

ANNEX C. REGIONAL DECENTRALIZATION AND REGIONAL POLICY

The nature of the relations between central government and sub-national authorities – regional and local – has considerable implications of a political, administrative and economic nature. The way people live in their own communities, the quality of the decisions made at the local level and their responsiveness to the needs and wishes of the people they affect most, the very sense of belonging to a community rather than simply living in it, are substantially affected, and often determined, by the way in which the relations between central government, regions and local authorities are organized. These relations influence the nature of political relationships among citizens. Along a different but inter-related dimension, they also affect the effectiveness of socio-economic development efforts. The nature and impact of regional policy depend closely on the nature and content of regional decentralization.

Taking the European Charter of Local Self-Government and European experiences of decentralization as a starting point, this note reflects on the current situation in Moldova and makes a number of comments and suggestions for the future, in the context of the Strategy for Development.

After a discussion of the fundamental principles and some aspects of the European Charter of Local Self-Government, section 2 discusses some aspects of the Western European experience with regional decentralization and some main dimensions of this process. Section 3 then considers the current situation in Moldova, enumerates a number of requirements and constraints for the process of regional decentralization and for regional policy, and puts forward a number of comments and suggestions concerning the strategy of regional decentralization and regional policy in the medium term.

A clarification of terms seems necessary at this point to avoid confusions. The term ‘regional policy’ is used below to designate the policy adopted by a region in order to advance its socio-economic development. It could also be called, in the right context, ‘local – or regional – economic development policy’. This avoids confusion with the economic policy of the central government towards the regions (inter-regional policy) or with the policy of regional decentralization.

Administrative decentralization and local self-government: European experiences

The European Charter of Local Self-Government: fundamental principles

On the 2nd May 1996 Moldova signed the European Charter for Local Self Government (hereafter referred to as “the Charter”). Ratification by the Parliament took place in July 1997, and the country therefore now considers itself bound by the Charter. In signing the Charter, Moldova chose to align itself with those European countries which accept its fundamental principles. The principles of local self-government – and the Charter – apply to all categories of local and regional authorities within the territory of the signatories. For this reason, it seems useful and appropriate to start this brief discussion of the European experience of local and regional decentralization with a reference to the Charter and some of its principles and implications.

First approved by member states of the Council of Europe in October 1985, the Charter is based on explicitly stated assumptions and on some fundamental principles. The preamble to the Charter includes the following considerations:

Local authorities are one of the main foundations of any democratic regime.

Citizens have the right to participate in the conduct of local public affairs.

This right can be exercised most directly at local level.

The existence of local authorities with real responsibilities can provide an administration which is both effective and close to the citizen.

The safeguarding and reinforcement of local self-government is an important contribution to the construction of a Europe based on the principles of democracy and the decentralization of power.

All this “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 means by which those responsibilities are exercised and the resources required for their fulfillment”.

The Charter defines local self-government as “the right and ability of local authorities to regulate and manage a substantial share of public affairs under their own responsibility and in the interests of the local population” (Art. 3, No. 1¹). This principle “shall be recognized in domestic legislation, and where practicable in the constitution” (Art. 2). Rather than discuss the Charter article by article, below we stress its fundamental principles.

Democratically elected bodies: Local self-government “shall be exercised by councils or assemblies composed of members freely elected by secret ballot on the basis of direct, universal suffrage and which may possess executive organs responsible to them” (Art. 3, No. 2). This principle has two aspects: first, it is a general principle of democracy; secondly, because of the association that exists, in democratic societies, between democracy and independence, the fact that local bodies are elected confers upon them a legitimacy that is separate and independent from that of central authorities. Such legitimacy constitutes an important basis for their autonomy.

Juridical autonomy: “Powers given to local authorities shall normally be full and exclusive. They may not be undermined or limited by another, central or regional, authority except as provided for by the law” (Art. 4, No. 4). This principle means that local authorities should be able to decide freely in matters of their own competence. Supervision by regional or national authorities of the way in which local authorities exercise their competencies should be strictly limited to ensuring that the law is being respected. The same is not, however, true of tasks which the local authority exercises by delegation from a higher level authority, in which case not only the legality but also the expediency – i.e. the correctness or appropriateness – of the decisions can be the object of supervision. The principle of independence also applies to the freedom that the local authority has “to determine its own internal administrative structures in order to adapt them to local needs and to ensure effective management” (Art. 6, No. 1). In practice, the degree of autonomy – juridical as well as effective – of decentralized authorities varies enormously from country to country, according to historical, cultural and ideological considerations, even among the signatories of the Charter.

¹ Unless otherwise indicated, article numbers in this section refer to the European Charter of Local Self-Government.

Financial autonomy: Closely connected with – and normally more closely regulated than – juridical autonomy is financial autonomy, without which juridical autonomy is not worth much. In practice, the freedom of action – and thus the autonomy – of local authorities depends on the importance of the resources available to them, both financial and non-financial. The Charter declares that local authorities are entitled to their own financial resources and that these should be commensurate with the responsibilities entrusted to them. As far as possible, grants to local authorities should not be earmarked for particular projects, since this decreases their financial autonomy. Furthermore, and to stress local autonomy, part of the financial resources of local authorities should derive from local taxes and charges of which the authority has, within the limits of statute, the right to determine the rate. Finally, the revenue sources should be diversified enough to enable them to keep pace with the costs that the local authorities incur in carrying out their tasks.

