adopted decisions. From this perspective, our study aims first to identify the factors potentially affecting the local governments' investment decision, to emphasize the particular transmission channels of their influence and to reveal their potential expected impact. On this base, secondly we aim to suggest some alternatives to counteract the negative effects of the discussed factors, as useful inputs for (new) public policies.

Keywords: *Local governments, Decision, Investments, Factors, Vulnerabilities*

JEL Classification: according to the JEL Classification System

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SECTION 1. FACTORS INFLUENCING LOCAL GOVERNMENTS' INVESTMENT DECISION

Generally, the concept of local public investment is treated to a lesser extent in the literature and legislative approach, and it is included, most of the time, in the broader understanding of public investment. This is why we chose to look at some important factors that extensively apply for local governments' investment decision like economic, financial, social, political, human and environmental factors, with endogenous and exogenous particularities. We will also look for connections between some of these factors and analyze them in certain situations. Furthermore, we will put into perspective some of the most common vulnerabilities in local governments' investment decision and see how these can affect investment projects in time, also looking for answers on how to minimize risk.

1.1 The economic factor

The economic factor is central to the local public investment decision because it influences both tangible and intangible investments. For local public investment, the economic factor involves a multitude of variables: the economic context, the level of taxation, the availability of funds and the ability to attract external financing sources, the establishment of investment expenses, etc. The economic context, at a given moment, influences the public investment policy. That is why investments reduce or prevent the negative effects of inflation and stimulate economic growth. Also, investments represent the first priority for relaunching the national economy, in situations where it has been affected by dysfunctions and economic crises, instead of loans that often go to consumption. Moreover, in the latest economic crises that our country went through, the decision-makers and public authorities in Romania "patented" the instrument of loans to temper the negative effects, thus resorting to reparative methods such as loans for consumption or public debt coverage at the expense of preventive ones and productive, namely public investments. This is counterproductive for local governments since taking loans and using them for public investments is the best financial alternative sources available. In support of this statement we will point out that loans – based on account criteria/local budget economy - are on top of the best sources for financing local public investments because they do not put immediate pressure on the local budget, the contracted amount is received in full, they are easy to contract because the public authorities have a high degree of trust and repayment is made over a long period of time.

With reference to the economic factor, some authors appreciate that, in the implementation of the investment policy, the institutions must not have as their primary goal the obtaining of profit, but have in mind a good correlation between

the costs involved and the global benefits to be obtained, so that to consider the entire local or national community (Oprea, 2020). This doesn't mean that local authorities shouldn't look to invest in profit-making objectives, like tax-parking, cultural infrastructure that generate income through ticketing, public spaces for rent, collaboration with private sector for the development of leisure areas, while other domains like education, health, local road infrastructure or security are free to use in the benefit of all citizens.

1.2 The financial factor

In the dimension of the financial factor, inflation plays a decisive role. We often witness - relevant to our analysis - updates of technical-economic indicators for various investment projects. These changes caused by inflation can generate delays, because the procedure for updating the indicators involves a certain bureaucratic route, from recalculation, to transposition into draft decisions and their debate for approval in local or county councils, and at other times they can cause decisions that change altogether the destiny of an investment, if it is considered that some costs become unbearable.

Regarding the fiscal policy, the local public authorities must identify those measures that lead to a better collection of taxes and fees for the local budget to cover expenses, including gathering funds for public investments. Often, local authorities are in the position of introducing new taxes or cutting public spending. There is no easy choice here, since both decisions have a negative effect on investments, because the first option (introducing new taxes) discourages private investments, while the second (cutting public spending) has an impact on public investments, since this is generally the first on the list of cuts for public spending, taking in consideration that there is a strong resistance in preserving a bloated administrative apparatus. That is why local public authorities must look for efficient and stimulating ways to collect revenues for the local budget, as the good practice of some local public administrations has shown, by granting exemptions or benefits to "on time" tax-paying citizens.

