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Policy Brief: Local Finances Decentralization

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Approval of new laws on administrative decentralization and functioning of local public administration (July – December 2006) created numerous positive expectations. This fact was appreciated in the monitoring Report of the European Commission and by the Council of Europe experts. Decentralization can effectively resolve many topical issues accumulated at the level of governance, i.e. the utilization of the public funds in Moldova. Unfortunately, in 2006, Moldovan authorities were not able to adopt a strategic concept on fiscal decentralization (a new law on local public finances, based on a totally new approach on inter-budgetary relationship) and the current trends confirm that, in 2007, there is also a real risk of reform deadlock and usage of some speculative arguments to maintain the existent system of financial dependency and clientelle. Under these conditions, the process of decentralization launched in 2006 could be easily jeopardized and postponed for another long-political cycle, while the real reforms - replaced by protracted ambiguities, budgetary inconsistency and systemic instability of the local public governments in Moldova. This may result in disillusionment of those who wish to build on a genuine European perspective for Moldovan citizens. It is therefore a right time to see what are the real threats and issues that need to be tackled today in order to promote a free, viable and decentralized local government in Moldova. And herein are some answers to this urgent priority need for reform.

What is the current fiscal situation at the level of local governments in Moldova? The current system of local public finances (2003) represents **an unbalanced, rigid and clientelist system** that does not allow local and sub-national (rayonal) authorities to administrate autonomously their resources. Under the conditions of this system, all local budgets of the Republic of Moldova are elaborated and adopted as a result of direct negotiations, however totally non-transparent, between the mayor and the rayonal financial departments. Respectively, the final version of the budget belongs rather to the presidents of rayons and the Ministry of Finance then to the respective 1st level local authorities. Normative spending acts serve as basis for negotiations, elaborated unilaterally and arbitrarily by the Ministry of Finances, outside of a fair legislative framework that would regulate this procedure and treat local authorities as autonomous actors protected by national legislation and constitutional regulations (art. 109). Thus, despite constitutional provisions on local autonomy, on a decision-making level, the Government of the Republic of Moldova imposes mandatory rules of local finances administration to local authorities. In the absence of a legal and transparent framework of negotiations, the regulations elaborated by the Ministry of Finances are applied uneven and discretionary in the advantage of certain clientelist groups of localities which results in unequal money transfers differing in 2-3 times and even more for some favored localities in the disadvantage of others.

Even though there is apparently a link between the local potential and expenditures, we should not forget that the analysis is done on basis of the entire group of communes and cities of Moldova. We can therefore notice that most of criteria under which the budgets are shaped out have nothing to do with the existing local economic potential. Thus, Sturzovca village (Glodeni rayon) is part of category VIII of mayoralties with an extremely small budget, and the local fiscal basis equals 202 lei per inhabitant or twice more than the mayoralty of Drasliceni (Criuleni rayon) that is part of category III. In category VI and VII there are 50 mayoralties with revenues higher than the average revenues of the first category.

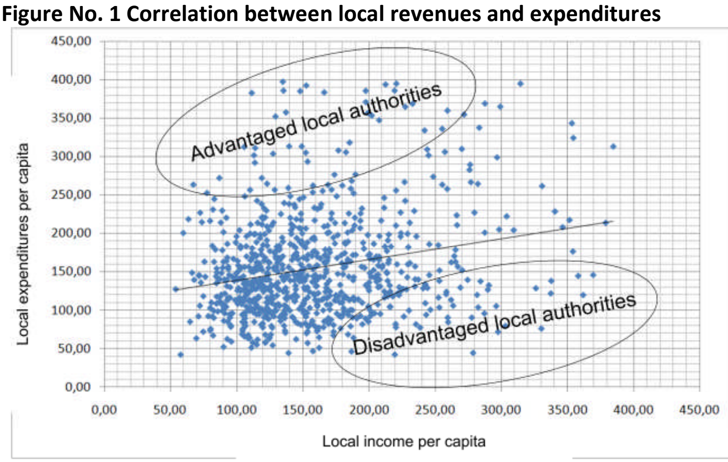
Scheme1. Repartition of mayoralties according to the size of local spending per inhabitant (total expenditures minus educational expenditures)

Mayoralty category	Local expenditures size per inhabitant, in lei	# of mayoralties	Average local revenue per inhabitant, in lei
VII	50 – 100	95	155
VII	101 – 150	350	170
VI	151 – 200	240	217
V	201 – 250	115	273
IV	251 – 300	55	332
III	301 – 350	15	309
II	351 – 400	10	265
I	Peste 400	20	967

Source: Ministry of Finances, local budgets for year 2005

The analysis of the level of correlation for each of the 898 mayoralties between local revenues and expenditures shows that there is no link between those two indicators (level of correlation equals 0.34[1]). Only 10-15% of mayoralties have expenditures that can be compared to their own revenues. The rest are either favored mayoralties (low revenues, high expenditures) or on the contrary are rich mayoralties economic potential of which is sublimated through expenditures constraint (high revenues, limited expenditures). This means that the local administration mechanism of financing, by approving revenues and expenditures at rayonal level is totally unsuitable and does not correspond to economic realities. Nearly 20-25% of mayoralties with reduced economic potential are favored artificially by the existent system of transfers and approvals that does not ease significantly their situation but on the contrary produce major perturbations in the budgetary balancing system and local economic development. Nearly 15-20% of mayoralties are artificially blocked because they can not use their accumulated resources through arbitrary decisions of tertiary authorities.