Solidarity: Financially weaker local authorities should benefit from financial equalization measures or procedures – normally involving differential transfers – designed to correct the effects of the unequal distribution of potential sources of finance and to help them bear the financial burden associated with carrying out their functions. These measures should, however, not decrease the discretion they may exercise within their own sphere of responsibility. In other words, any transfers should be unconditional, without which the local authority might see its autonomy severely curtailed.

Subsidiarity: “Public responsibilities shall generally be exercised, in preference, by those authorities which are closest to the citizen. Allocation of responsibility to another authority should weigh up the extent and nature of the task and requirements of efficiency and economy” (Art. 4, No. 3). Subsidiarity has emerged as one of the basic principles regulating the attribution of competencies among authorities at different levels: national and regional, regional and local or – in the case of the European Union – Union and national governments. It is seen as a defense against big government and bureaucratization, and as having a positive impact on government accountability and therefore also on citizen participation.

As indicated above, the Charter is meant to apply to all subnational authorities, i.e. both local and regional authorities. It is also worth mentioning that the Congress of Local and Regional Authorities in Europe is currently at work on the draft of a document likely to become a European Treaty on Regional Self-Government. The guiding principles of this document are basically the same as those of the Charter of Local Self-Government. It affirms that the regions are one of the foundations of the European states’ democratic regimes, and an appropriate level of authority both for encouraging the exercise of the right of citizens to participate in the conduct of public affairs, and for effective implementation of the principle of subsidiarity. Among the most interesting novelties in this document is the statement that the decision-making and managerial powers of regions should be such as to enable the adoption and implementation of a specific regional policy for each region. Also interesting is the affirmation of the principle that, “In so far as rules adopted at state level may alter the scope of regional self-government or concern the interests of regions, regions must be able to participate in the decision making process” (Art. 12, No. 1 of the draft). This participation may take a number of different forms, including representation of the regions within legislative or administrative bodies, consultation between the state and each region, or consultation between state bodies and a structure representing the regions.

Regional decentralization in Western Europe

Inevitably in such a diverse continent, the West European experience of regionalization is an extremely varied one. Among the signatories of the Charter there are countries where no regions have been defined (e.g. the Netherlands, where the intermediate administrative instance is the

province); others, such as Portugal, where only part of the territory has autonomous regions; others where regions, with different degrees of autonomy and different sets of competencies, are an important part of the political and administrative systems, such as Italy and Spain; there are, finally, federal states such as Germany, Belgium and Austria, and the Swiss Confederation. In all these cases diversity, reflecting different historical, political, ideological and administrative traditions, is the rule rather than the exception.

The degree of decentralization in Europe varies. France, for example, has long had a centralist tradition, in the form of the *département*, where the executive was controlled by a centrally appointed *préfet* who was the head of the public administration in the *département*². Close to the other end of the spectrum, Germany is a federation of *Lander* or states, who exercise all governmental powers and discharge all governmental functions except those reserved by the constitution for the Federation (which include the usual list of defense, foreign affairs, citizenship, border controls and protection, customs, monetary policy, statistics for federal purposes, postal affairs and telecommunications, air transport and railroads of the Federation, etc.). In matters of the competence of the States, the role of the Federal Government is limited to issuing general administrative rules and to exercising supervision to ensure that the States comply with applicable law.

There is also great diversity in relation to the problem of the distribution of competencies between the central administration and territorial entities. This is a topic of the greatest importance, since the distribution of competencies determines, to a very substantial extent, the way in which political power is shared among the various territorial levels. Regional or federal states again show great diversity of solutions in this respect. Basically, all models of distribution of competencies function on the basis of one or more lists of competencies, plus a residual clause which, depending on the origin and formation of the composite state, assigns residual competencies to the center or the regions. In this way, for example, Italy, where regionalization was superimposed on a unitary state, has in its constitution a single list of competencies of the regions, leaving all residual power for the central state, which also establishes the general principles of regional legislation. This leads in practice to a system where all regional competencies are in fact shared with the central government. In the constitution of the United States, on the other hand, there is a list of competencies of the Federal State, plus a general clause that states that all other powers are the States'. The German constitution has a list of powers reserved exclusively for the Federation and another of competencies in relation to which the Federation and the States have concurrent powers, i.e. where the States have the power to legislate as long as and to the extent that the Federation does not exercise its right to legislate by statute. The residual competencies are, again, the States'.

