



The Fiscal Decentralization Initiative  
for Central and Eastern Europe

# Fiscal Equalization: The Case of the Republic of Moldova

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## Abbreviations

<b>ATU</b>	Administrative Territorial Unit
<b>ATULN</b>	Administrative Territorial Unit of the Left Bank of Nistru (Transnistria)
<b>GDP</b>	Gross Domestic Product
<b>LGA</b>	Local Government Authorities

## Executive Summary

During the last ten years in Moldova, a series of administrative-territorial reforms have taken place as the government tried to find the necessary economic or political solutions for the country's regional development. Now, Moldova has two levels of local public administration: villages, communes, and towns at the first level; and *rayons* and municipalities at the second level. The multinational structure of the population and different ethnic interests allows the creation of administrative-territorial units with special status that belong to the second level of public administration. The total number of localities in the Republic of Moldova is 1,679, including 147 on the left bank of the Nistru River. It created 901 local authorities at the first level and 35 at the second level.

This legislative framework provides considerable autonomy, including fiscal autonomy. Local authorities were given a number of direct competencies, as well as being granted delegated responsibilities. The main competencies are concerned with local economic development, education, housing, youth development, sport, and environmental protection. Taking into consideration its limited financial resources, the Republic of Moldova used transfer mechanisms for equalizing local budgets.

Transfers from one budget level to another are calculated based on formula. The central government grants funds to the second level of LGA, and the LGA from the second level makes provisions of resources for the first level.

Two types of transfers (grants) are used in equalizing procedures: first, there are general transfers that are based on the difference between anticipated revenues

and expenditure needs, and second, special allocations to fund specific non-planned activities in the beginning of the budget year.

Formerly, in the Republic of Moldova, expenditure norms were established and the difference between total expenditures and total revenues was covered with transfers. Local governments had no hard budget constraints. Now, local governments must maintain a balanced budget and the nature and role of transfers have been changed substantially. The present mechanism attempts to estimate the difference between anticipated revenues and costs at the local government level, and then provides a lump-sum transfer equal to the difference. If expenditures are higher or revenues lower than the forecasts, then local governments must make adjustments to balance their budget.

The intergovernmental finance system in Moldova recognizes that grants (transfers) should be allocated by objective criteria, incorporated in the formula. The presently used formula has several shortcomings:

- It ensures transfers of general character and does not offer a clear explanation on the coefficient of adjusting average expenditure per capita;
- Expenditure estimates are often based on availability of resources rather than needs;
- The risk is that budgeted instead of collected taxes will be covered by the state budget transfers.

Local autonomy principles are not applied well in the Republic of Moldova budget procedures. Because of this, further improvements in intergovernmental finance relations need to be accomplished.

The main recommendations regarding intergovernmental finance could be:

- To improve transfer formula;
- To develop the fiscal indicators included in the formula;

- To establish a clear normative (criteria) for financing public services included in the transfers (grants);
- Better cost assessment of all levels of the autonomous administrative-territorial unit (ATU) – per type of costs, per capita;
- Development of transfers' mechanisms – direct granting from state level to first level of ATU.

## Introduction

### Recent Reform History and Issues to Be Solved

As a full member of the Council of Europe since 1995, in May 1996, Moldova signed the European Charter of Local Self-government. This Charter “entails the existence of local authorities endowed with democratically constituted decision-making bodies and possessing a wide degree of autonomy with regard to their responsibilities, the ways and the means by which these responsibilities and the resources are exercised and the requirements for their fulfillment.”

In the Soviet era, the Moldavian SSR had 38 districts of which eight districts were on the left bank of the Nistru River. This territorial division existed until 1998, when the government of Moldova introduced a series of legislative proposals designed to reform local government. The administrative-territorial reforms were aimed at changing the inefficient command-driven bureaucratic administration into a self-governing system. The reforms were based on the principles of transition to a market-oriented economy and a democratic society, and aimed at achieving a more representative, efficient, and autonomous system of local government. Article 110 of the Constitution of the Republic of Moldova (see Box 1.) and the Law on Territorial-administrative Organization provide the legal framework for the territorial-administrative organization of the Republic of Moldova.

The territory of the republic was administratively organized into 11 regions, which included nine counties (*judets*), one autonomous region, Gagauz-Yeri, and the Chişinău municipality. In February 1999, Parliament adopted the Law on Local Public Administration, which established and regulated the current organization and functioning of public administration in administrative-territorial units – *rayons*.

After the parliamentary election in 2001, the administrative territorial division was amended to the *rayon* system with effective power to be exercised after the local elections of 2003. At the same time, the legislative

framework was also changed. A new Law on Local Public Administration was elaborated. Modifications to the Law on Local Public Finance have also been elaborated. Other laws have been amended.

#### Box 1.

#### *The Constitution of the Republic of Moldova on Local Public Administration*

##### **Article 109. Basic Principles of Local Public Administration**

- (1) Public administration as manifested in the administrative-territorial units is based on the principles of local autonomy, of decentralization of public services, of the eligibility of local public administration authorities, and of consulting the citizenry on local problems of special interest.
- (2) The concept of autonomy encompasses both the organization and functioning of local public administration, as well as the management of the communities represented by that administration.
- (3) The enforcement of the principles described above may not detract from the unitary character of the state.

##### **Article 110. Administrative-territorial Organization**

- (1) The territory of the Republic of Moldova shall be organized, from administrative point of view, into villages, cities, *rayons*, and the territorial autonomous unit of Gagauzuya. Under the conditions of law, some cities may be declared as municipalities.
- (2) The localities on the left bank of Nistru River may be granted special autonomous forms and conditions under the special status passed through an organic law.
- (3) The status of the capital of the Republic of Moldova, City of Chişinău, shall be regulated through organic law.

The new legislation represents a two-fold approach to an overall reform strategy: strengthening the state administration to improve central government efficiency through decentralization, and promoting local autonomy through the transfer of power and responsibility to local government.

However, there is no transition mechanism or implementation plan for enforcing the two laws. In fact, the introduction of a representative of the state public administration in each region – to oversee the proper implementation of government decisions, to improve central government efficiency, and to provide more support to local government – has the effect of reinforcing central government authority without promoting local government autonomy.

Until now, public services in Moldova have been managed weakly by the central and local governments.