In practice, local authorities do not have sufficient funds to implement large investment projects, therefore, correlated with the human factor (also explored in this chapter), they must have the ability to attract external financing sources. Furthermore, the establishment of investment expenses, as previously stated, depends on the level of current expenses, having advantages and disadvantages. Unlike current and unproductive spending, investment spending has the ability to generate future net benefits. Also, public investment expenditures have a multiannual feature, being included in investment plans as annexes to local budgets. Thus, even if the level of expenses for investments is lower, these expenses are staggered to ensure the necessary for financing the investments

assumed by the local public administration. As a disadvantage, we point to the fact that, when a reduction in spending costs is imposed, those that will be affected first are investment spendings, which can lead to the postponement or even cancellation of some public investments. For example, in the first quarter of 2023, to cover a deficit for budget expenses of 33,1 billion lei, Romania's government had to cut 8,8 billion lei from European fund investment, 2,2 billion lei from The National Recovery and Resilience Program grants and 17 billion lei from The National Recovery and Resilience Program loans. In this case, the damages increase in proportion to the stage in which the project or projects affected by the cut in investment spending are. Due to some questionable legislative stipulations, this technique is also used on a smaller level, where local governments' are justifying investment budget cuts by invoking the phasing of ongoing projects. While this may pass the legal argument, it makes an unhealthy practice that affects local public investments and generating longer times for any project implementation.

1.3 The social factor

The third influencing factor for the local public investment decision that we analyze is the social one. Customs, culture, religion or ethnicity are determining elements of the diversity that characterizes modern society and local communities in particular. Each region, each larger or smaller community has different social needs, which implies different approaches from local public administrations in investment policy. Basically, a social need results from the sum of individual needs in a community, best known at the lowest level of administration. That is why some authors (Dondinelli, 2006) made connections between decentralization and the social impact of local public investments, pointing out that positive outcomes depend in part on the accuracy of local opinion about needs and priorities while other empirical tests (Faguet, 2004) demonstrated that decentralization does change patterns in local public investment, and this difference was strongest in the social services and urban development.

We can agree that every community needs utilities, roads, educational institutions, hospitals, recreational spaces, but there are particularities of social nature that influence the investment decision. A first general differentiation is made between urban and rural environments. For example, the decision to build a stadium or even an airport may be justified for the urban population, but for some rural environments, where priorities are still at the basic level, such investments would be absurd. On the other hand, we have to turn our focus to the correction of these disparities when the social factor is brought into discussion, because the responsible approach involves creating an environment that improves the education and health systems, reducing inequalities between women and men,

between the rural and urban environments, respectively the promotion of a social environment where citizens feel valued and supported.

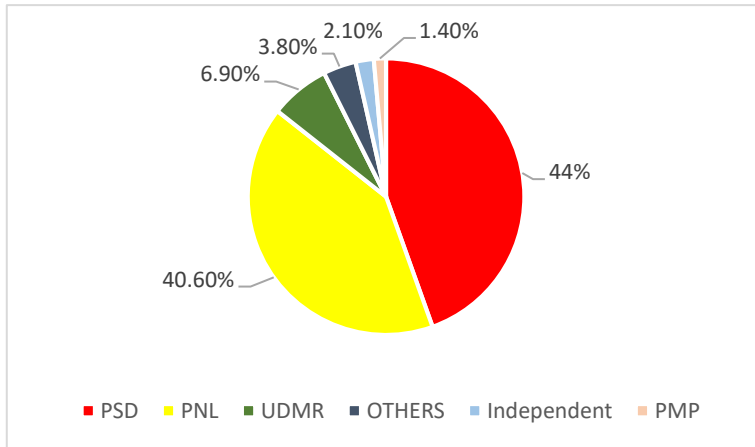
If not taken seriously by local public authorities, the social factor can have negative effects on local public finances and implicitly on local public investments. For example, in a community with a high number of social assistance beneficiaries, the public authority is faced with decisions that may have different consequences. If the budget expenses will be overwhelmingly directed to social assistance, respectively current expenses, then investment expenses will be undersized and the social problem will deepen even more. In some cases, local public administrations prefer this state of affairs for electoral reasons (the political factor comes into discussion and will be later analyzed). On the other hand, in this scenario there is also the option of reducing social assistance spending and increasing public investment to stimulate a better standard of living, which would facilitate new jobs and boost productivity.