Spain is, like Italy and France, a unitary state; in spite of this, however, the Spanish regions have a very high degree of autonomy, which fully justifies their official designation of Autonomous Communities. The Spanish constitution of 1978, formulated in an atmosphere of strong autonomist, even separatist, claims on the part of certain regions, has two separate lists of competencies: those which are the exclusive competency of the State, and those which the

² This arrangement is usually designated as deconcentration, since the public services and ministry sections at the level of the *département* exercise their functions by delegation from the central authority, before whom they are responsible and by whom they are basically controlled. Although it aims to bring government closer to the citizen, deconcentration does that to **central** government. Deconcentration may increase the effectiveness of central government, but it is not, and it should not be mistaken for, decentralization. After 1982, the French system of local government has evolved towards greater devolution and greater autonomy of local government. The prefectoral system described above can, however, still be found today in Europe, most notably in Greece, where the central government, through the prefects, exercises considerable control over local governments.

Autonomous Communities could, upon approval of their statute of autonomy³, assume as their own. This second list had a transitory nature, in the sense that, five years after the approval of its statute of autonomy, an Autonomous Community was allowed, by means of a reform of that statute, to assume all the competencies not reserved exclusively to the State. In addition to this there is a double residual clause, stating that (a) matters which are not of the exclusive competency of the State can be assumed by the Autonomous Communities, and (b) those matters that the Autonomous Communities do not take up through their autonomy statutes will remain part of the State's competencies. A particularly innovative aspect of this system is the evolving nature of decentralization; as the Autonomous Communities assume a greater proportion of their competencies, the distribution of competencies between them and the Central Government changes accordingly. The Spanish Constitution and the Statutes of Autonomy of the various regions have succeeded in solving potentially serious problems of separatism and at the same time to reinforce Spanish democracy and local participation.

Without fiscal decentralization, administrative decentralization may be no more than an elaborate charade. In Spain, for instance, reflecting the development of a real process of decentralization, the expenditures of the Central Administration went from 89.95 percent of the total consolidated budget in 1980 to 63.42 percent in 1992. In the same period the expenditures of the local administration went from 10.05 percent to 14.00 percent of the budget, while the share of the Autonomous Communities went from zero (they started to function only in 1981) to 22.58 percent.

The shares of the different levels of administration in total state expenditure can be used as a first indication of decentralization, although it must be kept in mind, when interpreting such information, that the delegation of central government functions to regional and local authorities also increases their share of the budget, without necessarily meaning that they have seen their decision-making autonomy increase. Table 1, in the Appendix, gives some information on the share of total expenditure accounted for by different levels of government, in a number of Western Countries.

Some requirements for successful decentralization

Despite its promise, and the very strong arguments in its favor, in practice decentralization is not always successful. What works for Western Europe, where there is a long history of institutional development and a long – though not unbroken – tradition of democratic government and of the rule of law, may not work equally well in other countries with a less favorable environment for decentralization. It is therefore important to pay some attention to the institutional framework, both formal and informal, within which decentralization is being proposed.

An important potential problem of decentralization is corruption. Local officials are more accessible than ministry officials and, especially at the local level, the difference between accommodating a reasonable request and bending the rules in unacceptable ways is often unclear. By bringing government closer to the people, decentralization also brings closer the possibility of corruption.

This problem is not made any easier to avoid by the generalized lack of training of local elected officials in the management of local affairs, or by the fact that local bureaucracies are often

³ The Statute of Autonomy is the basic law of each Autonomous Community, which determines the extent of the Community's autonomy through the specification of which competencies the Community assumes as its own, within the limits set by the Constitution. The Statutes of Autonomy of two different regions may differ according to the sets of competencies assumed by each of them.

less competent and less motivated than their national counterparts, and thus fail to provide local elected officials with the technical and administrative support they need. These problems occur even in Western Europe, where there are substantial differences in the quality, training and motivation of local elected officials and bureaucrats from country to country and from region to region.

Another, related, matter, concerns the fiscal responsibility of local authorities. Decentralization entails that local or regional authorities assume control over financial resources and responsibility for managing public expenditures. Here we can distinguish a number of potential problems. The first occurs when the transfer of responsibilities to a decentralized authority does not go hand-in-hand with the transfer of revenue sources. In such cases – which should be avoided at all costs – local authorities soon find it impossible to perform their assigned functions, and this has a very serious impact on their morale and on the trust that local citizens place on the authority. Along another dimension, the management of financial resources and public expenditures requires technical competence in order to maintain adequate accounting systems and to carry out the necessary forecast of revenue and expenditure. Such skills are scarce in many countries, and may be especially difficult to find at the local level.

Finally, the institutional arrangements in place may encourage inappropriate behavior on the part of decentralized authorities, particularly in relation to public expenditure. The more a local institution relies on its own sources of revenue, the greater incentive it has to make responsible fiscal decisions, balance budgets and strive for efficiency. If, however, such an authority receives a subsidy that depends on its costs, the incentive structure changes, and it will tend to maximize such costs rather than try to minimize them. In an extreme case, if grants are based on local poverty, it would be in the interest of such an authority to maximize local poverty. Another negative consequence of a system based primarily on grants and transfers is that such a system tends to generate an attitude of dependence, rather than self-sufficiency, in the local authority. It is important to design the transfer system, when it exists, so as to minimize these problems. An unconditional system based on a formula for distribution of resources is preferable to systems based on projects or on the calculation of the costs of specific activities, although such systems may be necessary during a period of transfer of new responsibilities to a decentralized authority.