There is little capacity at the local government level to operate as an independent and autonomous local government body. Notwithstanding a legislative and constitutional scenario that recognizes the autonomy of local government, the reform strategy will remain confined to a statement of principles unless local government institutions are strengthened and appropriately structured.

**Number and Size of Local Governments**

The recent administrative-territorial reform established 32 *rayons* (districts), two municipalities, and one administrative-territorial unit with special status, Gagauz-Yeri. The settlements on the left bank of the Nistru River could have a special autonomous status but are not included in the total number of *rayons* and municipalities presented here. To create or to change the status of an administrative-territorial unit is possible only if implemented by the Parliament after public consultation.

The smallest settlement is a *village*, an administrative-territorial unit that includes a rural population from one territory, sharing geographical conditions and traditions. Two or more villages together could create a *commune*, an administrative-territorial unit that includes rural population with common interests and local customs. The village where the local council is established is called the residence village, and from which the commune gets its name.

The *town* is a more developed economic and social administrative territorial unit with an urban population. By law, it is possible to declare a town a municipality. The *municipality* is an urban locality with a leading role in economic, social, cultural, scientific, political, and administrative life of the country, and with impor-

tant industrial, commercial, education, and healthcare structures.

The *rayon* includes towns, villages, and communes joined together by territorial, economic, and social-cultural relations. Municipalities and towns may have in its territorial administration one village or more. (Figure 1.)

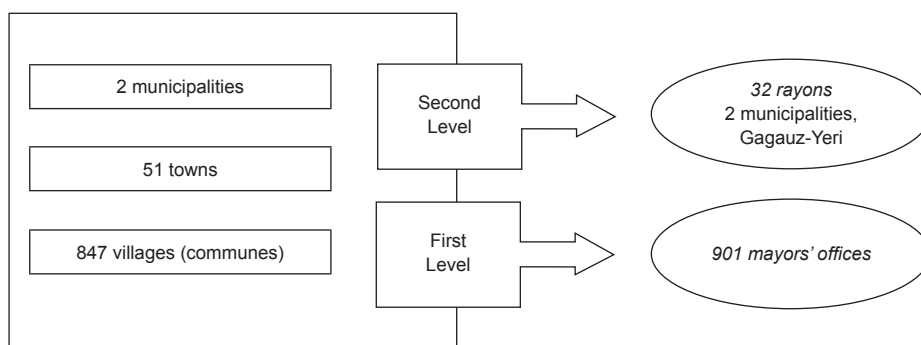
The total amount of localities is 1,679, including 147 from the left bank of the Nistru River (see Appendix 1.). The figure represents the localities which contribute to the consolidated budget of the Republic of Moldova.

**Basic Competencies of Local Governments**

After implementing the Law on Local Public Administration and Law on Local Public Finance for two years, there are several opinions on the assignment of functions among local public authorities in the villages (communes) and towns (municipalities) (1<sup>st</sup> level), and *rayons* (2<sup>nd</sup> level). From the mayors' point of view these functions must be distributed with a more detailed explanation. On the other hand, all functions were delegated to the local authorities without financial, material, logistical, or legal support. This transferring may depend on the state's resources, which in this case are not large enough, and the level of local autonomy should not undermine stability.

Responsibilities for providing local government services in the legislative framework of the Republic of Moldova are stipulated in two laws: the Law on Local Public Administration and the Law on Local Public Finance. In both documents, responsibilities are divided separately between subjects of the local administration.

Figure 1. Administrative-territorial Structure in Moldova\*



\* The structure presented does not include the localities from the left bank of the Nistru River.

### ***Service Responsibilities of Villages, Communes, Towns, and Municipalities***

First level governments in Moldova are responsible for the following services:

- Social-economic and territorial development;
- Construction and maintenance of roads, streets, bridges, public places, and streetlights within the locality;
- Communal services and local public transport;
- Construction and operation of the water supply system, sewerage system, water treatment, locality sanitation, storage and recycling of waste;
- Social assistance of the population, including social assistance to families, children's rights protection, and pensioners;
- Housing construction to people in need and maintenance of municipal housing facilities;
- Pre-schools, primary schools, secondary schools, gymnasiums, evening and correspondence secondary schools, and other educational institutions from the locality;
- Youth activities and sports;
- Community centers, libraries, and other cultural institutions;
- Markets and market places;
- Local property management;
- Civic and fire protection;

- Green spaces and parks;
- Cemetery maintenance;
- Mayor's office and central accounting unit; and
- Other institutions and activities related to ensuring the good functioning of the region.

### ***Service Responsibilities of Rayons***

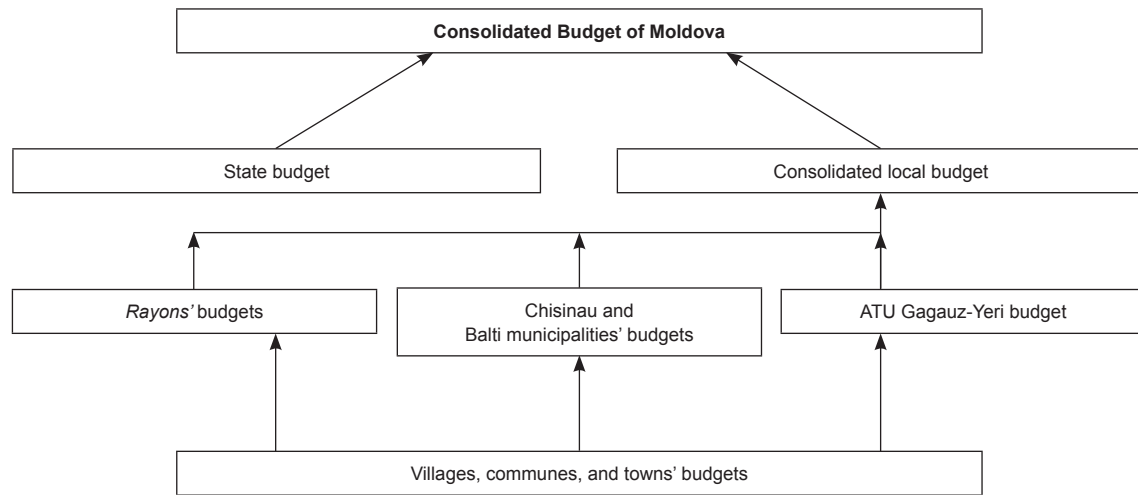
Second level government in Moldova includes *rayons*, the Municipality of Chisinau and Balti, and the Autonomous region of Gagauzia. They are responsible for the following services:

- Social-economic development of the territory and urbanism development and planning;
- Construction and maintenance of *rayon* roads;
- Construction of public assets for the *rayon*;
- Lyceums except first level education institutions;
- Social assistance services;
- Conducting youth and sports activities on the *rayon* level;
- *Rayon* transport development;
- Environmental protection;
- Own property management;
- Construction of pipelines within the *rayon*;
- Land problem management within the legal framework; and
- Office of the *rayon council and ATU management*.