1.4 The political factor

The political factor acts decisively on the investment decision. Under the influence of this factor, the extent to which the project corresponds or not to the general local public development strategy, if it is imposed by a political group, if it respects or not the conditions of economic, financial and social rationality appears relevant to our paper. The right way of this factor occurs when the political party or the political group in power is implementing the program with which it presented itself to the voters in order to obtain their votes. On the other hand, the political factor can have serious consequences over the finances of a local community, when the policy for investments are only related to satisfying the political interest of the local government, without considering and justifying the implications. A first example refers to the abundance of public investments that local authorities begin or complete in election years. To support this statement, we point out to the fact that at the beginning of this year (2023), Romania's government announced a record sum of 110 billion lei for public investments that also reflects in the projection of local authorities investment programs. From this point of view, there is the risk that such investments will no longer take into account the other factors that we invoke in this part of the paper, because nothing matters anymore, in an election year, than the image of the authority that it has delivered something at this point.

Fund allocation formulas from government programs have been constantly criticized due to political algorithms. For instance, the allocation of funds from the latest national program "Anghel Saligny" for local investments appears to be relatively balanced politically, close to the results of the 2020 elections, as we see in Chart 1, based on numbers available in 2022.

Chart 1. Proportion of allocated funds from Romania’s “Anghel Saligny” national program for territorial administrative units by political representation in Parliament (2022).



Source: (ExpertForum <https://expertforum.ro/harta-proiecte-saligny>)

The party represented with yellow obtained 25% of the votes in 2020, while the party represented with red had 28,9% of the votes. There was a third political party that obtained 15% of the votes for the parliament elections but as it now representing the opposition and it does not have a strong territorial structure, it doesn't figure into the above representation. This led to larger allocations for the first two ones, and more to the green one, that had only 5,74% of the votes, but also joined the government structure. One of the disadvantages of this type of allocation is the lack of firm control over the spending of funds from these sources and the lack of sufficient transparency, supported by the fact that the allocations are granted by order of the minister, without any clarity regarding the applied algorithms. Furthermore, another disadvantage of these funding sources is subjectivity, because there is a risk that some local governments are favored over others, depending on political affiliation, encouraging clientelism.

We went through this short analysis to demonstrate that the interference of political factor in fund allocations affects the public local governments' investment decisions, because national local development programs cover a large part of expenses for investment projects in the most basic community needs like roads, water and sewage systems, natural gas networks, health and school infrastructure.

1.5 The human factor

The human factor is given particular importance, because the investment potential of a local public authority is not always reflected by the volume of financial and material resources involved, but more often by the decision-making

factor's ability to transform them into expected effects. There is always a concern about finding competent human resources in marginal communities and often, decision makers are the mirror of the community they come from: better access to education, personal development infrastructure, better life conditions leads to better trained personnel.

It is worth pointing out that decision-making capacity is measured by the ability to create investment options in accordance with the established objectives and goals, to improve the development strategy and policies in order to enhance the effects of investments and to select investment projects that allow the rational capitalization of all material and financial resources to achieve the set objectives (Zait, 1987). Under these conditions, the human factor becomes particularly relevant in the investment decision-making stage. Compared to the private sector, where the decision benefits from a wide freedom, it is admitted that in the public administration, it is limited by legal criteria and political interests. The legal criteria is established by the legislative norms that guide the administrative act, while the political interests take into account the doctrine of the party or group of political parties in power at a given time. The constant invocation of these two aspects risks marginalizing the most important criteria on which the entire public administration is built, namely the public interest. It is also worth mentioning here the capacity of human resources management which should not mean the well-being of the employees, but should be reflected in their contribution to the performance of the organization (Bercu, 2019).

1.6 The environmental factor

The environmental factor has gained increasing relevance in investment policies, both public and private. Sustainable development, international and national environmental protection policies require responsible conduct in public investment policy.