Some of these problems can be solved by providing training to local elected officials and local bureaucrats. Such training could go a long way to make people aware of what their responsibilities are and of how best to discharge them. Local elected officials would in addition need to be given the opportunity to attend such training, which might require special dispensation from their place of work.

In addition to this, local bureaucrats need to be paid at a level commensurate with their capacities and responsibilities. Furthermore, an appropriate career structure, with clear performance-related rules for promotion and salary increases, normally constitutes a factor of stability, enabling decentralized authorities to keep their best staff, and provides an important incentive for improving qualifications and performance.

Regional policy in Moldova: some comments and suggestions

Constraints and requirements relevant for regional policy in Moldova

Some contextual aspects of the Moldovan reality play an important role in determining requirements and constraints for administrative decentralization and for regional policy. Among these, the most important (though not in any particular order of importance) are the following:

- Although substantial progress has been made, the country is still in the process of completing the institutional reforms necessary for a full transition to a market economy. Areas where further reform is deemed necessary comprise privatization, state-owned enterprises, agricultural reform and the restructuring of the energy sector. On another front, that of political development, the country has made impressive progress and, leaving aside the case of Transnistria, democracy appears to be well on its way to consolidation.
- In spite of the success in achieving macroeconomic stability, the failure in achieving public revenue targets implies that there is little or no room for any increase in expenditure, particularly on investment.
- There is no sign of significant amounts of foreign resources finding their way into productive investment.
- The widening trade deficit and the country's external debt situation imply that export growth is a high priority.
- The Moldovan Parliament is currently deliberating on new laws that will, if approved, substantially decrease the number of *raions* and reform their administration. These laws do not affect the special juridical status of Gagauz-Yeri.
- A solution to the situation in Transnistria is likely to require that a special statute of autonomy be approved for it; given the economic importance of the region, this is likely to include a considerable degree of economic autonomy.

The lack of definition of the situation in Transnistria and the fact that there seems to be significant opposition from certain sectors of the Parliament to the laws reforming regional administration imply that there is at present a higher level of uncertainty in the area of regional policy than is normal in similar cases, even taking into account that strategies are by definition formulated in uncertain environments. What can at present be said about regional policy must therefore be stated with some flexibility in order to accommodate the very open and uncertain future of this particular sector.

The discussion below is organized around three main questions:

- What are the main conditions for effective regional policy?
- Are the current or the proposed regional administration schemes in Moldova most likely to realize such conditions?
- What should be the focus and the approach of regional policy, in the current context of Moldova?

These questions will be taken up in successive sections below.

Conditions for effective regional policy

Experience indicates that among the conditions necessary for a regional authority to be able to take the main responsibility in the formulation and implementation of a policy designed to advance the socio-economic development of its region the following three are most important:

- The authority must dispose of a certain degree of juridical and administrative autonomy.

- This autonomy must go hand-in-hand with the availability of sufficient resources, financial and human, for accomplishing the task.
- The region which is the object of the development policy must be of a certain minimal size and complexity.

The first of these conditions requires no special elaboration: without some autonomy, the regional authority is no more than an agent of the central government, and is in no position to take initiatives or to make the required choices. As for the second condition, what financial resources are ‘sufficient’ depends crucially on the approach adopted towards the development of the region and on the policy itself. In fact there is less flexibility in relation to human than to financial resources, since the availability of a core team of competent and committed professionals is an essential requirement for a successful regional development policy.

As for the third condition, leaving aside special cases of very favorable locations or natural resource endowments, the more complex (in terms of activities and interactions) a region is, the greater is likely to be its development potential – and complexity is normally associated with size. Small or simple (e.g. homogeneous) regions are severely constrained in their development potential, no matter how autonomous they are: their scale and lack of complexity limit what can be done with them (or what they can do themselves), in development terms. This condition is also often interpreted as implying that the region must contain within its territory at least one secondary city. Such a city is expected to provide the socio-economic complexity – in terms of activities, interactions, relationships and networks – that the rest of the region may lack, and thus increase the viability of development efforts.

Regional decentralization in Moldova

Comparing the present system of regional administration with the system proposed in the draft laws currently being considered by the Parliament, especially from the point of view of the principles of the European Charter for Local Self-Government and of the conditions enumerated in the preceding section, some observations seem opportune:

- First, by their sizes, the *raions* proposed under the new draft laws appear more capable than the current ones of providing conditions for an adequate regional development policy as well as a more viable regional administration. The smallness of the current *raions* has long been the target of criticisms that stressed their lack of socio-economic viability, and proposed alternatives comprised a far smaller number of *raions* than at present. On the other hand, even the new *raions* are relatively small, and not all of them will at first contain secondary cities. Their smallness is, however, a reflection and a consequence of the smallness of the country, and the location in *raion* capitals of a genuinely decentralized regional administration may be expected eventually to lead to an increase in the number of medium-sized urban centers in the country.
- It must be stressed that, even with the existing *raions*, it would not be impossible to formulate regional development policies, although this could only be achieved by incurring significant additional co-ordination costs. One possible way of doing this would be through the creation of associations of *raions* for that specific purpose. A very successful experience along similar lines was that of Portugal in the years immediately following the revolution of 1974. Faced with very small municipalities and with considerable scarcity of financial resources and technical staff in the local administration, the Central Government led a process of creation of associations of municipalities, each of which was then endowed with a well-equipped and well-staffed technical office. These technical offices, carrying out studies and designing projects both for the association and for individual municipalities, played a key role in overcoming the problems

associated with their small scale. They were also an important occasion for municipalities that had until then worked and made decisions in isolation to open themselves to co-operation with others, and to learn to work together and make joint decisions. As a consequence of their creation, the quality of municipal and inter-municipal planning improved substantially.

- Still on the matter of size, the maintenance of the current *raion* towns as sectors or *plasa*, and the maintenance of basic public service provision from those sectors, seems a very sensible way of minimizing the effect of the proposed reform on the distance between the administration and the citizens. Care must be taken, however, to avoid the multiplication of public services and functionaries, which might lead to unacceptable increases in the cost of provision.
- The separation of competencies between the regional and local levels also seems to have improved in the new draft laws. In the current system, the competencies of the councils, both local and *raion*, were formulated in the same article, which reflects the relatively small difference between the two types of authorities; in the new draft laws, there is a very clear separation of functions between both types of decentralized authority, reflecting the increased differentiation between them. In other words, the proposals represent a genuine attempt at introducing intermediate level authorities, between the Central Government and local authorities. At the same time, care has been taken to avoid that the new regional authorities take over the competencies of the existing local authorities, which would go directly against the principles of local self-government.
- As to whether the new *raions* will have sufficient resources available to them to be able to carry out effective development policies, much depends on laws and regulations that are still on the drawing board. If regional decentralization is taken seriously as a policy objective, such laws and regulations should follow the principles mentioned in sections 2.1 and 2.3 above, of financial autonomy, solidarity and fiscal responsibility. Given the financial constraints under which the country finds itself, it may be anticipated that financial resources for new investment – and probably also for current expenditure – will be very scarce. This has implications for the approach to regional development that may be adopted by the *raion* authorities. It must be stressed, however, that especially under such conditions it is vital that each *raion* be able to rely on a strong team of core staff especially oriented towards socio-economic and territorial development. Without such high-quality human resources to compensate for the scarcity of financial resources, the newly created administrations will be forced to limit themselves to routine tasks and become increasingly demoralized, while the population is likely to experience growing disenchantment and demobilization.
- Although a serious effort has been made to define broad competencies for the new regions, the administrative system adopted in the new proposals is not very decentralized. First, the competencies, both of local and of regional authorities, are defined in a list, with the implication that all functions not on the list are of the competency of the State – as in the Italian system mentioned earlier. This attribution of competencies is closed, in the sense that no possibility is envisaged of the decentralized authorities progressively assuming more competencies. Secondly, a new position is created in the regions, that of prefect or head of the State administration in the region. This is clearly inspired in the French and Greek models which are among the least decentralized of Europe. Admittedly, considerable effort has been made in the draft law to establish a clear separation between the attributions of the prefect and those of the Regional Council; in spite of that, however, the proposed system has the potential for subordination of the Regional Council to the Prefect. Of course, given the right people on both sides, the proposed system could lead to a constructive co-operation between prefect and council; however, organizations should not be designed on the assumption that individuals will perform at optimal levels. The prefect is bound to be a professional, probably rather senior civil servant,

while the regional council – and even its permanent bureau – will be made up, basically, of amateurs. Under these conditions, and given the relationships established in the proposed draft law, it is not difficult to imagine a situation in which the prefect would come to play a dominant role in relation to the council. This, even if it increases efficiency, will do so at the cost of autonomy.

- One area where, apparently, much remains to be done concerns the juridical status and the legal protection of even the limited autonomy of *raion* and local governments. *Raion* and local councils are directly elected by their constituents and derive from such elections a legitimacy that does not depend on the central government. Under similar conditions, democratic countries normally have laws and regulations for the legal protection of the autonomy of local authorities against the central government. In Moldova, however, in case of a conflict of interests or perspectives between central government and decentralized administrations, the organs of these do not currently have the right to oppose the central government, for instance by taking it to court⁴. This means that, regardless of the goodwill manifested at the center, peripheral authorities currently have no legally protected autonomy. From this point of view, they are still placed in a position of agents of the central government, on which they ultimately depend, and to whose goodwill they owe whatever limited autonomy they enjoy.
- It can, of course, be argued that in the current stage of the process of state formation too much decentralization may imperil national cohesion. The comparatively small size even of the new *raions* does not, however, seem to justify such worries, since they would not be very viable independent units. On the other hand, Transnistria will probably demand a much greater degree of autonomy than is contemplated in the draft law. The coexistence of two very different levels of autonomy, one for Transnistria and the other for the other regions, may become a cause of significant tensions as the *raions* make comparisons between the degree of decentralization they enjoy and that of Transnistria. It could also be argued that a more decentralized – or at least a more open – solution for all regions could facilitate the normalization of the relations between Moldova and Transnistria, by making that particular region less of a special case.