**Table 1.**  
***Delegated Functions of Local Public Authorities***

Local public authorities in the villages (communes) and towns (municipalities)	Local public authorities in rayons, Chisinau and Balti municipalities, and ATU Gagauz-Yeri
1st level	2nd level
<ul style="list-style-type: none"> <li>• social care of the population, including unemployment benefits;</li> <li>• public hygiene;</li> <li>• exploration and protection of the soil according to the law;</li> <li>• green spaces and parks;</li> <li>• public order;</li> <li>• some measures regarding mobilization of the army and other military activity in national defense, according to the law;</li> <li>• civil protection.</li> </ul>	<ul style="list-style-type: none"> <li>• social care of the population, including unemployment benefits;</li> <li>• healthcare including children and mothers;</li> <li>• public order;</li> <li>• some measures regarding mobilization of the army and other military activity in national defense, according to the law;</li> <li>• secondary boarding schools, boarding gymnasiums and lyceums, special boarding schools, vocational professional schools, vocational schools, music, drawing, and art schools;</li> <li>• natural resources protection;</li> <li>• consumer protection, according to the law;</li> <li>• managing activities in civic protection.</li> </ul>

Figure 2.  
Structure of the Consolidated Budget



In the competence of the administrative-territorial units, there are delegated functions from the state level. We can find them in the Table 1.

Local public authorities have the right to their own financial resources, proportional to the resources they have, that they may freely dispose of in order to meet the interests of their local communities. Moreover, the adoption of the Law on Local Public Finances on October 16, 2003, contributed to establishing the delimitation of competencies based on prerogatives specified in the Law on Local Public Administration on spending public money and the delimitation of revenues between the budgets of administrative-territorial units, improved local budget forecasting, and borrowing.

The relations between central and local public authorities are based on the principles of autonomy, legality, and collaboration in the solution of common issues. This statement is stipulated in Article 109 of the Constitution of the Republic of Moldova (see Box 1.). The local councils, as deliberative bodies, and mayors' offices, as executive bodies, act as autonomous administrative authorities and solve public matters in communes (villages) and towns (municipalities) under conditions provided by the Law on Local Public Administration and the Law on Local Elected Officials.

Delegation of some important attributes from central specialized public administration (ministries and departments) to local collectivities does not diminish the role of central specialized public administration, as

it might seem at first sight. On the contrary, local public authorities undertake the role of organizing and rendering respective public services, and the ministries undertake the coordination role of public services (and not the role of managers!). They develop strategies and promote sectoral policies, and expend the programs and methodology for meeting population needs nationwide.

Concluding here, it is necessary to say that the legislative framework of legal autonomy of local governments has been established in Moldova. The principle of local self-government is recognized in the Article 109 of the Constitution of the Republic of Moldova, Article 7 of the Law on Local Public Administration, and the Law on Administrative-territorial Organization.

The warranty of fiscal autonomy with respect to budgeting, expenditure, revenue-raising authority, and borrowing is stipulated in the Law on the Budget System and Budgetary Process, the Law on Local Public Finance, and the Tax Code. The legal base for property ownership by local governments is legislated by the Law on Public Property. The administrative-territorial units possess the property that is administrated by local authorities for the benefit of the local population and in accordance with effective legislation.

### Basic Structure of the Intergovernmental Finance System

The administrative-territorial units' capacity for self-financing plays an important role in striving for local

autonomy. The budget system, the budget mechanism, and the process for both central and local governments in the Republic of Moldova is outlined in the Law on the Budget System and the Budgetary Process. (Figure 2.)

The state budget includes all revenues and expenditures, strategies, and objectives of the central government regarding public finance. The consolidated local budget includes the budgets of all the *rayons*, the budget of the Chisinau and Balti municipalities, and the budget of the autonomous administrative-territorial unit (ATU) based on revenues and expenditures established by law for implementing the strategies and objectives of local authorities and stipulated by state government.

The state budget and the consolidated budgets of the administrative-territorial units form the consolidated budget of the country. Relations between them are carried out through allocations from general state revenues, transfers for financial support of regions, and earmarked transfers.

As independent elements, the state budget and the consolidated budgets of *rayons*, Chisinau and Balti municipalities, and autonomous territorial unit Gagauz–Yeri, make up the consolidated budget of the country.

The State Social Insurance Budget, Compulsory Medical Insurance Funds, and the consolidated budget create the national public budget of the country.

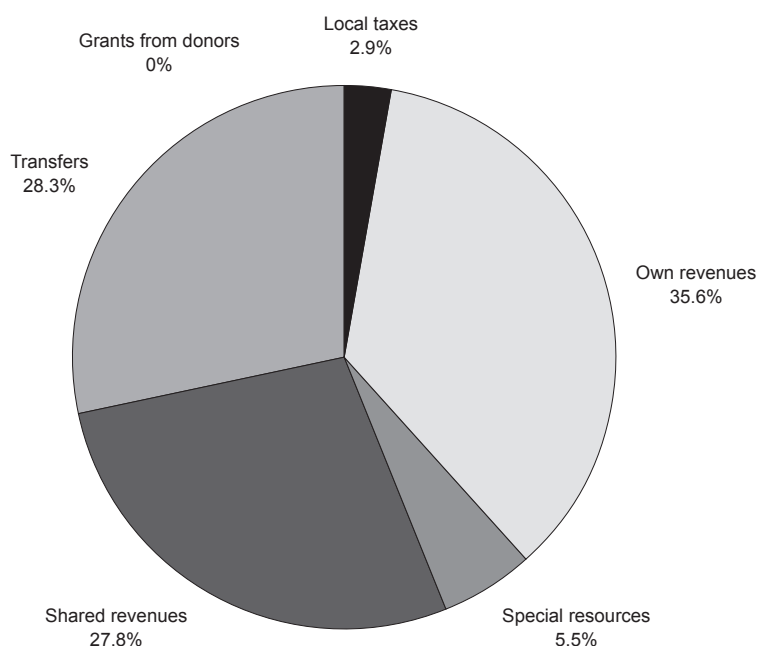
The legal base of the finance system for local budgets is established as well by the Law on Local Public Finance and by Tax Code (Titles I and VII). Based on the legislative framework, the administrative-territorial units have fiscal autonomy, and elaborate and approve their annual budgets. The Annual Budget Law stipulates the norms of deductions from state taxes, and by which the state regulates the revenue part of the budget system and amount of transfers (grants) from the state budget to local budgets.