Figure No. 1 Correlation between local revenues and expenditures

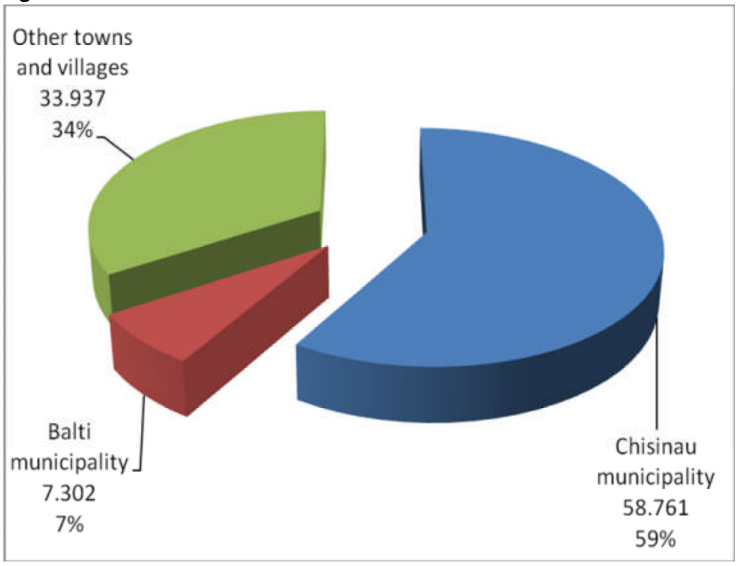


Source: Ministry of Finances, local budgets for year 2005

[1] From 0,2-0,5 the correlation level is very low which means that there is no relation between local revenues and expenditures. Between 0,5-0,75 the correlation is moderate. But taking into consideration the fact that local revenues are analyzed in dynamics, for a correlation with local expenditures to exist, this indicator has to be at least 0,8.

Another consequence of the current system relates to the education of a complex of "parasitism" in local public administration. Local authorities are no longer interested in manifesting initiative for optimizing own expenditures or encouraging the local entrepreneurial environment but is exclusively preoccupied with "getting resources from central administration" using with this aim all possible relations (party-line or personal). Public funds circulate within the system of local public administration depending on the degree of "political nepotism" or other type, and not according to criteria of competency, merits of its own, or priority on the national level. Under such conditions, we face an extensive atrophiation of the territorial components that belong to the system of local public administration through its convergence: from authorities delegated to administrate on behalf of the local community the citizens' interests (according to the European Charter on local Autonomy Exercise) in assimilators of resources transferred by the central administration, or otherwise stated, in subsidiary branches of the central government. We mention that, the current law on local finances (2003) had the doubtful "merit" to limit the 1st level local public authorities (mayoralties) from the most important revenue sources, except taxes. Those represent currently, however, nearly 100 mln lei (65 mln lei of them are collected only in Balti and Chisinau municipalities) [2]. The rest of revenues transferred to local budgets represent the outcome of some "informal" negotiations between mayoralties and rayons.

Figure No.2 – Division of local taxes on localities

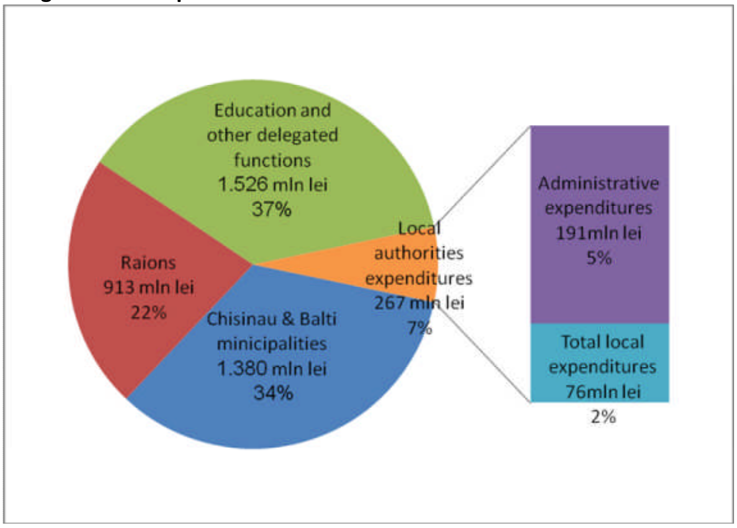


Source: Ministry of Finances, local budgets for year 2005

The conclusion that can be extracted from this scheme is that, currently, all 1st level local authorities from the Republic of Moldova (896 mayoralties) – that represent more than 2.5 mln inhabitants – administrate "freely and independently" only 34 mln lei annually, which represents 5 times less as volume than the budget of national Customs Service of the Republic of Moldova (183 mln lei) [3].

