

# Increasing Local Self Governance

## Strategic options for a reform of local public administration in Moldova

**Georg Milbradt, Jörg Radeke, Nikolas Schmidt**

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# Summary of key recommendations

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1. **Status quo:** while government responsibilities de-jure already decentralised, level I local public administrations (LPA) too small and lack financial means to fulfil their news tasks → need to continue past reforms
2. **Objective** increased local self-governance → local population not central government organises key public services and infrastructure
3. Increased local self-governance requires **territorial reform** and **increased funding and budget autonomy**
4. **Territorial reform:** Size of level 1 LPAs need to be increased and their number reduced to allow them to govern themselves.
5. Of the three reform options discussed, the aim should be the “the compact scenario” **with about 100 level 1 LPAs**
6. The **minimum size** of tier 1 community **is increased to 5.500 inhabitants**
7. Achieved through **two phases of amalgamation**. Phase 1: voluntary amalgamation to be followed by phase (according to clear criteria) 2: amalgamation by law
8. More tasks requires **increased funding and budget autonomy** which will provide strong incentives for voluntary merger of local authorities
9. **Cost savings** generated by almaganation **should be given back** to newly merged local authorities
10. **Broad political consensus** of main stakeholders (including opposition parties) needed to move forward

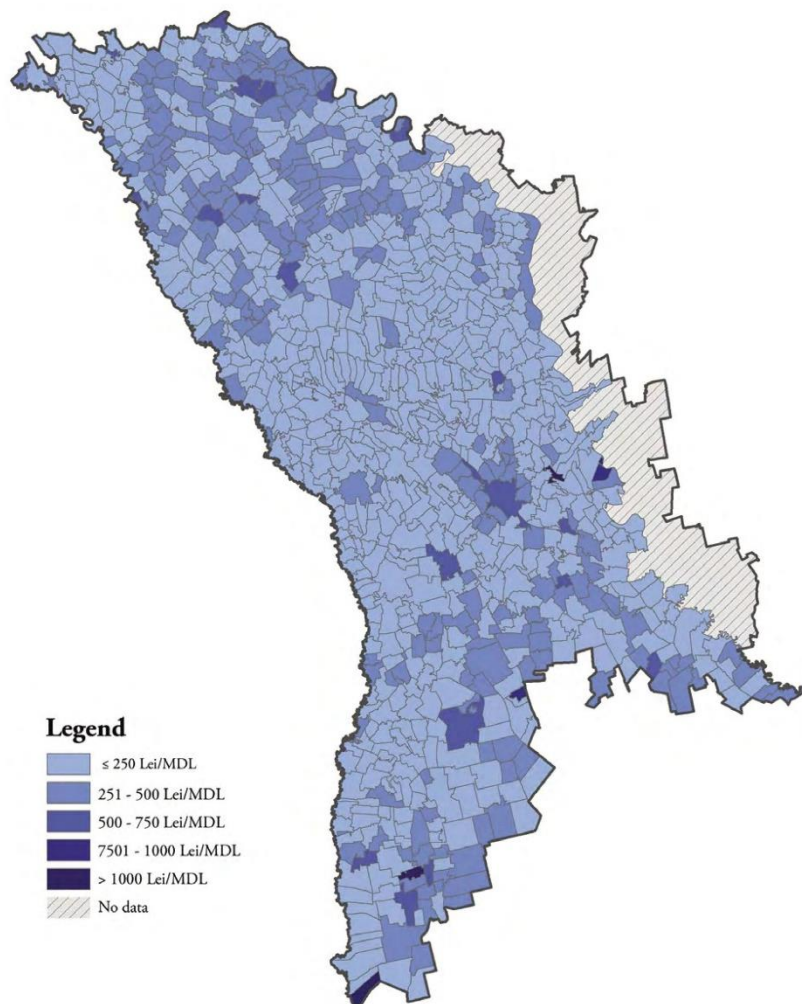
# Structure

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1. **Status quo**
2. Lessons learned from East Germany and Ukraine
3. Reform options
4. Implementation strategy

# 1. Status quo: high fragmentation and dependence

Distribution of administrative-territorial units of level I by own revenues per capita, 2017



