

IMPROVING LOCAL FINANCING SYSTEMS

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The topic I have chosen for this conference is the Improvement of Local Financing Systems. For some years now I have been studying thoroughly the Government Budget. For this matter I have prepared articles and presented them in conferences and other academical round tables. Since a part of the incomes of such budget is reversed in the local power I am of the opinion that a detailed study in this field, in order to come to some conclusions, would be necessary. At the moment the local power in Albania is partially financed by the Government Budget and their incomes, assured by local taxes, investments, grants ect. I believe that a study of the way these organs are financed and the improvement of financing systems would be very valuable and important in the light of European Integration. Apart from the above I have the intention to include in my article the comparison between the Kosovo legislation on the field, seeing both legislation under the same view and arriving to the proper conclusions and what can be improved.

Improving Local Financing Systems

Local Government is one of the two principal divisions of powers in the Republic of Albania. Due to the growing sensibility it has in the citizen's life, its regulation and functioning remains one of the greatest challenges of our politics.

Local Government in Albania has been functioning in Albania for over 17 years and after the reform of 2000, it has come to a consolidation as an important part of the executive power in regional and local level for the effective and efficient of public functions and services. Decentralization of Local Government is valued as a process generating services closer to the community, increasing the communities participation in the governing, the efficiency in the usage of public funds, develops the consciousness of the local administration about the real conditions and necessities of the citizens. At the same time the decentralization of the local government, gives space to a greater dedication of the local authorities towards the political and strategic issues, increases the responsibility of the Central Government toward the initiatives taken for the local needs, as well as simplifying the burocratic procedures in the central planning and controlling of social programs.

Local Governing in the Republic of Albania is based in the principle of decentralization and is enacted according to the principle of local autonomy. According to article 108 of the Albanian Constitution, "Units of local governing are municipalities and districts. Other units of local governing are established by Law."

In the third paragraph of this article: "the municipality and district are the basic units of local governing. They all have governing duties, with the exception of those duties the Law gives to other units.

Local Governing in Albania is composed of:

- First level – municipalities and towns
- Second Level - Districts

Municipalities and Towns constitute the basic units of local governing, while district constitute a second level of this governing. Local Units are decentralized and autonomic public authorities, responsible of giving and distributing in accordance to the Law public services and goods.

Nowadays Albania is constituted of:¹

- 12 districts (Berat, Diber, Durres, Elbasan, Fier, Gjirokaster, Korce, Kukes, Lezhe, Shkoder, Tirane and Vlore). They are divided in 36 circuits.
- 308 towns.
- 65 municipalities. (The municipality of Tirana has 11 units).

Subdivisions of towns are villages and in specific cases cities, subdivisions of a municipality are neighborhoods, while the districts are called circuits.

Local Units are legal entities. They have independent budgets, which is created in the foreseen legal way. Decentralization of local power is accompanied by the financial and fiscal decentralization, which has brought a displacement of public funds toward local government, giving this latter authority and autonomy in collecting these funds. Even though financial decentralization is still on process and the amount of public funds in usage of the local government are relatively very little in comparison to the other countries of the region, the concern of public opinion, communities and civil societies about the way how these funds are used and spent is ever growing.

Let us start our analysis with the way local governing is financed, who are the actors financing local units, how are the funds collected, and how are they distributed in order to fulfill the needs and necessities of society.

In the legal framework of each country it has been known the necessity to predict and document regularly financial facts which constitute potential objects of the financial and economical politics of a country in the future. This is what corresponds to a previous budget.²

According to the predominating doctrine, a budget is an account, in which are shown actives and passives relating to a certain period of time, presented as an accounting document which is a prediction of the results of a certain category of actions, which will be concluded over a period of time.

As proclaimed by the Albanian doctrine and legislation, "State Budget" is the financial annual program which is composed of the approved funds from the Parliament, in which all of the incomes, loans and other gaining are included, as well as respective expenses for exercising activities and competences of the highest institutions, of the administration, local authorities and judicial power. The budget is the principle instrument for executing economical

¹ Law No. 8653, dated 31.07.2000 "On the administrative and territorial division of local units".

² Shkenca mbi financat dhe e drejta financiare – Kristaq Gjyli

and social politics.”

From the above definition, the budget is defined as:

1. Annual financial program
2. Financial Instrument

According to Law No.9936, dated 26.06.2008 “ On managing the budget system in the Republic of Albania”, the time frame for defining the Budget is the same as the calendar year and start on the 1st of January until the 31st of December of each year.

The State budget is the main document, upon which the local government units is drafted and implemented. The budget of each local government unit includes all expenses and incomes, and also the loan payment.