For comparison, we shall note that the budget of the Fiscal State Inspectorate is also 5 times higher than all budgets formed from local taxes of 1st level authorities in the republic of Moldova. It is clear that under the conditions of the operating law, the priority of local development is insignificant as long as the mayors administrate only 0.3% of the total 12 bln lei that form the consolidated state budget. The importance of local authorities is obviously directly proportionate with the funds administrated within the system of local public administration.

Figure No.3 Structure of local expenditures as part of local authorities budgets in the Republic of Moldova



Source: Ministry of Finances, local budgets for year 2007

In fact, local authorities from the Republic of Moldova have at their disposal nearly 4.2 bln lei – this is the size of all 1st and 2nd level local budgets. Out of the total of 4.2 bln lei, nearly 200 mln lei are distributed for special funds and means, and local budgets administrate directly only 4.07 bln lei. Out of this amount – 55% recur to budgets of rayonal councils, Chisinau and Balti municipalities, and 36% - are transferred for realization of delegated competencies by the state to local public authorities. What needs to be mentioned here is that those 896 mayoralties of Moldova, in 2007, are responsible for the administration of 267 mln lei, 191 mln lei out of which will be used to maintain the administrative apparatus (executive structures of the local public administration). Thus, we notice that local authorities have at present only 76 mln lei to solve all vital problems necessary to local communities (roads, sewerage, potable water, district heating, territorial cleaning, gasification, sanitation, etc). Practically, planned expenditures for all citizens' needs outside Chisinau and Balti are estimated at an amount smaller than the amount allotted in 2006 to a state enterprise „Air-Moldova" to buy one single airplane of secondary use [4] (!). This comparison aims to emphasize the dramatic discrepancy that exists between the effective capacity of local authorities and the capacity of intervention of the central government, which does not fall into the logic and meanings of decentralization, adopted legislatively by the Parliament of the republic of Moldova (December 27, 2006).

Still, things are much more complex than they seem. It is obvious that only 76 mln lei are not at all sufficient to bring to good condition local roads, to gasify localities, etc., and that is when the Government of the Republic of Moldova invented a **system of discretionary distribution** of some important budgetary resources, using in this regard several notable and ingenious instruments.

Firstly, the Parliament of the Republic of Moldova takes the decision to transmit subsidies directed through some **special allotments** [5], of nearly 206 mln lei, with the apparently noble and fair goal to transmit certain financial resources to local public authorities (see Annex 18 and 19 of Law on state budget for year 2007). Neither at the adoption nor afterwards, the criteria for selection of localities and local projects financially supported were not properly and clearly described, and there is no possibility foreseen to evaluate the efficiency and efficacy of these state investments operated in these localities. This method to support local development, in reality, is a form of centralizing the decisions that produces inefficiency in using these

[2] Information regarding local tax collection of 1st level budgets, report of the Ministry of Finances for year 2005
[3] Law on state budget for 2007, No.384 of 23.11.2006

[4] Decision of the Parliament of Republic of Moldova regarding allocation of budgetary resources to state-enterprise „Air-Moldova";
[5] Law on state budget for 2007, No.348 of 23.11.2006, Annexes 18 and 19;

resources and encourages the consolidation of a clientelist circle of favored localities which impedes very limited state budget resources from reaching the most stringent needs but the most "pressing personalities".

The second method of supporting local authorities by the state relates to the **correction of the state budget throughout the budgetary year**. We mention that this method is a very non-transparent method and favored a lot by the central government. In 2006, the Parliament of the Republic of Moldova, at the initiative of the Government, modified the law on state budget 3 times, and in July of 2006, again 254 mln lei were allotted to local public authorities[6]. We shall mention that, according to the opposition MPs, 95% of these allotments reached the localities run by mayors of the Communists' Party of the Republic of Moldova.

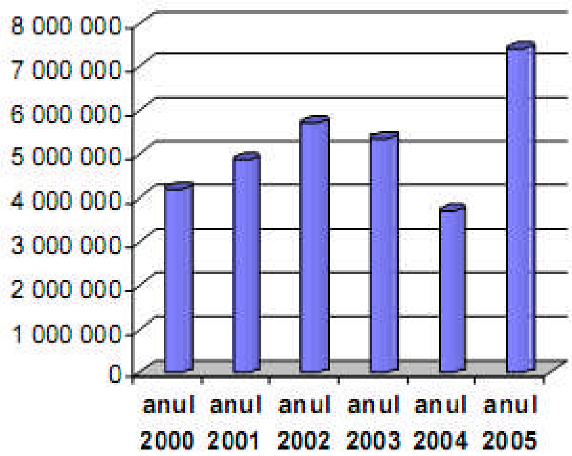
The third method relates, generally, to the usual **„gifts" made unilaterally through governmental decisions**. Almost weekly, the Government adopts at least 3-5 decisions regarding the disbursement of considerable financial means to various local authorities (1st and 2nd level), by request. This is usually done on a case-by-case basis, without appropriate foundation of the criteria or impact assessment that such infusions shall pursue to their aims, and such ad hoc decisions aim usually to avoid, in reality, the existing legislation.