### Local Government Revenues

There are three revenue sources for local governments in Moldova:

- Own source revenues from taxes, fees, and other sources;
- Shared revenues: allocations from state taxes;
- Transfers from the territorial financial support fund created in the state budget (grants).

Figure 3.  
Structure of Local Budget Revenues, 2003 Actual Budget



Source: Ministry of Finance, 2003 budget execution.

The share of each type of revenue in the structure of local budgets is represented in Figure 3.

*Own source revenues* are formed from direct taxes and fees, approved within each territory separately, and collected directly by the local budget (Box 2.). In the structure of local revenues, own source revenues constitute around 40 percent.

**Box 2.**

**Own Revenues for Local Governments**

**First level governments own revenues  
(Villages, communes, towns, and municipalities)**

- Real estate tax
- Land tax (from agricultural land, non-agricultural land, and from physical persons)
- Income from selling housing to citizens
- Income from selling land
- Sale of confiscated property
- License fees
- Fees for entrepreneurial patents
- Revenue from leasing local property and other sources

**Second level government own revenues**

- Income tax on physical persons (payroll tax)
- Natural resources taxes
- Revenues from capital transactions
- Private tax
- Revenue from sale of confiscated property
- Court fees
- Other revenues and fees

The Tax Code's Title VII establishes the tax base and maximum rates of local taxes and fees. The local authority may approve its own rate and tax base, but within the limits established by law. One severe limitation on local autonomy in this revenue assignment is that central government, Parliament in particular, retains the right to define the tax rates applied by local governments. For example, land tax and real estate tax rates are both specified in the annex of the Annual Budget Law, with no opportunity for local discretion in rate setting.<sup>2</sup> In some cases, a range of tax rates is permitted, but in reality the upper limit of that range is a real constraint

<sup>2</sup> The Tax Code has introduced all provisions regarding the real estate tax; however, its implementation was postponed since 2004.

for local governments. Full fiscal autonomy requires a greater degree of tax-rate determination by local government units.

*Shared revenues* are transferred to the local budgets from state taxes or from the second level of government to the first level. The sharing percentage (norms of deductions) is approved in the annual budget law by Parliament. Deductions from the second level *rayon* budget to first level local budgets are approved by the *rayon* council.

The following shared revenues are recognized as taxes:

- Corporate tax,
- Payroll tax, and
- Road fees.

The sharing percentage (deduction) should be not less than 50 percent from the total amount of tax.

**Table 2.**  
**Tax-sharing Rates between Central and Local Governments**

Administrative-territorial Units (ATU)	Rayons	Chisinau municipality	Balti municipality	ATU Gagauzia
<i>Corporate income tax</i>				
2002	100	50	100	100
2003	100	50	100	100
2004	100	50	50	100
2005	100	50	50	100
<i>Fee for travel on roads of Moldova by vehicles registered in the Republic of Moldova</i>				
2002	50	50	50	50
2003	70	70	70	70
2004	50	50	50	50
2005	50	50	50	50
<i>VAT on domestically produced goods</i>				
2002	100	10	100	100
2003	100	10	100	100
2004	—	—	—	100
2005	—	—	—	100
<i>Excise</i>				
2002	—	—	—	100
2003	—	—	—	100
2004	—	—	—	100
2005	—	—	—	100

Sources: Ministry of Finance and annual budget laws.

*Transfers (grants)* from one budget to another level are calculated by a formula. This method of transferring funds to local governments takes two forms. First, there are general transfers that are based on the difference between anticipated revenues and expenditure needs. These transfers embody an element of equalization as they provide additional resources for communities whose revenues fall short of expenditures. Second, there are special allocations to fund-specific activities. Transfers are made from the central government to ATUs, and then transfers are made from the ATU budgets' second level to sub-ATU local governments – first level authority. The Municipality of Chisinau receives the least transfer revenue, both in absolute and relative terms, generating just five percent of its total revenue from general transfers. The remaining ATUs earn anywhere from 10 percent to 80 percent of their total revenue from general transfers.

*Special sources* collected from the population for the services provided by public institutions help to collect additional money for the budget. Their share in the total local revenue is 5.5 percent. This percentage is almost the same in all ATUs' budgets.

The share of local revenues in 2003 *rayon* budgets have been registered between 15 and 61 percent, while for transfers it was 74 percent (excluding the Dubasari *Rayon*) to zero percent (excluding the Municipality of Chisinau). These figures do not include additional transfers with special destinations. The percentage of shared taxes in the revenue stood at six to 39 percent. Similarly, as with transfers, Besarabiasca, Chisinau, and Balti have the largest share of 39 percent, 32 percent, and 28 percent, respectively (see Figure 4.).

The disproportions between the *rayons* are obvious (see Appendix 4.). Compare Chisinau, where the per capita revenue is MDL 1,287, with Telenesti, where it stands at MDL 184. The main reasons for such large differences are the following:

- a relatively high concentration of economic activity in Chisinau, the capital;
- a well-pronounced difference between the living standards in the capital and the overall country;
- the enormous divergence in the development of infrastructure and production factors in the capital and the rest of the country; and
- the business registration procedures, whereby most businesses prefer to be registered in the capital and pay their main taxes in the locality where the company is registered.

### Composition of Local Government Expenditures

Local governments are obliged to provide many services. Some of those services are directly required by law, such as the list of responsibilities in the Law on Local Public Finance and in the Law on Local Public Administration. (Figure 5.)