\* All data does not include Transnistria

1) Level II LPAs: 32 rayons + UTAG, Chisinau, Balti

Source: GIZ Study "Administrative-territorial Reform Scenarios in Moldova"

- **High administrative fragmentation:**
  - ~900 level I local public administration units
    - 1/3 of units have <1,500 inhabitants
    - 9/10 of units have <5,000 inhabitants
  - 35 level II authorities<sup>1</sup>
- **High degree of financial dependence:**
  - 9/10 units **cannot cover administrative costs** from own revenues
  - In most units **own revenues per capita are <250 MDL**
  - At the same time, the **administrative cost per capita is 2.5 times higher** in units of 1,500 inhabitants than in those with 5,000 (620 MDL vs 250 MDL)
- LPAs have **many competencies, but limited capacities** to perform them
- **90%** of LPAs have **≤6 staff** units
- **Delimitation of competences** among levels is **not finalized**

# Current own competencies of LPAs

## Own competences of LPAs of levels I and II

### LPA I

- Urban planning;
- Management of green spaces of local interest;
- Construction, maintenance of **local roads** and street lightening;
- Local **public transportation**;
- Local **pre-school** and extra-school education;
- Urban networks for the distribution of gas and heating;
- **Water** supply and **sewerage**;
- Culture, sports, recreation and youth activities;
- Local economic development (farmers markets, commercial space, etc.);
- Social housing and other benefits for social vulnerable layers;
- Protection of culture patrimony and public monuments;
- Management of assets of local public and private domains;
- Organizing of territorial **rescuer and fireman** services;
- Household **waste management**;
- Organization and maintenance of cemeteries.

### LPA II

- Establishing a general framework for territorial planning at district level;
- Protection of forests of district level;
- Construction, management and repair of **roads of district interest**;
- Ground **passenger transportation**, management of **bus stations** and stops of district interest;
- General **primary and secondary education** and extra-school facilities of district level;
- Construction of gas pipes and of other thermal energy objects of local destination;
- Management of assets from the public and private domains of the district;
- Management of culture, tourism and sports facilities of district level;
- Supporting and stimulating economic development initiatives of the administrative-territorial unit;
- Developing and management of **community social services** for social-vulnerable categories, monitoring the quality of social services;
- Protection of cultural heritage and public monuments;
- Management of **social assistance** units of district interest.

Source: GIZ Study "Administrative-territorial Reform Scenarios in Moldova"

# Past experience: unfinished reform and reversion

	Reform of 1998	Reform of 2001
<b>Minimum limit</b>	1,500-> 2,500 inhabitants	1,500 inhabitants
<b>Level I LPAs</b>	912/845* -> 662/593*	912/845*
<b>Level II LPAs</b>	40->10	32
<b>Public services</b>	Managed at level II by government appointees	8 new regional offices of State Chancellery
<b>Implications for public funds</b>	<p>Caps on all local taxes.</p> <p>Level I LPAs would receive <math>\geq 50\%</math> of CIT**, <math>\geq 10\%</math> of VAT on goods produced and services provided locally, <math>\geq 50\%</math> of the road tax</p>	<p>CIT and PIT*** collected by level 2 and distributed to level I</p> <p>Rayons would receive <math>\geq 50\%</math> of CIT and <math>\geq 50\%</math> of the road tax</p>
<b>Financial and administrative decentralization</b>	No decentralization in the area of finances, asset management or administrative functions took place	Instead of decentralization, financial centralization took place
<b>Key learnings</b>	<p>Fragmentation was still significant</p> <p>Distances to public services increased</p>	<p>Mostly done to revert the previous attempt</p> <p>Reduced level I LPAs financial autonomy</p> <p>Promoted more politicized decision-making</p>

\* Excluding Transnistria, \*\* Corporate Income Tax, \*\*\* Personal Income Tax

# Structure

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1. Status quo
2. **Lessons learned from East Germany and Ukraine**
3. LPA reform options for Moldova
4. Implementation strategy

## 2. Lessons learned from East Germany and Ukraine

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### Initial problems in both East Germany and Ukraine

- Centralisation of power due to previous communist rule
- Many small and fragmented local administration units
- Little tradition of local self-governance, especially in Ukraine
- Overlapping competences between different levels of government
- Low quality local public services