Analyzing the functioning of the current system of budgetary relations between the state and local public authorities, we notice that the most significant share of transfers from the state budget (estimated annually at 600 mln lei) to local authorities take place in uncertain, unclear and non-transparent conditions. This fact does not favor in any way local development, assumption of administrative and functional autonomy, ands the creation of a responsible group of local public officials and public servants committed to the public interest at the local level.

The lack of financial resources at local level and the increasing role of the programs that EU orients towards its extra-territorial neighbors represent a serious motivation for local authorities to cooperate more actively to attract European funds. Despite general attractiveness of the process of attracting European projects, local authorities are oftentimes in the situation to give up these opportunities being unprepared to take all responsibilities that derive from the administration of European funds. There are two main impediments that have to be analyzed: 1) lack of a long-term vision concerning the local development objectives that would strengthen the conceptual basis of decentralization and local development, including projects of understructure investments, set-up of qualified public institutions on territorial and sub-national level, 2) lack of financial resources needed to cover "local contribution" (10-20% co-financing of the total cost of the project is a main condition, generally applied in all projects financed by EU (TACIS, PHARE and obviously the future EU instrument for the countries that are not included in the process of immediate adhesion – the ENPI).

The experience of recent years confirm that local public authorities hardly assimilate less than 10 mln USD per year for all localities of the Republic of Moldova (exception makes Chisinau and Balti municipalities), and the central reason for that is the lack of a systemic and rigid practice of autonomous administration of local finances, and the lack of stability of the local public administration system. Most of the projects with external financing, from outside of the local communities, are implemented by the Social Investment Fund of Moldova (FISM) that allots annually nearly 8 mln USD. In order to attract this important amount for various community infrastructure projects, local authorities have to contribute with nearly 15% of own resources for each proposed project to FISM; this is a difficult task to be implemented for most of the small communities, and therefore, local authorities appeal to the help of ordinary citizens or services of the local businesses[7].

Figure No.4 SIFM allocated resourses, dynamics per year, USD



Source: Annual report 2005, presented by the FISM executive office

The permanent deficit of resources in the local budgets represents a serious impediment for the consolidation of local democracy – a basic institution of the democratic state, and simultaneously, a major criterion for assessing individual performances of states – members of the Council of Europe, and of the states aspiring to join the European Union. The fact that Moldova has serious problems at this chapter has been noticed only currently. Numerous times, Moldovan authorities are warned about the extremely negative effects of hyper centralization of state decisions, lack of adequate financial autonomy and waste of public funds, through hazardous and non-transparent decisions. **The EC report vis-à-vis the draft law on local public finances promoted by the Ministry of Finances in 2006 affirm that "we acknowledge that the draft law does not respond to the severe critics drawn to the system of local finances of Moldova 3 years ago. A detailed revision of the system is necessary to bring the Moldovan legislation in conformity with the European Charter for Local Autonomy" [8].**

Only in 2006, central authorities of the Republic of Moldova decided to respond to these important problems. First step was the set-up of a Special Commission of the Parliament of RM aiming to elaborate and complete the effort of adoption of a set of new laws in local public administration and to create a legislative framework for the process of decentralization (administrative, patrimonial, and local public finances). The second step was the institutionalization of the process of decentralization by creating a Ministry of Local Public Administration (created in January and started to work in May 2006). The result of this effort of the Commission, Ministry and civil society was the approval, in December 2006, of 2 new laws, followed by the third law on public finances to be approved by the end of 2006 establishing a new system of local public finances in the Republic of Moldova, decentralized, autonomous from the central budget, and protected by safe guarantees on a legislative level that would ensure its good functioning, predictability and coherence.

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[6] Law on modification and completion of the law on state budget 2006, No.252 of 26.06.2006;

[7] See Study „Unofficial taxation in the Republic of Moldova: study prepared by IDIS Viitorul in 2006", www.viitorul.org.

[8] Report on draft laws on „Local public administration", „Administrative decentralization" and „Local public finances", PCRED/DGI/EXP (2006), Strasbourg, December 13, 2006

In general lines, the new model on decentralization of local finances should consist of the following elements:

1. Separation of the local budgetary process from other level budgets.

The main goal of changing the system of local public finances is to ensure a real autonomy to the local public authorities in the domain of public finances. This system will cancel the existent procedures of establishing the regulations on a vertical up-down basis, as well as the procedures "of negotiation" of the main parameters of local budgets between mayoralties and rayon, rayons and state, currently totally non-transparent. All inter-budgetary relations have to derive exclusively from the law on local public finances and should not admit exceptions and possible interpretations. The new system introduces clear rules of conduct and financial prognosis for all local and central actors ensuring conditions for sustainable growth and development of communities.

2. Creating the local financial basis

Local authorities of level I and II benefit from 5 types of distinctive revenues, clearly stipulated by law, and the mechanism foreseen by the law ensures the stability and the predictability of revenues accumulation: (1) tax revenues that for the fiscal basis (income tax on natural persons, private tax, real estate tax, value added tax); (2) local non-fiscal revenues (local taxes, taxes for using natural resources, license tax, patent tax, tax for notary acts, revenues from the administration of local public properties, revenues from the activities of local authorities, grants); (3) tax on public transportation; (4) special revenues (formed from special funds and means); (5) general transfers. This classification rationalizes the multitude of revenues administrated by local authorities, bringing more clarity, preciseness, and eliminating ambiguities and interpretations existing at present. Clear definition of the types of revenues impedes the abusive interventions of some levels of administration in the budgetary process of other levels. Local authorities will be able to protect their financial autonomy by using one single financial relation with the central administration: the fund for financial support of the regions.