Often there are requests to provide additional services. In such a situation, it is important to have in mind clear principles on whether it is sensible for the local government or the private market to provide the said services. In this context, it is necessary to say that the Law on Concessions is approved and its provisions could improve this area of activities.

In the case that during the year the government approves new responsibilities to the local governments or decides to increase expenditure norms (e.g., teachers' salaries), the state budget compensates for these additional expenses by making special transfers (grants) for covering these expenses. It is prohibited to use this money for any other purpose.

But the norms are neither well developed nor transparent enough. At the local level this creates a lot of problems for reliable budget projections. Prices and conditions are not the same in different parts of the country. The Ministry of Finance applies a coefficient only for the Chisinau municipality.

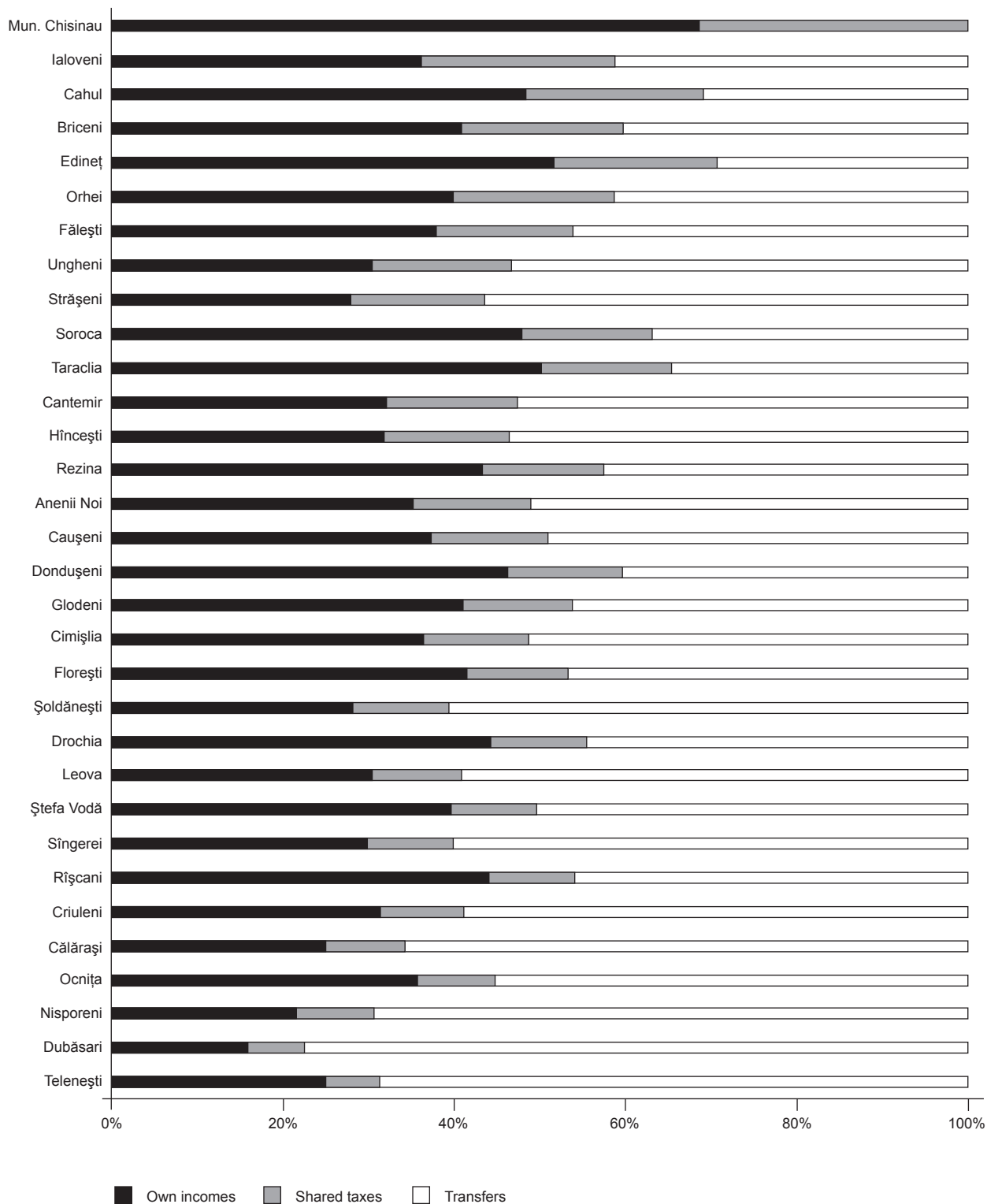
Local governments are required to pass balanced budgets, and are "obliged to undertake all necessary actions" in order to maintain a balanced budget throughout the budget year. Any over-collection remains at the local government's disposal but with the condition of budget modification.

### Equalization Measures

The fiscal disparities that become relevant for considerations in the equalization discussion arise from a decentralized political structure in which the designated units of government possess independent taxing and spending authority. The political decision processes within each administrative unit generate and impose a pattern of taxation and spending in accordance with localized conditions and circumstances.