Today, no public investment project is carried out without environmental impact measurement. In the global assessments of the impact on the environmental factors, due to the activities carried out within the investments, it is customary, from a technical point of view, to resort to comparative evaluation methods between the ideal state of the environment and that due to the projected anthropic activity, taking into consideration all environmental factors. Although the need for environmental protection is undeniable, it comes with multiple challenges for public investments, especially those in tourism and road infrastructure, mostly due to the unpredictability of the appearance of the effects, which involves the possible repositioning of the investment project. There have been quite a few cases in Romania when road infrastructure projects have suffered blockages caused by various environmental factors that require the protection of

some animal species: bear trails that intersect with highway projects, shoals of protected fish species on the construction route of bridges, etc.

Nowadays, the biggest environmental challenges are found in the development of cities and urban metropolises, and from Romania's point of view certain factors come into discussion: industrial emissions, private cars and conventional transport vehicles, household activities, burning vegetable waste, all combined with the lack of green spaces in urban areas. The European Union recommends a minimum of 26 square meters of green space, while the World Health Organization a level of 50 square meters/capita. Statistics reported by IQAir, one of the largest platforms in the world that stores information about pollution, are showing that lack of green spaces is directly related with high pollution, as large cities like Bucharest, Cluj, Iasi, Brasov or Craiova have high values of pollution and fewer green spaces than international recommendations. We are pointing out to these statistics because local public investments always come with the environmental challenge. For example, building roads means more pollution, building schools, hospitals or other public service structures means taking in consideration the utility works and the intensification of urban mobility that affects soil, groundwater and air quality.

As we said before, there are certain relations between some factors influencing public local governments' investment decisions. Let's take, for example, the political and economic factors. A robust economic growth mixed with a stable political environment should lead to increased public investment in infrastructure and social programs. On the other hand, political instability combined with a lesser economic growth could lead to more conservative spending on investments projects. Looking forward to relations between human factor and environmental factor we acknowledge that both contribute to sustainable development of any local community, understanding of public needs while building for future generations. Furthermore, the relation between financial factor and social factor takes in consideration the implications of investment choices to ensure that projects align with community needs, enhance public welfare, and remain financially sustainable.

SECTION 2. VULNERABILITIES IN LOCAL PUBLIC INVESTMENT DECISION

Adapted to the level of local public investments, the decision engages human judgment in the analysis of several possibilities, methods or possible options for choosing one of them in order to achieve a goal, having a certain degree of autonomy based on a normative framework. The manifestation of will or determination to act involves a complex decision-making process that engages responsibility on the part of the authority to eliminate or minimize risks and errors.

Some authors (Rajaram, A., et al, 2014) identify a series of vulnerabilities that can lead to the failure and inefficiency of public investments, also applicable to local ones, which we will look to debate further.

2.1 Lack of inter-institutional coordination

Most of the time, several actors are involved in the process of implementing an investment, whether they take the form of separate institutions or departments within an institution. The decision on local public investments can in turn be influenced by poor inter-institutional communication, risking being postponed or misunderstood. Thus, in the longer process of implementation, local investment projects may suffer delays that involve risks, some minor, which can be rectified, or others major, which may even lead to the loss of funding. We believe that this risk can be reduced by the public authority or authorities involved by using modern communication mechanisms, such as digital ones, and by creating joint working groups either between institutions, when several entities are involved, or within it, between departments whose efforts converge in order to implement a public investment project and organizing progress meetings.

2.2 Political influence

The political decision in the public administration has a major role in the implementation of the investment plan and should not be seen as a weakness, if it emanates from the will of the majority vote of the population in a community. Political implications can represent vulnerabilities when there are deviations from the political program for which the popular vote was sought and granted.

It often happens that an investment project is postponed or stopped when the interests and political vision of a new leadership at office do not resonate with the previous one. The resilience of the local public authority to vulnerabilities of a political nature is a subject that arouses public interest, most of the time from a negative perspective. In this case, vulnerability does not only emanate from the interests of some decision-makers who lead the destinies of a community, but is often caused by central influences, as government decisions regarding the financing of local public investments often depend on the mere color of a political map, as we shown in the previous chapter.