Fiscal decentralization in Moldova

A key problem in territorial-administrative decentralization concerns the financing of decentralized government. A full-fledged discussion on fiscal federalism would be out of place here; it seems, however, appropriate to discuss briefly some aspects relating to the financing of local and regional government in Moldova⁵. Local government has primarily functions that involve the allocation of resources to competing ends; to a smaller degree, it also carries out some redistribution and other functions. Local government finance must be designed in such a way as to ensure three important characteristics for local government: autonomy, accountability and equity. In turn each of these has some associated requirements.

Autonomy. Three requirements are normally associated with the financial autonomy of local government. First, local authorities should finance a large share of their expenditure through their own taxes. Of course, the central government may distribute considerable resources in the form of grants, but several types of grants tend to undermine the autonomy of local government. The central government is, after all, accountable before its constituents for the money it distributes in the form of grants, and may as a consequence ask local authorities to account for their use of the

⁴ An exception to this is the case of Gagauz-Yeri, whose popular Assembly has the right to appeal to the Constitutional Court in case of certain conflicts with the central legislative or executive authorities where its autonomy may be threatened.

⁵ The discussion below is based on D.N.King, "Fiscal Federalism", in R. Paddison and S. Bailey, editors, **Local Government Finance: International Perspectives** (London, 1988: Routledge).

money. Secondly, local authorities must be able to determine, to a significant extent, the tax rates they set, so that they can best respond to the special preferences of their constituents (e.g. for level or types of public services), which may differ from those in the rest of the country. Finally, local authorities must have effective control over their own budgets, which means that they should be able to increase or decrease revenues without such choices having a disproportionate effect on the tax rates they apply. Together, these requirements basically imply that local taxes should account for a large slice of local authority income, and that local authorities should have access to more than one substantial tax (in terms of the revenue generated).

Accountability. The financial framework in which local authorities operate should be conducive to efficient budgets. In particular, this means that local authority spending on local services should be only up to the point where the marginal cost of such services equals the marginal benefit derived from them. Among other things, this means that it is important to avoid local finance schemes that encourage overspending. Ensuring the visibility of local taxes can contribute to this, by making local people aware of the cost of services provided by the local authority. A similar argument applies to regional taxes. It is also important to avoid grants that introduce changes in the marginal cost of services (e.g. matching grants, or grants based on the costs of local government). The best grants from this point of view are unconditional, lump sum grants, over the spending of which the local authorities have complete control.

Equity. There are two aspects to equity: within areas and between areas. Within areas, equity is ensured by progressive systems of local taxation – or at least systems that are not too regressive. Between areas, a system of equalization grants which transfers resources from richer to poorer areas may be used. It is, however, important to ensure that such grants do not stimulate overspending and do not reduce the incentive for revenue collection by the local authorities that benefit from them. This can be achieved by using formula-based grants, in the calculation of which the costs of the local authority do not play a role. The Canadian system of calculating inter-governmental transfers, based on a “Representative Tax System” that gives a good approximation of the revenue each decentralized authority could raise, if it so wished, is a good example of a system that minimizes the negative effects of redistribution.

There are several aspects in which the fiscal situation of local and regional (*raion*) governments in Moldova deviates from these sound principles. First, although the competencies of the various tiers of authorities are well defined in the law, the scarcity of resources at the local and *raion* level means that often certain departments of the central government take over responsibility for services or infrastructures for which the local authorities have no money. This may be better than having no services or allowing the infrastructure to deteriorate, but it contributes to blur the line separating decentralized authorities from the central government, and erodes their sense of autonomy. It would be far preferable to transfer those resources to the decentralized authorities and allow them to assume the responsibilities that the law ascribes them.

Even though the law on local public administration assigns certain taxes, and certain percentages of other taxes, to *raion* and local authorities, the Ministry of Finance determines both those percentages and the tax rates for all the important taxes. The decentralized authorities seem to have little or no autonomy in that respect, particularly in relation to the taxes that raise most revenue.

Another difficulty follows from the fact that a large and increasing proportion of the revenues of local and regional authorities comes from central government grants. In some *raions*, the Ministry of Finance even subsidizes the payment of salaries, despite very low levels of tax collection. For the reasons mentioned above, such practice tends to encourage both dependence

and fiscal irresponsibility on the part of the *raion* authority. Even Gagauzia, which has a special autonomy statute, only raises 5 to 6 percent of its revenue from local taxes

The large volume and the relatively arbitrary level of subsidies from the center also play havoc with local and regional autonomy. If, for instance, a regional authority succeeds in obtaining permission for increasing a particular tax rate, it normally sees the subsidy it receives from the central government cut in the same proportion. It is difficult, under such conditions, to take seriously claims – normally made at the central level – of financial and administrative autonomy of the territorial-administrative units.