3. Ensuring proportionality of resources against allotted competencies.

Exerting legal competencies, solicit local public authorities a continued effort that has to be supported by the existence of a personal fiscal basis. We estimate that the system of local finances has to guarantee to local authorities of the Republic of Moldova a fiscal basis of nearly 1.6 bln lei. From this amount, the income tax on natural persons would represent nearly 1.1 bln lei, real estate tax – 250 mln lei, VAT – 250 mln lei. The next source of non-fiscal local revenues will represent 250 mln lei, including: 120 mln lei – local taxes, 20 mln – tax for natural resources, 15 mln – for licenses, 30 mln – for patents, 20 mln – notary acts, 40 mln – property).

Separation of these revenues and non-inclusion in the structure of calculation of transfers will spur the initiative and responsibility spirit of local authorities and will allow for an increase of at least 2 times of encashment from these revenues, consolidating thus the local autonomy. The revenues from transportation tax in amount of nearly 70 mln lei will be used exclusively for construction and maintaining of roads. Allotment through law of own revenues to local authorities will allow for a clear separation of state budget revenues from local revenues thus creating for the first time, a clear coverage of competencies recognized by law. These provisions will allow strategic planning of competencies decentralized at national level.

4. Creating a transparent, fair and credible mechanism of equalization of local budgets.

A Fund for regional support has to be institutionalized in the Republic of Moldova that would administrate nearly 400 mln lei, under the conditions of year 2007. Nearly 180 mln lei will be raised from the well-off mayoralties (with superior fiscal basis), and the rest will be covered with transfers from the central state budget. To administrate the resources of the Fund for regional support, the Rayonal departments of financing will be divided into two types of authorities: finance section (subdivision of the Rayonal council) and finance direction (deconcentrated service of the Ministry of Finances), ensuring thus the process of performing transfers to local budgets. The Fund will operate as follows: collected revenues from the well-off mayoralties of 50% from the amount that overpasses 120% of the average per country will be collected and oriented to mayoralties with revenues lower than 90% of the average per country.

5. Creating conditions for spurring local initiatives

The new system of local finances will definitely separate the fiscal revenues from the non-fiscal, revenues that are included in the calculation of general transfers and revenues that are not included. Thus, local public authorities will be encouraged to increase the quality and performance of administration of goods and services detained, spurring local initiative and professional competency. The new law prepares the ground for adopting a new legislative framework for administrating and developing municipal properties, developing the market of municipal bonds, introducing policies for maintaining the quality of public services, increasing local responsibilities and the quality of local policies. Meanwhile, this system will reduce the dependency and clientelism between certain local authorities and central administration. This approach will considerable strengthen local autonomy.

6. Protection of local financial autonomy from the interference of other public authorities.

None of the administrative levels can influence the structure of revenues accumulated by other administrative levels. General transfers represent a simple form easy to manage by local authorities, transparent and fair, which can balance different potentials of local public authorities of both levels. On the other side, transfers offer the possibility of spurring local initiative and local development. Budgetary balance will be achieved through transfers with general destination from funds of financial support of administrative-territorial units. The innovation consists in the fact that in basis of calculus formula stipulated by law, each administrative-territorial unit will be able independently to calculate the size of transfers. The performance of transfers will be a technical procedure and not an element of negotiations between the local public authorities of 1st and 2nd levels but central level. This fact will ensure independence to local public authorities of any level from public authorities of higher level.

7. Delegation of competencies to local public authorities exclusively in conditions of parties equality, integral coverage of costs and legal protection of local autonomy.

Any delegated competency from central to local level will be transmitted with a financing mechanism stipulated in the law on local public finances. Any relation between local and central public authorities is regulated strictly by law. Thus, for each delegated competency, there is a separate article in the law on local public finances that stipulates the mechanism of their financing. The law will offer a legislative framework, transparent and correctly procedural on the mode of negotiating transfer mechanisms to cover costs related to delegated competencies. The law will stipulate the exact method for establishing the volume of transfers and the method for distribution according to the quality standards and equity criteria formulated through policies at national level. Thus, the state will ensure the prevention of social crises offering legislative framework for local authorities and pubic organizations to manage competitively their interests.

8. Opening the capital market to local authorities.

Due to the ensured by law stability of the fiscal basis and own revenues, and due to the innovative method foreseen by law, local authorities will be able to attract loans from the financial market for capital investments. According to the articles of the law, local public administration will be able to attract by loans up to 700 mln lei (according to situation in 2007-2008). The set-up of a personal financial basis and the creation of conditions to contract loans will increase responsibility and local initiative. Thus, legislation will allow local authorities to be perceived as credible, stable partners, with respect by the private business, the least having the opportunity to involve more actively in the development of certain services of local interest within public-private partnerships.