The state budget aims to:

- make efficient use of resources while carrying out the duties and functions;
- represent clearly the financial situation of each local government unit;
- give the necessary information enabling the citizens to participate in the decision making process pertaining to the functions and competences carried out by the relevant local government unit.

Following the approval of the budget by the local council, the local units follow its implementation programme aiming at:

- *Using effectively the human resources in exercises the functions and carrying out the duties.*
- *Providing services on due time and that fit to the citizens need.*
- *Guarantee a broad participation of citizens in the decision-making process in relation to the regarding the functions and competences carried out by the relevant local government unit.*

The right to have an independent budget is an essential element of the principle of local autonomy. In this perspective, the right to collect incomes and to make expenses, gives the local autonomy the required financial instruments to exercise the local government related functions and competences. The local government bodies, by means of this right, guarantee the possibility to draft and approve their own budget and make use of their own financial resources, and therefore meet their mission to define and collect incomes from local taxes and duties, exercise internal financial audit, etc. In addition, it is Article 122 of the Constitution which provides that there cannot be autonomy in exercising the duties or competences, unless having financial and fiscal autonomy.

Financial autonomy of the local government bodies such as municipalities, communes or districts shall mean:

• **Firstly**, improvement of the local bodies' decision-making abilities to extend their internal financial resources structure, for each local unit. Clearly, in our case, extension of autonomy is reflected in the transfer of some taxes from national to local, such as the tax on small business, tax on immovable property, tax on the registration of vehicles, tax on the transactions of immovable properties, as well as on loans, etc.

• **Secondly**, a better definition of the local council capacity to evaluate the potential possibilities and impose the rate of local taxes, in compliance with the national applicable legislation, to adopt the national development policy with local socio-economic situation. Besides the capacity to increase or decrease the tax rate having as reference the legal norm, the local councils are entitled to decide upon applying or non-applying the taxes, to exclude from taxes a given target, although of a temporary nature, etc.

• **Thirdly**, the right of the local government bodies to define the local taxes on public services applicable by them. Meanwhile, a re-classification and a fair division between taxes and duties have been applied. It makes possible that the duties on services The council, utilizing the local autonomy as a development mean in the local unit, defines the local duties taking into consideration the factors in general and associates them with the increase of incomes with the rise of the standard level, which leads in the gradual increase of the living standard.

• **Fourthly**, the decision-making right on how the funds are going to be used (making expenses). The local government bodies, in exercising their legal functions, have full rights to decide on the mean, destination and the amount of funds for each item, in relation with their funds provided by means of internal resources or through funding from the unconditional state budget. Such right gives them the opportunity to use effectively and rationally the financial resources, creates them the capacity to meet the public commitments according to the local programmes and priorities, but, on the meantime, and increases their responsibilities in using the local public funds.

The law No. 8652, date 31.07.2000, “On the organization and functioning of the local government”, among other rights, it enlists also the right govern, the right to property, the right to collect incomes and to make expenses, the right to carry out economic activities (in order to fulfil their public functions in the interest of the community they represent, they exercise economic activities that do not interfere with the fundamental orientation of the state economic policies. The incomes benefited by the economic activity are used, mostly, to support and fulfil the public functions), the right to co-operate, the right to legal personality, and others.

The incomes of local government in Albania

The local government in Albania is entitled to fiscal autonomy as provided under the Constitution of the RA, the organic law No. 8652, of 2000 and the Law No. 9632 of 2006 “On local tax system”. The constitutional principle provides that the national and local taxes, duties, and liabilities, relief or exemption from them of different target categories of taxpayers, as well as the method of collection is provided by law. In addition the law provides the types of taxes, their basic level and rate. The Assembly of People, in its law on taxes, has established:

- *the type and category of local taxes;*
- *the basis and rate of local taxes;*
- *exemptions from local taxes.*

The local government bodies, in order to regulate and manage independently the local issues under their

jurisdiction, are entitled to collect and expend incomes under their authority and discretion.

Incomes in the local power consist of:

- annual incomes;
- incomes generated by the division of national taxes on personal incomes and tax on profit.
- incomes transferred to the local government in the form of grants, whether conditioned or unconditioned.

According to the law on local tax system, the local government has to right to collect the following taxes:³

1. Local tax on small business.

It is the most important tax to the local budget as it brings higher incomes in comparison to the other local taxes. The tax on small business is payable by the businesses that have an annual turnover up to 8 million ALL. The level and rate of such tax is defined by the law. The municipal council has the right to increase or decrease the rate of the tax with +10% - 30%, as well as to make sub-categorizations of the taxpayers. The tax on small business is managed by the local government, which was passed under its competence since 2006. The local tax offices collect such tax and the Mayor is the tax appeal authority. Regarding the tax on small business, it was argued that its rates should be increased in accordance with the annual increase of GDP rate.