It must be kept in mind, when discussing matters of financial autonomy of local and regional authorities, that the central government, and particularly the Ministry of Finance, faces significant financial shortages as a consequence of a number of well-known factors: the crisis of transition, the growth of the shadow economy, etc. The seriousness of those problems does not, however, justify the disregard for sound principles of fiscal federalism. The challenge here is simultaneously to increase the degree of decentralization and the effectiveness of tax collection, by creating and strengthening incentives for the decentralized authorities to collaborate with the central government in the collection of taxes. At the same time, incentives must be created or reinforced that will lead those authorities to exercise fiscal discipline in line with the needs of the Moldovan economy.

The focus of regional development policy

Coming next to the subject of what main questions are likely to be at the focus of regional policy in the next few years in Moldova, an obvious remark is that, if regional administration is truly decentralized, the regions will find their own solutions to the problems confronting them. Such solution will then differ from region to region. Consequently, no more can be done at this stage than indicate a number of policy areas likely to concern both the national and the regional authorities in Moldova.

A first such policy area, likely to remain a central concern of the National Government, relates to the reintegration of Transnistria into the Moldovan economy. The economy of the region seem to have declined further than that of the rest of the country, without having yet gone through the painful reforms that the rest of Moldova has already experienced. Reintegration will also not be made any easier by the fact that, during the period of the centrally planned economy, Transnistrian industry was integrated, not in the Moldovan, but in a much wider economic space. It is very probable that the reintegration of Transnistria, when it occurs, will have rather large costs for the rest of the country. Even if Moldova succeeds in obtaining special assistance to ease this process, this integration is likely to exert additional pressure on the country's already stretched financial resources.

At the regional level, diversification of regional economies is likely to constitute the main challenge facing the regions. Outside the cities, the Moldovan economy remains largely dependent on agriculture, directly or indirectly. Diversification will decrease such dependence, as well as the vulnerability of regional economies to the failure of particular crops.

A major component of regional and local economic development is local industrialization, which creates non-agricultural jobs, thus contributing to the diversification of the local economy and to the creation of wealth. Local industrialization efforts may be classified into two main categories: (i) attempts at attracting outside investment, and (ii) inward-oriented strategies, focusing largely on small business development. Attracting outside investment – or, as it is also sometimes called, 'industrial boosterism' – usually involves several

different actions. These include most notably marketing the region or locality to footloose entrepreneurs and 'gap-financing', i.e. providing the minimum amount of subsidy to private investors which will make it attractive for them to move to the new location. This subsidy usually takes the form of various types of concessions, such as the direct provision of land or buildings, preferential rates for public utility services, tax holidays and exemptions, provision of finance on advantageous terms, etc.

Questions have, however, been raised concerning the long-term viability of this approach to local industrialization, since it often amounts to little more than individual deal-making, often with outside investors playing one community against another in a zero-sum game. Realistically, luring inward industrial investment makes sense only for regions or urban centers that have large populations, are strategically located or have sophisticated local governments or good infrastructure. Outside such areas, a more inward-looking approach is called for. It is necessary to stimulate the growth of local industry rather than just try to attract outside industry.

In relation to the idea of 'growing' local industry, the main focus in recent years has been on small-scale industry (including parts of the so-called informal sector), flexible specialization and on the related theme of industrial districts. Flexible specialization is characterized, on the production side, by its reliance on flexible (multi-use) equipment, customized designs, small production runs and a relatively skilled labor force, and on the demand side by paying greater attention and adapting to the requirements of increasingly discriminating customers. Flexible production is associated with the clustering of factories and workshops in **industrial districts**, where they benefit from the support of local authorities and from their membership of co-operative networks that help spread market information and technological innovation throughout the industry. Trust plays an important role in maintaining the viability of such co-operative networks, and the co-operative competition that they enable is seen as crucial to the competitiveness of firms in the industrial district vis-à-vis the rest of the world.

The concept of industrial district reflects the fact that, in the context of the global economy, development does not occur uniformly over national territories. Michael Porter, in his well-known analysis of competitive advantage⁶, introduces a very clear spatial dimension when he associates competitiveness (which he sees as a consequence of innovation and continuous improvement in products, processes and organizational performance) with clustering of industries, not only in the sense of industries connected through vertical and horizontal relationships, but also in a geographical sense: 'Competitors in many internationally successful industries, and often entire clusters of industries, are often located in a single town or region within a nation' (p. 154). He goes further: 'Locational effects are powerful ones even if cultural, political or cost differences between locations are small' (p. 158). In connection with this, Porter raises the question whether the nation is a relevant unit of analysis, and concludes that, although nations are still important, 'it is the combination of national and intensely local conditions that fosters competitive advantage. National policies will be inadequate in and of themselves. State and local government can play a prominent role in industry success' (p. 158).

In the global economy, networks of contacts and linkages play a key role, both at the local level and with the global economy, to ensure competitiveness. To assure themselves of the innovation that maintains and strengthens competitiveness, entrepreneurs must create and manage relationships with both clients and external suppliers. In this respect, local development authorities may play a useful supporting role.