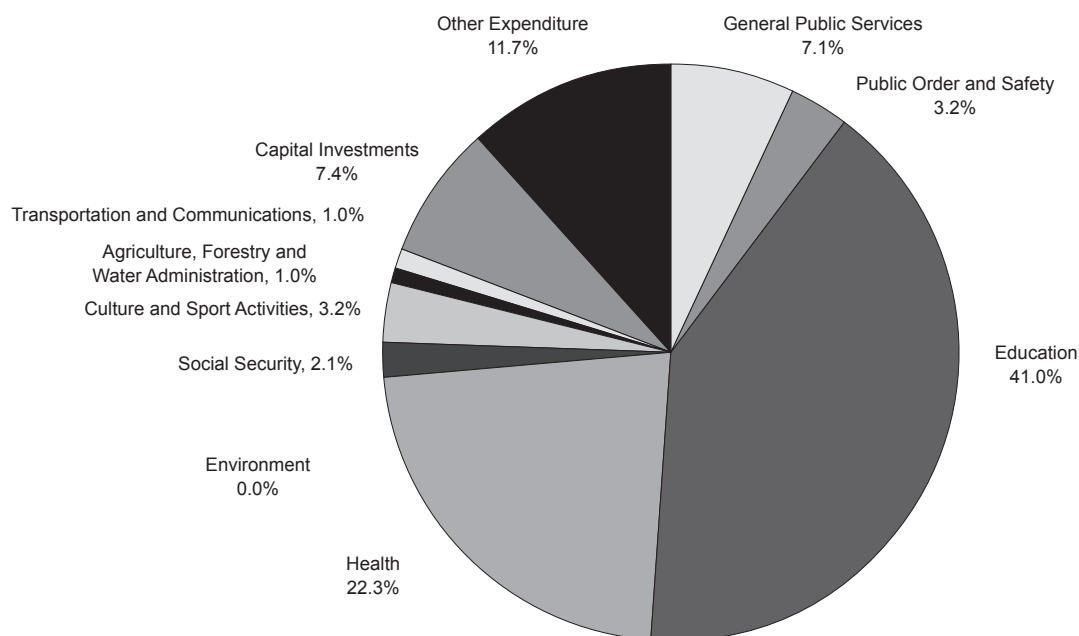
In order to equalize the financial situation of local governments in Moldova, the Ministry of Finance uses equalization transfers (grants). These transfers are calculated on the basis of differences in the per capita income of local governments and on some measure of local governments' expenditure needs. In the Republic of Moldova, the current budget and transfer mechanism

Figure 4.  
Revenue Structure by Rayon, 2003 Effective Budget



Source: Ministry of Finance of the Republic of Moldova, 2003 Budget Execution.

Figure 5.  
Structure of the Local Budgets Expenditure in 2003



Source: Ministry of Finance of the Republic of Moldova, 2003 Budget Execution.

have been improved substantially over previous methods. Formerly, expenditure norms were established and the difference between total expenditures and total revenues was covered with transfers. Local governments had no hard budget constraint. If they ran a deficit, another transfer was provided. Now, local governments must maintain a balanced budget, and the nature and role of transfers have been changed substantially.

The present mechanism attempts to estimate the difference between anticipated revenues and costs at the local government level, and then provides a lump-sum transfer equal to the difference. If expenditures are higher or revenues lower than forecasted, the local government must make adjustments in order to balance its budget.

The process of equalization starts with the budget process. The Ministry of Finance communicates the methodology of developing the budget and it determines the interbudgetary relations between the state and *rayon* budgets, the central budgets of autonomous territorial units, and the Chisinau and Balti municipal budgets, based on the principles of the state policy on revenues and expenditures for the coming year.

Local governments should present their estimates of expenditures to the Ministry of Finance. Total expendi-

tures for the respective territory are evaluated considering the expenditures for each group, which are calculated based on the structure of population, children, and the norms for maintaining their living standards. After having estimated the total amount of expenditures, the share of *expenditures per capita is estimated (C)*.

For the administrative-territorial units that have a specific expenditure, the *adjusting coefficient of the average per capita expenditure (F)* is used.

The tax base of local governments is estimated based on local revenue collection, excluding local taxes and fees, approved by the local councils on each territory. Special resources are estimated as revenues received from provided services and transfers from the other budget level. The own revenues included in the calculation are considered at a standardized tax rate. The *share of per capita revenues (V)* is calculated as the estimated tax base.

The difference between the per capita expenditures of each administrative-territorial unit and the share of per capita revenues constitute the *amount of transfer (t)* per citizen.

$$t = F \times C - V$$

By multiplying the amount of per capita transfers by the *total number of citizens* ( $n$ ) in the territory the amount of *transfers* ( $T$ ) for each administrative territorial unit is estimated.

$$T = t \times n$$

Administrative-territorial units where the share of per capita revenue exceeds the average per capita expenditure by 20 percent

$$V / F \times C > 120\%$$

should transfer the amount that exceeds 20 percent to the administrative-territorial units Financial Support Fund.

The formula presented above is a subject of Article 10 of the Law on Local Public Finance. The Ministry of Finance receives all data from local governments in order to have the correct estimates of the revenue and expenditure included in the calculation formula. The amount of calculated transfers for each local government is published in the annual budget law as separate annexes. By the end of the budget year, the total amount should be transferred to the local governments in monthly installments.

In the structure of the local government budgets, around 30 percent of revenues are from transfers. In analyzing the average revenue per capita before and after equalization, the equalization measure increases the per capita revenue for the poorest quintile (20 percent) to the level of the wealthiest quintile (20 percent) regions before equalization. Some poor local governments are saved from bankruptcy by this system (see Appendix 5.).

In order to cover additional delegated functions from the government, the local governments could receive *transfers with special destinations*. These transfers are calculated additionally to the equalization transfers and should be used only for the expenditures that cover delegated function.

The *rayon* council has an important role in the process of resource allocation among *rayon* and mayors' offices. The methods of distribution are unclear and non-transparent. The established rule is not applied in practice by all local governments. In practice, the "list of needs" is established based on a per capita normative revised by each *rayon*, using its own methods. This creates a situation where usually the norms included in the transfers calculations received from the state budget do not correspond with those included in the transfers from the level II to level I. Therefore, some mayors' offices could receive more transfers than others the same size.

Of course, equalization depends on a lot of negotiations: the mayors negotiate with the *rayon* council on the shared revenues' percent. The higher the shared revenues, the less the transfers – resulting in lower direct dependence within the formula. Local taxes and fees are totally excluded from the negotiations. Taking all this into account, the *rayon* is the most responsible for equalization, in contradiction with the autonomy principle guaranteed by the Constitution and the Law on Local Public Administration Law.

## Conclusion

The intergovernmental finance system in Moldova recognizes that grants (transfers, in this case) should be allocated on a formula basis that incorporates objective criteria. This is an important factor in ensuring that localities make the best use of their available resources in the future.

While incorporating essential equalization elements, the present formula has several shortcomings:

- It ensures transfers to a general destination and does not offer a clear explanation to the coefficient of adjusting average expenditure per capita. The questions are: which expenditure can be qualified as special and how discretionary is its degree of adjustment? The explanatory note to the annual budget law tried to make some explanations but they are insufficient.
- Expenditure estimates are often based on availability of resources rather than needs. Expenditure needs should be assessed based on real needs such as the percentage of the elderly in the population or the number of school-age children.
- The risk is that tax arrears will be covered by the state budget.