### Solutions

1. Local budget autonomy to provide responsibility and incentives
2. Increased responsibilities and rights
3. Capacity building of local officials through training and increased wages
4. Reduction of number of local authorities



## 2. Lessons learned from East Germany and Ukraine

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- **Increased local budget autonomy**
  - Enlarged share of revenues from unconditional transfers, shared national taxes and own local taxes to provide financial means for increased set of tasks
- **Increased responsibilities and rights:**
  - Subsidiarity principle: fulfil task on the lowest level possible, only hand over to a higher layer of government if absolutely necessary
  - Enshrine in constitution rights and budget autonomy of local public authorities and make them legally enforceable (local authorities can sue against higher authorities in court)
  - Legitimacy: public officials are locally and directly elected

## 2. Lessons learned from East Germany and Ukraine

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- **Capacity building of local officials through training and increased wages**
  - Training for new responsibilities
  - Competitive remuneration to attract and retain talent (similar pay scale at national and local level)
  - Reduce potential for conflict of interest (e.g. of local business leaders, families of local officials, etc.)
- **Reduction of number of local public authorities**
  - Amalgamation of municipalities to pool resources (human and financial) to provide better public services for everyone
  - Improved local infrastructure (e.g. public transport) to connect the “old” entities

## 2. Lessons learned from East Germany and Ukraine

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### Differences between East Germany and Ukraine

- (On-going) political challenges in Ukraine
  - Lack of consistent legislative majority (until 2019)
  - Lack of cooperation by other levels of government

### Challenges and issue to watch

- Loss of power, money and jobs on other levels of government can cause resistance
- Corruption can re-emerge at local level, but influence is lower
- Change of constitution is key to enshrine and protect the reform

## 2. Lessons learned from East Germany and Ukraine

Outset and initial problems	Solutions	Goals and outcome
Fragmentation of local administration	<ul style="list-style-type: none"> <li>• Territorial and functional reform</li> </ul>	<ul style="list-style-type: none"> <li>• Larger local entities with more competencies</li> </ul>
Centralisation of power, over-regulation and low quality of public services and infrastructure	<ul style="list-style-type: none"> <li>• Budget autonomy</li> <li>• More competencies for level I local public administrations</li> </ul>	<ul style="list-style-type: none"> <li>• Better local economic development and governance</li> </ul>
Lack of local responsibility, accountability and participation	<ul style="list-style-type: none"> <li>• Training of local administrative staff</li> <li>• Direct election of local officials</li> <li>• Conflict-of-interest rules</li> </ul>	<ul style="list-style-type: none"> <li>• Improved local public services</li> <li>• Local accountability and legitimacy</li> <li>• Overall improved democratization, participation and less corruption</li> </ul>

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1. Status quo
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- 3. Reform options**
4. Implementation strategy

# 3. Reform options

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## Which reform model should be chosen?

- Key aspects to be decided:
  - Number of level I and level II authorities
  - Functions and responsibilities each level
  - Budget distribution
- Past projects have researched these question in detail and provide well-research recommendations about the reform options, there is not need for additional analysis
- In particular the **GIZ study “Administrative territorial reform scenarios in Moldova”** outlines three scenarios
- We reviewed the proposed scenarios and find them suitable
- We recommend the government to aim for the **compact scenario** reducing the number of level 1 authorities to below 100 with a minimum population of 5,500 inhabitants

# LPA reform options: 74%-90% reduction of level I LPAs

Indicators	Current situation	Scenarios		
		Moderate	Intermediate	Compact
Total number of level I LPAs	896	231	154	93
Reduction of level I LPAs	-	74%	83%	90%
Average number of level I LPAs amalgamated	-	4	6	10
Average size of population of new level I LPAs	3,000	11,500	17,500	28,000
Minimal size of population of new level I LPAs	294	1,700	2,500	5,500
Maximum size of population of new level I LPAs	37,000	51,000	51,000	65,000
Number and share of new LPAs with <5,000 population	800 (89.2%)	44 (19.1%)	12 (7.8%)	0 (0%)
# of new level II LPAs	35	5	5	5

Source: GIZ Study "Administrative-territorial Reform Scenarios in Moldova"