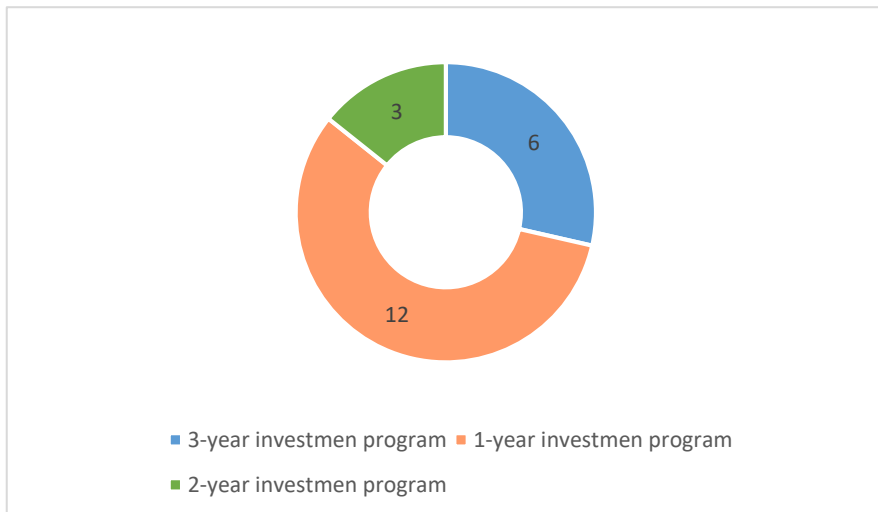
On the other hand, vulnerability arises from misunderstandings in local or county councils on political grounds, in the conditions where the opposition, for reasons of political gains, refuses to give credit to the local government for the investment initiative. Faced with this vulnerability, all decision-makers must bear in mind that the mission of the local public administration is to serve the citizen's interest and that the political influence exerted to the detriment of the community is harmful and will be sanctioned by the electorate at the next election.

2.3 The multiannual allocation problem in a weak budget system

It is generally accepted by practice that the process of financing a local public investment is, in most cases, a multi-year one, which requires the existence of a set of skills of the departments that deal with local finances, respectively the construction of the budget, in which case the method of collecting incomes, distribution of expenses and budget forecasting take on an important role. This takes us back to the relations between human factor and financial factor. In case of dysfunctions at these levels, of poor management of the annual budget, if the investment decision is not accompanied by a long-term vision and properly substantiated, the future financing of local investment projects is put at risk, which leads to the postponement or the abandonment of those that have just been initiated, respectively the degradation of the existing ones and in the process of implementation.

As it shown in Chart 2, in our study of the length of local multiannual investment programs, most local public authorities analyzed appears to have a poor forecast of funding sources for ongoing investments, which shows that local financial managers risk losing the overall vision of investment projects.

Chart 2. The report on the time horizon of the investment programs chosen by the county councils and municipalities in the North-East region of Romania (2022)



Source: (Own processing after territorial administrative units' official websites)

Referring only to the information made public through the official websites of municipalities and county councils in the North-East region, we conclude that

most of them use annual or multiannual programs over a period of two years, which shows that local financial managers risk losing the overall vision of investment projects. Such an approach will generate effects in the amortization plan of the projects and will have an impact on their financing sources. Accepting that the ideal length of local government programs is three years, considering the short duration of investment programs, respectively the predominance of annual investment programs, we appreciate that local public authorities aim to implement small local investment projects, which do not involve high costs and bring them immediate benefits at the expense of long-term investments

2.4 Corruption

In the public sector, with reference to corruption reports, reference is made to two elements: exaggeration of the cost of public investment projects or the use of inferior materials, sometimes both (Haque and Kneller, 2008). In other words, corruption inflates the level of expenditure on investment projects, but lowers the return on future benefit. Such practices have a wasteful effect on public investment, for several reasons. Public administrations must take into account that the route of an investment project is public (voting of the preparatory documentation in local councils, publication of auction announcement, investment costs, allocations contained in annual budgets), so that public opinion will be able to have an image in relation to possible exaggerations of the cost of an investment project.

Corrupt practices lead to poor quality public investments that will require much higher maintenance costs. That being the case, any form of corruption will, at some point, be detrimental to a community's finances. This vulnerability arises as a result of the fact that external control over public investment is often carried out at the end of the project and not at the beginning or during the implementation of local public investment. A possible measure to diminish this phenomenon can be adapted according to the model of projects financed from European funds, applying the method of staged monitoring by a control/audit body throughout the process of implementing the public investment.