⁶ Porter, M.E. (1990) *The Competitive Advantage of Nations*. London: Macmillan.

While industrial districts are very difficult to induce or to plan for, they provide a useful template for the analysis of local and regional realities: the identification of local comparative advantages may be followed by efforts on the part of regional authorities to stimulate co-operation among small-scale industrialists with a view to increase the competitiveness of each of them.

Of course, despite the attractiveness of small scale industrialization, regional authorities would be well advised not to place all their hopes on the development of small scale industry, and even less on industrial districts; depending on the specific characteristics of the region and on its advantages, policies aimed at stimulating inward investment by medium and large industrial firms, at improving income distribution and at developing and diversifying agriculture itself remain necessary for local and regional development.

The approach to regional development

Our final question deals with the approach that decentralized regional authorities should adopt, in the Moldovan context, to the development of their own regions. In this respect the financial constraints discussed above play an important role. To put it plainly, there will be little money to spend on infrastructural projects and none to provide subsidies to attract industry to the regions. It is therefore worth mentioning that the traditional approach to regional development, based on spending relatively large amounts of money to increase the region's attractiveness and to solve its problems, is currently being replaced by another, with a very different emphasis.

It is nowadays commonly accepted among both academics and practitioners that regional planning has been in decline for the past two and a half decades. Indeed that decline has been such that in some countries regional policy seems to have disappeared without trace. A partial explanation for this is the widespread adoption of the 'new' model of development and public management, characterized by reduced government intervention in the economy, liberalization of domestic markets, privatization, increased emphasis on the private sector as the engine of economic growth, lowering of barriers to foreign trade and the introduction of export incentives. This model of development leaves even less space for regional policy than it has enjoyed in the past⁷.

At the same time as regional planning declined, expectations of effective development policy shifted from the national state, increasingly seen as both incompetent and impotent to stimulate regional economic development, to the regional and local levels. This shift started in the developed countries of Europe and North America. It was there that the promotion of **local economic development**⁸ emerged in the 1980s as an important focus for research and policy, gradually replacing earlier emphases on national and inter-regional development and planning. It then eventually found its way into developing countries, where privatization, structural adjustment and trade liberalization left national states less able and willing to intervene in their own economies.

It must be stressed here that talk of the decline of regional planning refers primarily to **inter-regional** planning, characterized as a national-level activity, largely concerned with the allocation of certain resources among the various regions of a country. Rather than these aspects,

⁷ At the same time, ironically, its adoption seems to have resulted in some of the same sorts of changes that regional policy strove for, with little success, for a long time: redressing the locational advantages of metropolitan areas in relation to secondary cities and rural areas, shifting the terms of trade in favor of exporters – often of primary products – operating from peripheral regions, etc.

⁸ The term 'local' in this context is used to distinguish the new approach from the 'old' regional planning. The new approach applies to regions as well as or perhaps even more than localities.

local economic development stresses endogenous development policies using the potential of local human, institutional and physical resources and based on variables controlled from inside the area, rather than allocation of outside resources from the national level. It is much more closely related to **intra**-regional planning, which concerns itself with the economic organization of geographic space inside the region, particularly through decisions affecting the location of population, infrastructure and economic activity within the region. While inter-regional planning declined, intra-regional planning retained much of its relevance. At the same time, however, there are differences: local economic development stresses action and intervention, promotion and mobilization rather than planning and rational decision-making.

Local economic development seems the adequate approach to the regional conditions in Moldova, where the decentralized authorities cannot expect much from the Central Government in the way of intervention. At the same time, given both the needs and the constraints in this area, regional authorities will almost certainly be forced to play an enabling and facilitating role rather than one of direct intervention. This means using the scarce financial and human resources available to them to mobilize the energies and creativity of all actors on the regional scene. This is done by shifting from a role of providing services and infrastructure to one of creating the conditions for others to provide them: formal and informal producers, community based and non-governmental organizations, the local governments and the communities themselves. This means, among other things, that markets, where they exist, should be allowed to work; communities and local governments should be mobilized and encouraged to solve their own problems; the construction of infrastructure should, whenever possible, be carried out by the private sector; where that is not feasible, it should be subjected to rigorous cost-benefit analysis. In the promotion of local industrialization, this means that regional authorities should facilitate rather than subsidize: providing technical support, helping prospective entrepreneurs obtain information and technology, find clients, establish contacts and link up with others in related activities, facilitating their access to training and to credit (but not giving them credit or subsidies), etc.

At a different scale, it may also mean participating in the creation of regional development associations, 'selling' the region to outside investors, co-ordinating and supporting efforts to improve productivity and to find new marketing channels for regional products, etc.

Many of these activities can be carried out at very low cost. In order for them to succeed, however, it is essential that the regional authority be able to rely on highly trained and motivated staff, not only technically competent but also capable of taking initiatives and of mobilizing the interest, the enthusiasm and the creative energies of the population – ultimately, the most important resource for regional development.