IDSI model on how to reform the local public finances system in the Republic of Moldova

We consider that the future system of local public finances from RM should contain the following basic elements:

Local public authorities have to dispose of **own revenues, and the size and mechanism of allotment of these revenues to be clearly stipulated by law**.

All revenues of local public authorities can be classified in 5 distinctive groups (details in tab. 2):

Tax revenues that form Local Fiscal Basis (LFB)

General Transfers (GT) through which local budgets equalization will occur

Non-fiscal revenues that have the goal to spur local initiatives (NFR)

Transport Tax (TT) which will be exclusively used for roads

Special Revenues (SR) formed from the Fund of Special Means of public institutions from territorial-administrative units.

Table No.2 Structure of local public revenues and their distribution on administrative levels after reform[2] (mln lei)

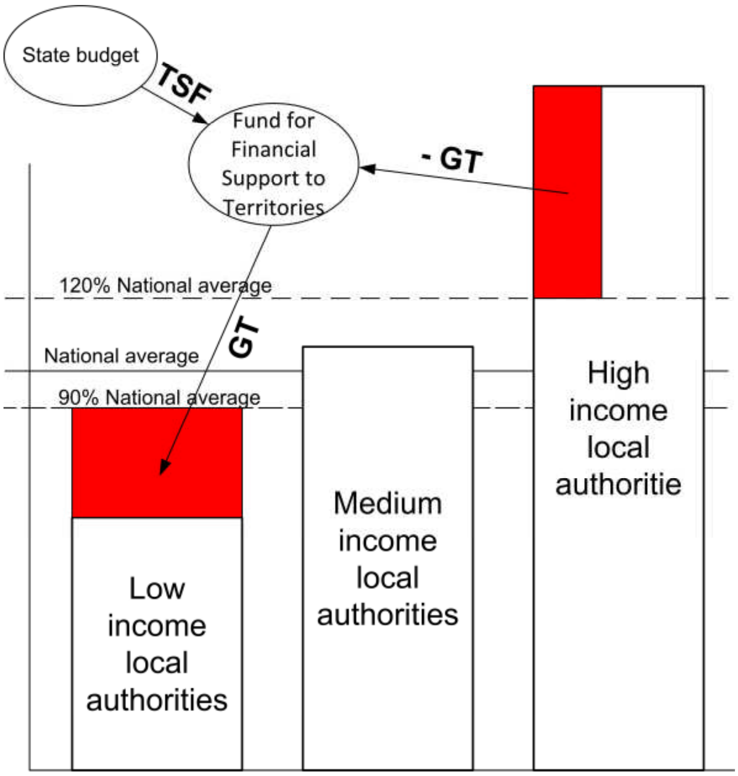
Local revenues	Mayoralties (except Chisinau mun.)	Chisinau mun.	Rayons	UTA Găgăuzia	**TOTAL**
1.Local tax revenues	525,7	675,2	130,1	45	**1.376**
1.1. Income taxation of natural persons	*310*	*650*	*130*	*10*	***1.100***
1.2. Real estate taxation	*215*	*25*	*0*	*0*	***240***
1.3. Private taxation	*0,65*	*0,2*	*0,1*	*0,05*	***1***
1.4. Value added taxation	*0*	*0*	*0*	*25*	***25***
1.5. Excises	*0*	*0*	*0*	*10*	***10***
2.General Transfers	230	-200	70	10	**110**
3. Local non-fiscal revenues[1]	122	117	3	0	**242**
3.1. Local taxes	*40*	*70*	*0*	*0*	***110***
3.2. Revenues from local public property management	*50*	*30*	*0*	*0*	***80***
3.3. Revenues from licensing and services delivery	*20*	*10*	*0*	*0*	***30***
3.4. Tax on natural resources	*12*	*7*	*3*	*0*	***22***
4.Tax for roads	0	25	32,5	2,5	**60**
5. Special revenues	142	51,5	33,5	4	**230**
5.1. Special funds	*70*	*14,5*	*16*	*1,5*	***102***
5.2. Special means	*72*	*37*	*17,5*	*2,5*	***128***
TOTAL	**1019,7**	**668,7**	**266,1**	**61,5**	**2.018**

1. Situation in 2007, calculations done in basis of 2007 state budget

2. Estimations in basis of results of 2005.

Local Fiscal Basis (LFB) together with General Transfers (GT) are revenues that ensure stability and equity of the system for all territorial-administrative units. General Transfers represent means of revenues distribution on local level from territorial-administrative units with high local fiscal Basis towards those with a reduced local fiscal basis (see Fig. 1).

Figure No.5 Equalization of local budgets through General Transfers



To avoid subjective intervention when determining the GT, all calculi will be performed in basis of the results obtained. Otherwise stated, when elaborating the budget for the following year, the last year results obtained de facto will be taken into consideration. The country average per inhabitant of local fiscal basis will serve as main element when calculating the GT. The average local fiscal basis is calculated both for mayoralties and for rayons. Local fiscal basis consists of the following elements:

Tab. No.3 Fiscal basis structure in the local public administration system

	Mayoralties	Mun. Chişinău	Rayons	UTA Găgăuzia
IVPF – income tax on natural persons	70%	100%	30%	30%
IBI – tax on real estate	100%	100%	0%	0%
IP – private tax (affiliation-based)	100%	100%	100%	100%
TVA – value added tax	0%	10%	10%	100%
A – excises	0%	0%	0%	100%

k – is the tax rate that rest sat the given territorial-administrative unit. For example, TVA in Gagauzia remains at the level of 100%, for the rest of territorial-administrative units – 10%

P – total population number of the given territorial-administrative unit.