## LPA reform: more competencies to level II and large level I LPAs

1. Transfer of competence of developing, implementing and monitoring strategies, plans, programs and projects of **regional development** from current RDAs to LPAs of level II (boundaries of old RDAs)<sup>1)</sup>
2. Transfer of competence of building, maintaining and operating **regional landfills** from LPAs of level I to LPAs of level II <sup>1)</sup>;
3. Transfer of competence of construction, administration and maintenance of **regional roads** from the CPA to LPAs of level II <sup>1)</sup>;
4. Transfer of competences of maintenance of **primary and secondary education** institutions from LPAs of level II to LPAs of level I, as it was before the 2013 reform;
5. Transfer of competences of administration of **culture, tourism and sport institutions** (at present called of 'district interest') and other activities of cultural and sport character that are in the competence of LPAs of level II to LPAs of level I.

*Only in the compact scenario*

1) based on GIZ Study "Administrative-territorial Reform Scenarios in Moldova"



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# 4. Implementation strategy

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## Key recommendations

- Focus of **communication** on objective of **increased local self-governance** and **high quality local public services**
- But make clear that achieving objectives **requires territorial reform**
- **Territorial reform initially voluntary** (based on clear criteria) followed amalgamation by law if necessary
- **Incentives: Increased funding, budget autonomy, responsibilities**
  - **Leave any financial savings to the LPAs**
  - Review the system of transfers to local budgets
  - **Strengthen LPA budgetary base** and financial management capacities
- Set up an **institutional framework for implementation**
- Seek **consensus among relevant stakeholders** including from other parties

# Increased responsibilities at local level

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## Public services

- Municipalities should offer local public services directly or through local public agencies
  - e.g. water, sewage, waste, public transport;
  - alone or in cooperation with other LPAs
  - also: communal properties, schools
  - But supervision by the state
- Exception: electricity supply – should remain centralized if this is already the case
- Prerequisite: amalgamation

# Increased funding and budget autonomy

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## Collection of local taxes and more unconditional transfers

- Budget transfers from central to local level to be unconditional where possible
- For local taxes (e.g. property tax) municipalities should have autonomy in setting the local tax rate
  - While the tax base to be regulated by the state
- Once amalgamation and training of local administrative staff has been successful, tax collection and enforcement of some taxes can be carried out at tier 1 level

# Larger share of PIT distributed to newly created level I LPAs

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## Personal income tax (PIT)

- Personal income tax should remain a national tax, administrated centrally – but revenues should be distributed almost completely to level I municipalities
  - To be divided among municipalities according to local revenue
- Question: revenue distribution by tax payer's residence or business location
  - Residence: better for rural development
  - Business location benefits urban centres (esp. capital)
  - Distribution according to registration should be avoided as this will favour the capital city
  - Compromise: split tax revenue – half by residence, half by business location / actual place of operation

# Value-added tax could be used to level budget differences

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## Value-added tax

- VAT is not suited to be allocated according to local revenue
  - Better to use other distribution keys such as population or economic data

## Property taxes and local fees

- Should be decentralized along with revenue from local property, such as rent from public land and buildings etc.

## Financial redistribution / revenue sharing

- Increase budget transfers without specific purpose → autonomy
- Improve fiscal equalisation (e.g. through VAT) to reduce the budget differences between municipalities

# About the German Economic Team



The German Economic Team (GET) advises the governments of Ukraine, Belarus, Moldova, Georgia and Uzbekistan regarding the design of economic policy reform processes and a sustainable development of the economic framework. As part of the project we also work in other countries on selected topics.

In a continuous dialogue with high-level decision makers of the project countries, we identify current problems in economic policy and then provide concrete policy recommendations based on independent analysis.

In addition, GET supports German institutions in the political, administrative and business sectors with its know-how and detailed knowledge of the region's economies.

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## CONTACT

**Jörg Radeke**, Project Manager Moldova  
[radeke@berlin-economics.com](mailto:radeke@berlin-economics.com)

German Economic Team  
c/o BE Berlin Economics GmbH  
Schillerstraße 59  
10627 Berlin

Tel: +49 30 / 20 61 34 64 0  
[info@german-economic-team.com](mailto:info@german-economic-team.com)  
[www.german-economic-team.com](http://www.german-economic-team.com)  
Twitter: @BerlinEconomics  
Facebook: @BE.Berlin.Economics

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