In addition to transfers based on outdated norms, the central government has other options to influence local expenditure patterns: matching, targeted, and earmarked grants. Such grants enhance local resource mobilization and efficient use of public resources. They are also the primary central government tools for influencing local spending by sector. In addition, these grants are excellent vehicles to ensure that, in certain expenditure categories (e.g., education and healthcare), minimum standard service levels are achieved.

The equalization system used in Moldova is one of the methods of increasing financial capacity of local

governments via equalizing the expenditures part of the budget and via sharing revenues. There are other methods that increase the tax capacity and need to be tested.

The equalizing grants affected local governments drastically, when economists assumed that governments would be able to carry out the policies dictated by agreed upon efficiency and equity criteria. The governments need to be able to create the conditions for high-income earners to migrate towards relatively poor regions. It could be implemented via territorial reforms or using equalization methods. The tax base of these regions could increase in both cases.

An important implication of the point made here is that, even if an idealized scheme of fiscal equalization may be shown to be efficiency enhancing, the implementation of this scheme may require the satisfaction of specific criteria concerning the distribution of the equalization benefits among taxpayers-beneficiaries in the recipient regions. The central government, which must, in any case, put any equalization scheme in place, cannot simply walk away from its follow-up responsibilities. A system of block grants, made to local governments on the basis of some equalization arguments, may not be efficiency enhancing.

## References

- Constitution of the Republic of Moldova. *Official Monitor*: No. 1, July 29, 1994.
- Annual Budget Laws for 2000–2005. *Official Monitor*.
- Law on Local Public Administration. No.123-XV. Approved on March 18, 2003.
- Law on Local Public Finance, No. 397-XV. Approved on October 16, 2003;
- Law on Territorial Division of the Republic of Moldova. No.764-XV. Approved on December 27, 2001.
- Tax Code. Title VII.

## Appendices

### Appendix 1.

#### Administrative-territorial Division of the Republic of Moldova, January 1, 2004

	Cities	Municipalities	Localities in the frame of cities (municipalities)	Villages (communes)	Localities in the frame of villages (communes)	Total localities
Republic of Moldova	5	60	39	917	658	1,679
Municipality Chişinău	1	6	2	12	14	35
Municipality Bălţi	1		—	2	—	3
Municipality Bender	1		—	1	—	2
<i>Rayons</i>						
Anenii Noi		1	5	25	14	45
Basarābeasca		1	—	6	3	10
Briceni		2	—	26	11	39
Cahul		1	1	36	17	55
Cantemir		1	—	26	24	51
Călăraşi		1	1	27	14	43
Căuşeni		2	1	28	17	48
Cimişlia		1	3	22	13	39
Criuleni		1	2	24	16	43
Donduşeni		1	—	21	8	30
Drochia		1	—	27	12	40
Dubăsari	—	—	—	11	4	15
Edineţ		2	4	30	13	49
Făleşti		1	—	32	42	75
Floreşti		3	—	37	34	74
Glodeni		1	1	18	15	35
Hînceşti		1	—	38	24	63
Ialoveni		1	—	24	9	34
Leova		2	1	23	13	39
Nisporeni		1	—	22	16	39
Ocnîţa		3	—	18	12	33
Orhei		1	—	37	37	75
Rezina		1	3	24	13	41
Rîşcani		2	6	26	21	55
Sîngerei		2	1	24	43	70
Soroca		1	—	34	33	68
Straseni		2	2	25	10	39
Şoldăneşti		1	—	22	10	33
Ştefan Vodă		1	—	22	3	26
Taraclia		1	—	14	11	26
Teleneşti		1	2	30	21	54
Ungheni		2	1	31	40	74
ATU Găgăuzia	1	2	1	23	5	32
ATULN	1	9	2	69	66	147

Source: Statisticul 2004 Yearbook of Moldova.

**Appendix 2.****Local Government Revenues and Expenditures**

	2005	2004	2003	2002	2001
<i>MDL Million / Year ending December 31</i>					
GDP	38,000.0	31,992.0	27,619.0	22,040.0	19,019.0
<i>Revenues</i>					
Public budget	14,524.7	11,322.1	9,417.0	7,339.7	6,118.3
Local budget	3,596.9	2,883.6	2,907.4	2,436.1	1,758.5
<i>Expenditure</i>					
Public budget	13,943.2	11,252.3	9,147.2	7,725.6	6,007.2
Local budget	3,605.4	2,874.1	2,788.4	2,359.7	1,767.7
<i>As a percent of public budget</i>					
Local budget revenues	24.8	25.5	30.9	33.2	28.7
Local budget expenditure	25.9	25.5	30.5	30.5	29.4
<i>As a percent of GDP</i>					
<i>Revenues</i>					
Public budget	38.2	35.4	34.1	33.3	32.2
Local budget	9.5	9.0	10.5	11.1	9.2
<i>Expenditure</i>					
Public budget	36.7	35.2	33.1	35.1	31.6
Local budget	9.5	9.0	10.1	10.7	9.3

Source: Ministry of Finance of the Republic of Moldova, 2006.

**Appendix 3.****Composition of Local Government Revenues and Expenditures**

*Table A3.1*  
*Comparative Budget Trends of Local Revenue Collection for 2001–2003*

	2005	2004	2003	2002	2001
<i>MDL Millions / Year ending December 31</i>					
<b>Total Revenue</b>	<b>3,596.9</b>	<b>2,883.6</b>	<b>2,907.4</b>	<b>2,436.1</b>	<b>1,758.5</b>
Local Taxes	101.1	99.6	84.2	79.2	75.4
Own Revenues	1,486.2	1,309.0	1,056.5	845.3	641.0
Special Resources		78.6	158.6	129.9	103.5
Shared Revenues	543.8	527.4	784.2	653.7	545.1
Transfers	1,465.6	865.9	822.8	723.8	378
Grants from donors	0.2	3.1	1.1	4.2	15.5
<i>In Percent of Total Revenues</i>					
Local Taxes	2.8	3.5	2.9	3.3	4.3
Own Revenues	41.3	45.4	36.3	34.7	36.5
Special Resources	0.0	2.7	5.5	5.3	5.9
Shared Revenues	15.1	18.3	27.0	26.8	31.0
Transfers	40.7	30.0	28.3	29.7	21.5
Grants from donors	0.0	0.1	0.0	0.2	0.9

*Source:* Ministry of Finance of the Republic of Moldova, 2006.