$\sum_{1}^{898}$ - total amount of collected revenues in all 898 1st level territorial-administrative units.

$\overline{BFL_p}$ - national average of local fiscal basis per inhabitant for mayoralties is formed from all revenues obtained in the reference year from the income taxation of natural persons, real estate tax, private tax that recur to mayoralties divided to the population number. Calculation formula, as follows:

$$\overline{BFL_p} = \frac{0,7 \times \sum_{1}^{898} IVPF_i + \sum_{1}^{898} IBI_i + \sum_{1}^{898} IP_i}{P}$$

When elaborating the budget for 2008, mayoralties will calculate $\overline{BFL_p}$ (average fiscal basis per inhabitant for mayoralties) in basis of the results obtained in 2006. Thus, the formula looks as follows:

$$\overline{BFL_p} = \frac{0,7 \times 1.039.300.000 + 238.600.000 + 1.064.000}{3.589.300} = 269,46\, lei$$

Thus, in 2006, own tax revenues on average for mayoralties constituted 269,46 lei. This amount will be taken into consideration when determining General Transfers.

For rayons, including the autonomous territorial unit of Gagauzia, when calculating the average fiscal basis per inhabitant, the income tax on legal persons is taken into consideration when it comes to rayons, the value added tax in the establish rates by law, the private tax, excises when established by legislation that are divided to the total population number.

Calculation formula will be:

$$\overline{BFM_r} = \frac{0,3 \times \sum_{1}^{898} IVPF_i + \sum_{1}^{898} k_i \times TVA_i + \sum_{1}^{898} k_i \times A_i + \sum_{1}^{898} IP_i}{P}$$

For rayons, calculi will be done analogically as for mayoralties:

$$\overline{BFM_r} = \frac{0,3 \times 1.039.300.000 + 0,1 \times 2.005.000.000 + 25.000.000 + 8.000.000 + 1.000.000}{3.589.300} = 152.20$$

Otherwise stated, the average local fiscal basis for rayons in 2006 constituted 152,2 lei.

The specific of calculations for rayons is that TVA is differentiated. UTA Gagauzia will receive 1000% from TVA and the rest of the territorial-administrative units – 10%. Also, UTA Gagauzia will receive 100% of excises for goods produced in UTAG, the rest of the territorial-administrative units – 0%. Therefore, in the formula the k_i indicator is included that shows the rate of the respective tax recurring in each case separately.

Each territorial-administrative unit is ensured 90% by law from the country average local fiscal basis. Each locality where the local fiscal basis is lower than 90% from the country average will benefit from general transfers in amount that will cover this difference. The calculation formula will be,

For mayoralties:

$$TG_p = 0,9 \times \overline{BFL_p} \times P - (0,7 \times IVPF + IBI + IP)$$

In 2006, Aluatul mayoralty (Taraclia rayon) obtained 26.430 lei from own fiscal revenues, having a population of 1.144 inhabitants. Thus, the average revenues per inhabitant equaled 23,1 lei which is 11,7 times lower then the country average.

Through General Transfers, the state will ensure Aluatul Mayoralty with own fiscal revenues of 90% from country average.

$$TG_{Aluatul} = 0,9 \times 269,46 \times 1.144 - (0,7 \times 15.900 + 15.300 + 0) =$$
$$= 242,54 \times 1.144 - 26.430 = 277.465 - 26.430 = 251.035\, lei$$

Thus, aside own fiscal revenues of 26,4 thousand lei, Aluatul mayoralty will benefit from over 251 thousand lei from general Transfers, revenues that will equalize the local budget. Besides these revenues, Aluatul mayoralty collects annually non-fiscal revenues of nearly 30 thousand lei (10 thousand lei from local taxes and 20 thousand lei from management of local public property).

Thus, for the execution of own competencies, Aluatul will have a budget of nearly 280 thousand lei annually which will be used for solving local-interest problems. Currently, the local budget equals 160 thousand lei (mayoralty budget minus education expenditures).

For rayons:

$$TG_r = 0,9 \times \overline{BFL_r \times P} - (0,3 \times IVPF + 0,1 \times TVA + IP)$$

For UTAG in case local fiscal basis is lower than 90%:

$$TG_{UTAG} = 0,9 \times \overline{BFL_r} \times P - (0,3 \times IVPF + TVA + A + IP)$$

In case when local fiscal basis per inhabitant is higher than 90% of the average per country, but does not overpass 120%, than these territorial-administrative units will not receive transfers, and will not transfer anything to the Fund for financial support of the regions.