2. Tax on real property, under which tax on buildings and tax on agricultural land are included.

The level of such tax is defined by law and the basis of the tax is the surface of the property. The local government has no discretion to make changes on such tax. However, despite the fact that it is a tax with high potential to increase the financial resources, and relatively easy to be collected, the statistics of the Ministry of Finances show that such tax is collected in low levels by the local government units.

3. Tax on hotel utilization.

This tax is payable by all persons who are accommodated in hotels. The maximal rate of this tax is 5% over the selling price and the municipal council has the right to decide on the level of this tax up to the maximal rate defined by law. An estimate on incomes by the tax on hotel is carried out on basis of the average room price and the average number of persons per year, and means that the incomes shall increase with 10%, due to the development of the market and by the increase of the number of hotel structures, as well as the number of visitors in towns.

4. Tax on impact on infrastructure of the new constructions.

It is a tax payable by all construction entities operating in the territory of the municipality. The minimal and maximal level of the tax is defined by law, respectively:
Municipality of Tirana 2 - 4% of the investment value;
Other municipalities 1 - 3% of the investment value;

The municipal council decides on the level of tax between the minimal and maximal rate defined by law.

5. Tax on passing ownership on real estates

This tax is applied on buildings and all the real estate's in the moment of passing ownership over them. This is a local tax and the law establishes the level and basis of the tax. The council has no fiscal discretion. This is a relatively high source of income for those units which have new constructions and transactions.

6. Tax on annual car registration

The basis for the tax on annual car registration is the type of transportation. The law has set a level and basis and the local council has no discretion. This tax is paid by all owners of an automobile and collected by the Directory of Road Transportation Services or Street Police, in the quality of tax agents.

7. Tax for occupying public spaces.

The basis of the tax is the surface in m², which is used by individuals and entities for business scopes. The law establishes the level of the tax while the council categorizes it. Mostly the tax is paid by private businesses.

8. Tax on tables

Tax on tables is paid by all the businesses who are obliged to have a table for their businesses. The level and by basis are set by law.

9. Temporary taxes

The local council has the full autonomy to decide the type, level and basis of a temporary tax if such are decided to be applied in its territory. The council has the autonomy for some of the levels of its taxes such as tax on small business to raise or lower it by 10 – 30%. As well it is recognized by law the right to categorize the taxpayers in other categories than those already set. This autonomy, even though limited, allows the municipality to enact its own politics.

These are the local taxes that the local units collect in order to realize the duties and purposes set by the law. It is very important to evidence and collect them since this is the only way the incomes may rise and the process of administration may function properly. Apart from local taxes, local units also gather and administer local tariffs which are a part of the incomes with non economical nature. When it comes to the ratio of collection of the tariff, it is foreseen that this ration will increase with a dynamic of an annual 5 % for the years to come. A positive factor in its collection is the consciousness of taxpayers of the important service to the city, expressed even in the citizens' opinions.

Such tariffs are parking tariff which goes to the local government. The provision for this service states that the service will expand during 2011 and the incomes will grow with a dynamic of 10% in the years to come and the service will operate successfully. Kinder gardens and dorms are other subjects for which the local authorities collect tariffs for the services they offer. The payment for

³ Law No. 9636, dated 30/10/2006 "On local Taxes"

this service is symbolic but nevertheless this amount goes to local authorities.

Part of the incomes with non fiscal nature that the local authorities collect are the incomes from economical activities; income from the sale of capital properties of the units; income from lease on the terrains and other buildings; income from contributions and sponsoring; income from fines etc. Due to their nature on the most part these incomes must be used mostly for the developing of the unit through investments and services relevant to the community.

Loans are also a financial instrument in the hands of local units in order to secure incomes. This opportunity has been given to the local government by Law No. 9869 dated 4/2/2008 "On Local Loaning". Under the conditions of a broader fiscal autonomy and transfer of a number of competences, so to guarantee an effective execution of their term and to guarantee as much public services as possible. The local government is allowed to loan only for capital investments or to reinforce the existing debts and to produce financial instruments such as actions. The law establishes rules and specific criteria for loaning. In the case of transactions of loans or for the specified cases by law, the local authorities have the right to open a bank account in the selected banks. Apart from its own incomes, local government insures incomes as well from national sources. The incomes are firstly unconditional transfers from the State Budget. The unconditional transfer is an income taken in a gift form without any condition, any interest, which is used to finance its duties and competencies, defined by Law No. 8652, dated 31.07.2000 "On organizing and functioning of local governing", as well as achieving the equality of resources between different units. The local authorities also benefit from conditional transfers. They are given as part of a fund for shared responsibilities and to finance the expenses of delegated functions. These funds will be used by local authorities only for the purpose for which they have been awarded and in accordance to the rules established by the central government. In the conditional funds there are grants for investments (for example for reconstruction and equipment of pre-university education ambient etc.) These transfers must be approved in the local budget, since the council has full authority to establish the object of investment.