*Table A3.2*  
*Comparative Budget Trends of Local Expenditures for 2001–2003*

	2005	2004	2003	2002	2001
<i>MDL Million / Year ending December 31</i>					
<b>Total Expenditure</b>	<b>3605.4</b>	<b>2874.1</b>	<b>2788.7</b>	<b>2359.6</b>	<b>1767.7</b>
General Public Services	246.4	227.2	197.1	167	139.5
Public Order and Safety	100.2	95.6	89.8	91	60.3
Education	1655.3	1381.2	1142.9	953.1	726.7
Health	38.5	53.2	623.1	529.7	376.2
Social Security	95.2	72.1	58	51.4	30.9
Culture and Sport activities	164.1	127.9	89	72.9	53.1
Agriculture, Forestry, and Water Administration	144	44.9	27.9	29.6	22.6
Environment	0	0	0.3	0.4	0.4
Transportation and Communications	46.8	49.8	26.9	24	19.5
Housing and communal services	648.1	511.8	317.4	272.1	247.0
Other Expenditure	466.8	310.4	216.3	168.4	91.5
<i>In Percent of Total Expenditure</i>					
<b>Total Expenditure</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
General Public Services	6.8	7.9	7.1	7.1	7.9
Public Order and Safety	2.8	3.3	3.2	3.9	3.4
Education	45.9	48.1	41.0	40.4	41.1
Health	1.1	1.9	22.3	22.4	21.3
Social Security	2.6	2.5	2.1	2.2	1.7
Culture and Sport activities	4.6	4.5	3.2	3.1	3.0
Agriculture, Forestry, and Water Administration	4.0	1.6	1.0	1.3	1.3
Environment	0.0	0.0	0.0	0.0	0.0
Transportation and Communications	1.3	1.7	1.0	1.0	1.1
Housing and communal services	18.0	17.8	11.4	11.5	14.0
Other Expenditure	12.9	10.8	7.8	7.1	5.2

*Source:* Ministry of Finance of the Republic of Moldova, 2006.

#### Appendix 4. Per Capita Revenues of Local Governments, 2003

	Administrative-territorial Unit	Population as of January 1, 2003	Total revenues	Of which transfers	Per Capita Revenues without transfers	Per Capita Revenues with transfers
		Persons	MDL 1,000	MDL 1,000	MDL	MDL
1	mun. Balti	148,356	130,373.3	14,185.7	783.2	878.8
2	mun.Chisinau	771,921	1,056,139.4	62,721.0	1,286.9	1,368.2
	<b>Total municipalities</b>	<b>920,277</b>	<b>1,186,512.7</b>	<b>76,906.7</b>	<b>1,205.7</b>	<b>1,289.3</b>
3	Anenii Noi	84,484	51,153.2	22,176.5	343.0	605.5
4	Basarabasca	29,976	25,408.1	6,361.4	635.4	847.6
5	Briceni	78,638	47,892.3	21,840.5	331.3	609.0
6	Cahul	127,090	82,058.8	17,790.3	505.7	645.7
7	Cantemir	66,315	38,823.5	21,548.4	260.5	585.4
8	Călărași	81,975	50,625.6	22,784.5	339.6	617.6
9	Caușeni	94,089	58,425.4	28,238.8	320.8	621.0
10	Cimișlia	65,065	38,233.1	17,058.7	325.4	587.6
11	Criuleni	73,173	44,199.2	23,813.3	278.6	604.0
12	Dondușeni	47,580	31,890.2	12,383.5	410.0	670.2
13	Drochia	94,905	52,153.8	9,620.8	448.2	549.5
14	Dubăsari	35,951	28,196.7	22,614.7	155.3	784.3
15	Edineț	86,782	68,158.7	15,922.0	601.9	785.4
16	Fălești	95,968	51,799.9	23,047.0	299.6	539.8
17	Florești	94,632	55,342.9	23,792.1	333.4	584.8
18	Glodeni	64,845	46,911.4	15,523.8	484.0	723.4
19	Hîncești	127,453	83,039.6	43,023.1	314.0	651.5
20	Ialoveni	95,736	57,219.3	21,675.7	371.3	597.7
21	Leova	55,586	33,207.0	17,351.9	285.2	597.4
22	Nisporeni	69,537	41,818.3	24,084.9	255.0	601.4
23	Ocnîța	56,106	33,982.1	17,870.8	287.2	605.7
24	Orhei	130,441	74,073.8	30,913.5	330.9	567.9
25	Rezina	54,401	35,852.7	11,446.1	448.6	659.0
26	Rîșcani	72,677	46,555.9	19,818.7	367.9	640.6
27	Sîngerei	96,505	50,682.6	28,455.1	230.3	525.2
28	Soroca	103,639	66,089.9	22,699.3	418.7	637.7
29	Strășeni	91,006	60,717.4	29,723.7	340.6	667.2
30	Șoldănești	45,852	25,212.2	15,840.1	204.4	549.9
31	Ștefan Vodă	74,345	46,255.0	22,616.5	318.0	622.2
32	Taraclia	45,860	37,067.3	12,975.0	525.3	808.3
33	Telenești	76,642	40,652.5	26,543.3	184.1	530.4
34	Ungheni	118,783	96,190.0	59,268.9	310.8	809.8
	<b>Total rayon</b>	<b>2,536,037</b>	<b>1,599,888.4</b>	<b>708,822.9</b>	<b>351.4</b>	<b>630.9</b>
35	ATU Găgăuzia	161,998	121,025.6	37,036.1	518.5	747.1
	<b>Total ATU</b>	<b>3,618,312</b>	<b>2,907,426.7</b>	<b>822,765.7</b>	<b>576.1</b>	<b>803.5</b>

Source: Ministry of Finance of the Republic of Moldova, 2004.

**Appendix 5.**  
**Average Per Capita by Quartile, 2003**

	Average per capita without transfers, MDL	Average per capita with transfers, MDL
Poorest 25%	231.68	557.83
Next poorest 25%	315.33	606.58
Next wealthiest 25%	374.73	657.51
Wealthiest 25%	643.29	878.68