In case when one territorial-administrative unit has a local fiscal basis per inhabitant higher than 120% from the average per country, then this unit will transfer from the amount that overpasses 120%, 50% to the Fund for financial support of the regions. The calculation formula will be,

For mayoralties:

$$-TG_p = 0,5 \times ((0,7 \times IVPF + IBI + IP) - 1,2 \times \overline{BFL_p \times P})$$

For rayons:

$$-TG_r = 0,5 \times ((0,3 \times IVPF + 0,1 \times TVA + IP) - 1,2 \times \overline{BFL \times P_r})$$

For UTA Gãgãuzia in case when revenues overpass 120% from the country average:

$$-TG_{UTAG} = 0,5 \times ((0,3 \times IVPJ + TVA + A + IP) - 1,2 \times \overline{BFL_r} \times P)$$

Alexanderfield Mayoralty (Cahul rayon) obtained in 2006 own fiscal revenues of 680 mln lei. For a population of 1,451 inhabitants, this amount represents 468,64 lei per inhabitant which is 1.7 times more than the country average. Revenues of up to 120% from country average will remain totally at the mayoralty and what overpasses 120% in proportion of 50% will be transferred to the Fund for financial support of the regions.

$$-TG_{Alexanderfield} = 0,5 \times ((0,7 \times 350.000 + 435.000 + 0) - 1,2 \times 269,46 \times 1.451) =$$
$$0,5 \times (680.000 - 470.000) = 105.000\, lei$$

For Alexanderfield negative transfers in 2008 will equal 105 thousand lei, funds that through the Fund for Financial Support of the Regions will go to poor mayoralties.

Tax revenues that remain in the mayoralty will equal 575 thousand lei. Besides these revenues, Alexanderfield mayoralty has non-fiscal revenues in amount of 75 thousand lei (local taxes – 25 thousand lei, revenues from property administration – 50 thousand lei).

Own budget of the mayoralty will equal 650 mln lei, funds for solving local interest problems. Currently the local budget consists of 250 thousand lei.

For Chisinau municipality, General Transfers will be calculated twice using both formula once as for 1st level territorial-administrative unit and secondly as for 2nd level.

Recommendations:

1. Immediate adoption of the law on local public finances.

The law has to be subjected to legislative debates and adopted in two lectures until the end of July. Otherwise, even if the law could be adopted in 2007, its implementation will be possible only starting with 2009 which will affect dramatically the entire legislative framework, adopted with such considerable effort in 2005-2006. Concomitantly, national authorities will finish the national concept regarding fiscal decentralization.

2. Public information campaign about the new local public finances system.

The Ministry of local public administration has to initiate immediately consultations with the actors of the public administration system (professional associations, local, sub-national and rayonal authorities, civil society, foreign donors, international organizations that monitor the implementation of the commitments of the Republic of Moldova regarding local governance) aiming at preparing the adoption of this law.
Energetic actions have to be planned and implemented to train and inform the newly elected officials regarding the future budgetary process, budgetary planning and the new legislative conditions. Mediatization of the adoption process and implementation of the new legislation has to crate a national framework for public debates, shows dedicated to subjects related to financial management of local communities, presentation of actions and vision, as a whole, opportunities created by the new system for local development in the Republic of Moldova.

3. Establishing the Fund for Financial Support of the Regions.

The need to establish this institution is dictated by the separation of local budgets from the budgetary process at national level, and local budgets of both levels.
The Fund ill be administrated by the Ministry of Finances through its territorial subdivisions in accordance with the new legislation.

4. Reforming rayonal departments of finances.

According to the goal of the local finances reform, rayonal departments of finances – subordinate currently to 2nd level rayonal authorities – will be reorganized in two distinctive units: local public finances section, as a subdivision of rayonal authorities and Direction of Finances, as a deconcentrated service of the Ministry of Finances, responsible for managing the Fund for Financial Support of the Regions.

5. Future steps planning of local public finances decentralization.

With the implementation of the new law on local finances which regulates only own revenues and expenditures of local public authorities, it is very important to determine the conditions of reforming the system of finances of delegated services. For each delegated service (education, social protection and special cases, capital investments in the energy sector, etc.), the Government is obliged to form specialized working groups to elaborate, test and regulate financing mechanisms of each separated competence delegated. Mainly, the Ministry of Finances should in tandem with the Ministry of Education and the Ministry of local public administration to elaborate a mechanism for financing education which covers 75-80% of all expenditures for competencies delegated currently to local authorities (or, nearly 2 bln lei).

6. Creating conditions for accessing the capital market.

The new law on local public finances creates healthy premises to access certain important private and public financial resources to develop local infrastructures. Thus, the Executive of the Republic of Moldova has to elaborate and improve the legislation regarding the capital market (municipal bonds, diversification of public guarantees, clear delimitation of the private and public).

7. Strengthening local institutional capacities.

Decentralization of local public finances will consolidate the independence and responsibility of local authorities to elaborate and administrate autonomously own resources. Local authorities will not be able to blame anymore other authorities for their own inefficiency and inaction. After the disappearance of existent regulations of local expenditures, established by the Ministry of Finances, as well as the cancellation of procedures of "negotiations" of revenues between mayoralties and rayonal departments of finances, local authorities will be the only institutions responsible for the local budgetary process. Under such conditions, local authorities of the Republic of Moldova will feel the need of an extensive methodological support and technical assistance to be able to respond to new challenges and consequences of the reform.

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