2.5 Lack of information

Some authors appreciate that *"the low profitability of public investments results from the poor selection and implementation of projects due to limited information"* (Dabla-Norris et al, 2011). Based on this statement, the decision taken on the basis of unclear indicators and distorted information, superficially related to the economic and social realities at a given moment, becomes inadmissible. Such approaches have resulted in the construction of schools in depopulated villages, sports infrastructure in aging settlements, football stadiums

without teams, particularly expensive and at the expense of other necessary investments.

The decision-maker must have access to all the information relevant to the investment decision, whether it can take the form of databases, indicators, statistical data or surveys, in order to have a clear view in the evaluation for the decision he is about to take regarding the local public investment. Moreover, the degree of correctness of the information has implications in reducing the risk of an erroneous assessment, giving the decision-maker a clearer and more complete picture of the investment project.

To diminish risks involving lack of information, it is recommended that the local decision-maker respects the stages of implementation of the local public investment and listen to the opinions of the working groups involved, in order to have a complete informational package in the perspective of the local public investment decision and to avoid skipping certain steps in the process of substantiating the public local investment decision.

2.6 Budget limits

We previously showed that most local public administrations concentrate the largest part of their local budgets in the consumption section. At the base of this phenomenon are factors such as the low level of income to the local budget (due to the lack of effective means of collecting taxes and fees) to which is added a stuffed organizational chart, which requires a consistent salary envelope that the authorities tolerate for political reasons. In this situation, the allocations of the development section become, most of the time, unsatisfactory and thus limit the possibility of decision. Under these conditions, local public investments are the ones that risk suffering from the budgetary cuts, in the way that the decision-maker, in a position of constraint, can take a decision that affects the investment process. Moreover, here it becomes important to emphasize the relationships between revenues and expenses in local budgets, in the sense that one of the principles of the European Charter of Local Self-Government shows that local public authorities have the duty to diversify collection systems in order to keep up with the cost evolution exercising their powers (Cigu, 2020).

In conclusion, we admit that public investment is characterized by risk and uncertainty, as we have seen before, which is why the local public authority has the role of transforming them into hope and probability, treating with caution and pragmatism the vulnerabilities and challenges that can intervene both in the process decision-making as well as in the implementation or post-implementation process.

CONCLUSIONS

Going through these influencing factors on the public investment decision leads us to the conclusion that the success of a project depends on how the local public authority relates to them. For example, inflation, as a vector of the financial factor, has a significant impact on the technical-economic indicators, affecting the financial allocation for a public investment project, a situation in which the beneficiary is faced with decisions, either to allocate more funds, destabilizing other priorities, or to suspend the investment project. In its turn, the social factor develops a series of dilemmas for the local public administration: in a community with a high number of social aid beneficiaries, if the budget expenditures will be directed overwhelmingly to social assistance, then public investment expenditures will be undersized and the social problem will deepen even more. The political factor in the public investment decision plays a determining role, in the sense that the right approach is for the decision-maker to respect the political program for which he obtained the trust of the citizens, while the wrong approach can be when an investment project is stopped prematurely when the change of power takes place, for eminently political reasons.

Analyzing vulnerabilities in local public investment decision, we came to the conclusion that coordination between institutions or within a public institution is nothing more than an official dialogue that helps to better understand the decision and its course. Political influence often manifests itself to the detriment of the investment process, presenting the risk that a newly invested authority at the office will have a different vision than the previous one, which can lead to the suspension or cancellation of an investment project, just for political reasons. Multiannual allocation proposes that the public authority commits to funding the public investment over several years, so the decision must be based on vision and a set of skills and competencies that eliminate the likelihood that the investment will be abandoned along the way. Corruption at the administrative level is one of the most impactful vulnerabilities, in that it leads to poor quality public investments that will require much higher costs for lesser quality and revenue. The lack of information creates the framework in which the decision is made based on unclear indicators and distorted information, superficially related to the economic and social realities at a given moment, with serious consequences on the outcome of the public investment. Last but not least, budget limits have weight in the decision regarding public investments, in the sense in which the decision-maker, in a position of financial constraint, can take a decision that affects the investment process.

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