

# The role of fiscal decentralization on economic development. Case of Municipality of Shkodra

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## Abstract

Local government is an important topic for all citizens of our country, and this because we are affected by it directly or indirectly, not only from local tax, but also through services that we as consumers take from it. It would be difficult to find a developed or developing country that is not realizing any kind of reform in public administration, focusing on a better management for people, increasing efficiency, effectiveness and quality of public services.

The process of decentralisation in Albania has started in 2000. The process has been accompanied by a growth of interest in local government reforms, concentrated in restructuring and reorganization. The territorial reform is seen as a very important element of this process. Decentralization reform in Albania has increased the responsibilities of local government and local autonomy for the allocation of expenditures, but with a less rapid development of local autonomy of earnings.

The prospective European Integration is dictating essential structural changes and socio-economic for Albania. Objectives of reform all over the world are similar, they differ mainly due to different stages of development of societies and due to different local values. Their implementation is a real challenge for central government and local government.

The purpose of this paper is to provide an overview of actual situation of local government management and the problems which it faces. The way that process of fiscal decentralization is implemented in Municipality of Shkodra will be the main point in our paper.

**Keywords:** Local government management, Municipality of Shkodra, fiscal decentralization, EU integration.

## Introduction

Although an independent country since 1912, Albania started building its democratic institutions only from the early-1990s, after almost half a century of dictatorship and centralized government. Following this, local governments were formally re-created, with some regulations passed on their competences and authorities. However, these regulations were not implemented, and local government in Albania possessed insignificant administrative and fiscal autonomy until the mid-1990s. Since the late 1990s a more consistent decentralization approach has been designed and an implementation strategy explicitly adopted; the latter is envisaged to gradually replace the inherited centralist state with a more participatory decentralized governance system. The 1998 Constitution of Albania establishes that local governments are founded on the principle of decentralization, and that the relationship between the state, the regions, and the local governments is grounded on autonomy, legality, and cooperation. Since the late-1990s, Albania has taken major strides in setting up a basic legal and institutional framework for the

implementation of an accountable decentralized fiscal and administrative structure. The Government has formulated and the Parliament ratified a decentralization strategy that is broadly consistent with the European Charter of Local Self Governments and the National Constitution.<sup>1</sup>

## 1. Fiscal Decentralization literature

### 1.1 The definition of fiscal decentralization

Fiscal decentralization covers two interrelated issues. First, it is the division of spending responsibilities and revenue sources between levels of government (national, regional, local etc). Second it is the amount of discretion given to regional and local governments to determine their expenditures and revenues.

These combined dimensions have a significant impact on the reality of decentralization in its broader political and administrative sense. How much power and responsibility

<sup>1</sup> Albania: Decentralization in transition

regional and local governments actually exercise depends substantially on:<sup>2</sup>

- (1) What range of public services they finance;
- (2) Whether their revenues are commensurate with these responsibilities;
- (3) How much real choice they have in allocating their budget to individual services;
- (4) Whether they can determine the rates of their taxes and charges (both allowing them to vary their level of spending and making them answerable to the payers).

Decentralization is a longer-term gradual process that involves, within an appropriate legal framework, various components, such as political decentralization, administrative decentralization and fiscal decentralization:<sup>3</sup>

- Political decentralization relates to the transfer of functions or authority from central levels of government to local institutions that are governed by local political representation. It means that certain, well described decision making powers, but also systems of accountability, are being transferred from central government to lower levels of government
- Administrative decentralization refers to the de-linking of line ministry staff from their respective ministries and bringing them under the control of the local authority; which includes procedures for establishing a local pay-roll. It means that local authorities can hire and fire their own staff
- Fiscal decentralization relates to the transfer of functions or authority from central levels of government to local institutions regarding local decision making on the allocation of financial resources (i.e. financial discretionary powers) and the powers to levy local taxes. Full fiscal decentralization requires political decentralization and, at least to some extent, administrative decentralization.

## 1.2 Advantages and disadvantages of fiscal decentralization

According, Elhiraika (2007) arguments for fiscal decentralization are as follows:

1. Fiscal decentralization enables sub-national governments to take account of local differences in culture, environment, endowment of natural resources, and economic and social institutions.
2. Information on local preferences and needs can be extracted more cheaply and accurately by local governments, which are closer to the people and hence more identified with local causes.
3. Bringing expenditure assignments closer to revenue sources can enhance accountability and transparency in government actions.
4. Fiscal decentralization can help promote streamlining public sector activities and the development of local democratic traditions.
5. By promoting allocate efficiency, fiscal decentralization can influence macroeconomic governance, promote local growth and poverty alleviation directly as well as through spillovers.

However, fiscal decentralization has its own limitations, which include:<sup>4</sup>

1. Failure to adequately address the question of how to manage intergovernmental fiscal relations in order to meet the growing needs for public services at the local level while preserving fiscal discipline nationally and sub-nationally. This requires institutional clarity and transparency to avoid coordination failures that lead to inefficient spending by local governments manifested in deficit bias and higher borrowing costs that can aggravate macroeconomic imbalances and instability. To avoid such undesirable outcomes, there is a need for incentives and capacity building on top of institutional checks and balances to ensure prudence in sub-national fiscal management.
2. Assignment of expenditure and financing responsibilities to sub-national governments can adversely affect service delivery in different ways. For example decentralization of water and sanitation services to small local governments in Latin America have led to a loss of economies of scale in service delivery. Many governments in Latin America and Africa keep the financing of health and education at national level because the spillover effects from health and education outcomes and their impact on equity are national. Assignment of certain business taxes to local levels in the United States have led to inefficient tax competition, constraining the ability of municipalities to generate revenue and deliver services.