Economical Aid to pay the care of disable persons and their social and health care are other incomes coming from the Ministry of Labor and Equal Opportunities as conditional transfers.

The growing of incomes is based on the general supposition which is closely related to a series of measures, to be taken by the local fiscal administration and the corresponding structures. These measures should be orientated by:

- Growth of the basis of taxpayers
- Growth of the level of taxes and tariffs by approximating them to the cost of services the municipality offers for the citizen's
- Growth of level of collection

Expenses of local governing units

By expenses of the local government we will understand the distribution of economical goods that the local unit uses to produce the services and goods necessary to fulfill the necessities of the community.

The expenses of the local units are divided in expenses for its own functions, for collective functions and for those who have been delegated. Individual Functions represent the functions that are exclusive competence of the local units. Their financing is done by the incomes of the local government itself and from the unconditional transfers from the State Budget. In the expenses for individual functions are included the expenses for local administration including salaries, social insurance contribution, operative expenses and investments; all expenses for public services such as: cleaning, greenness, decorations, etc. including personnel costs, operative expenses and investments ; all expenses for sports and culture institutions; all expenses for building and maintenance of local infrastructure including personnel costs, operative expenses and investments; expenses for urban transports; subvention of water-supplies etc.

Common Functions are related to those areas of activity which are common responsibility of both local and central government, responsibility clearly divided for each level. Expenses for such function are dealt with by the unconditional transfers from the budget to local governing; local units own incomes; grants for pre-university education and grants for primal health care. In the expenses for common functions will be included every type of expense which is foreseen for education, health, expenses in case of civil emergency etc.

Expenses for delegated functions will be the expenses for health care, expenses and economic aid and care for disables, etc.

These are the expenses of the local government in order to comply with the requests and necessities of the communities. If we would have to sum them up in a table of incomes and expenses of the local government we would have the following:

Income	Expenses
1. Individual Income <ul style="list-style-type: none"> • Local Taxes • Local Tariffs • Income from economical and non-economical activities • Local Loans 2. Income from State Budget <ul style="list-style-type: none"> • Unconditional Transfer • Conditional Transfer • National Taxes (Tax on Profit and Tax on Income) 	1. Operational and Maintenance Expenses 2. Capital Expenses or 1. Expenses for Individual Functions (public services) 2. Expenses for Collective Functions (education, health) 3. Expenses for delegated functions

Local Financial Resources in Kosovo (Comparison with the Albanian Legislation)

Law on Local Governing of 2008 contains dispositions about the source of income of the municipalities pointing out that the financing of municipalities is regulated with specific Law. Municipalities have their own budget and income to execute the competences the Law has given them. The Budget of a municipality is composed of their own incomes, grants awarded by the government of the Republic of Kosovo, donations and other incomes.

Law No. 03/L-049 is the one regulation the finances of local government in Kosovo. As to its content we can say it is almost the same as the provisions on local financing in Albania with some minor changes, concerning the circumstances and different facts of both countries.

Competences of Local Government in Kosovo are divided in individual competencies, delegated and added. In regard to the source of financing, article 7 of this Law expressly foresees:

"Financial sources of a municipality are

(i) *The municipalities own incomes as it is stated in article 8 of this Law*

(ii) *Operational Grants*

(iii) *Grants for added competencies*

(iv) *Transfers for delegated competencies,*

(v) *Extraordinary Grants*

(vi) *Financial Aid from the Republic of Serbia,*

(vii) *Income from Loans"*

Hence in general local financing has the same character. Distinguishing from Republic of Albania where local loaning

is regulated with specific Law, in Kosovo this right is clearly given to local governing.

As well as taxes and tariffs which in Albania are regulated by a special Law, in Kosovo they are foreseen by the same Law. Municipalities also benefit from State Budget for services such as education and health. These are in fact two areas in which the two countries are still problematic and yet need the help of central government operators for coordination and organization. This is a direction in which it is obvious that a lot of hard work is being accomplished to fulfill European standard.

Conclusions

Local Government is an important part in the governing of a country. It is the power which actually, even for its nature, is closer to the citizen's everyday life with the services it offers, starting by the most basic ones.

The known principle of market trade shows us that the incomes of a country are always limited in comparison with the unlimited necessities of the society. That is why we cannot be static and definite in our conclusions. What we can say is that there need to be taken a series of measures and reforms to evidence the incomes that go to local authorities in order to increase them so the bodies of local governing can do their work better.

This can be achieved by raising the base of taxpayers: raising the level of taxes and tariff so they can be as approximate as it is possible to the cost of the service offered by the municipalities.

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