## 2. Fiscal decentralization in Albania

### 2.1 Progress of fiscal decentralization in years

Fiscal decentralization reform in favor of local government includes some important aspects such as:

- Strength revenues of local government
- Increase the autonomy of local government
- Distribution of conditional and unconditional transfers
- Effective management of public enterprises and sectors in the local government

The evolution of the decentralization process goes through several key moments:

#### 1. The period 1992-1998

At this period the legislation was simple and not complete. One characteristic of this period was the effort to separate national from local taxes. By law no. 7777 dt.22.12.1993 for "Tax system in the Republic of Albania" for the first time we have tax sharing system on national and local taxes. Taxes were collected by those that perform the service. The period 1992-1998 is characterized by general taxes and fees on low and medium level, which was adapted to the conditions and economic development of municipalities and communes of the country. The role of municipalities and communes was still weak for the tax collection. A most of them collected by tax agents, which leads to a mismanagement of tax collection system, in tax evasion, and finally to low-income for municipalities and their communes. Their budget from grant, which awarded by central government, captures to 80% and only 20% was covered by revenues from taxes and fees.

<sup>2</sup>Kenneth Davey; *Fiscal Decentralization*

<sup>3</sup>Niña Boschmann, 2009

<sup>4</sup>Elhiraika, 2007

## 2. The period 1998-2002

The year 1998 marked a step forward, in terms of space of local taxes. The legislation for this period has added and removes certain fees that must be collected by municipalities and communes. The particular of this legislation was because creates the opportunity to municipality and communes to set temporary taxes for new services in the interests of the inhabitants. All the incomes realized by local taxes, were discharged municipalities' budget. This means that the municipality has more space to realize more income and to use these incomes for the public. So, we have an consolidation of local government. The municipal revenues consist of: local revenues and central budget revenue. Municipalities and communes now play a very important role in the tax collection.

## 3. The period 2002 and so on

The year 2002 can be considered as the year that jumped a step ahead in the field of local taxes and at the same time the beginning of the consolidation of responsibilities maturity of political in the in management of local revenue. This coincides with the adoption nr.8982 dated 12.12.2002 "On local tax system" law nr.8978 dated 12.12.2002 "On local taxes on small business" and "Simplified Profit Tax". For the first time we have the establishment of local taxes and fees, collection and management of them by local governance through municipal councils or municipalities. Fiscal package created new taxes and fees and reclassificaty existing taxes.

### 2.2 Local Government Functions and Competences

The Law distinguishes exclusive functions, shared functions and delegated functions<sup>5</sup>:

#### Exclusive Functions of Communes and Municipalities:

The commune and municipality have full administrative, service, investment and regulatory powers for their exclusive functions. Exclusive functions include: (1) infrastructure and public services; (2) social cultural and recreational functions; (3) local economic development; and (4) civil security.

#### Shared Functions of Communes and Municipalities:

Communes and municipalities may undertake any of the shared functions separately or jointly with the central government. Communes and municipalities may undertake any of the following shared functions: (1) preschool and pre university education; (2) priority health service and protection of public health; (3) social assistance and poverty alleviation and ensuring of the functioning of relevant institutions; (4) public order and civil protection; (5) environmental protection; (6) other shared functions as described by law.

#### Delegated Functions of Communes and Municipalities:

The central government institutions, allowed by law, may authorize the commune, municipality or region to undertake a function under their [central government institution] jurisdiction. The Local Government units may be authorized to undertake other functions or competencies of

the central government which are non-mandatory [optional]. This should be done solely by an agreement between the central government representative and the local government unit. In any case, the central government guarantees necessary financial support to the local government units to exercise delegated functions and powers.

## 3. Effects of fiscal decentralization on the Municipality of Shkodra

The beginnings of the institution of the Municipality of Shkodra date in 1865.

Just like any other local government unit in Albania, the Municipality of Shkodra after 2000 took the responsibility of new powers in terms of income source and manner of their expenditure. The logic is the same, the municipal budget consists in two main lines: the conditionally budget and independent budget. Another important source for the municipality are donors who are not included in government grants.

### 3.1 Incomes.

Incomes of local government units are composed:

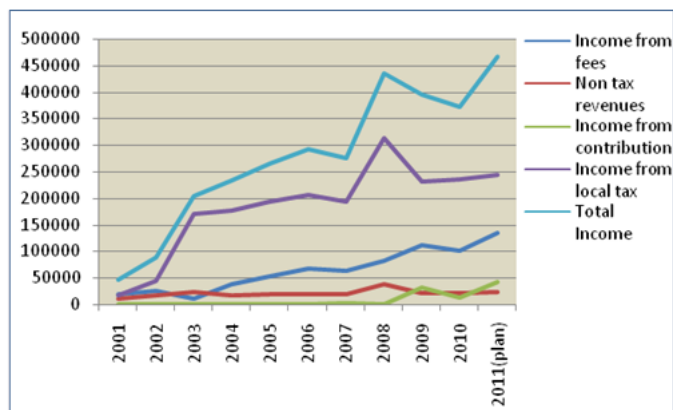
- ✓ Own revenues.
- ✓ Incomes from national sources.

#### 3.1.1 Own revenues of the municipality are composed by:

1. Local income taxes.
2. Income from fees.
3. Non-tax revenue.
4. Income from contributions.
5. Other revenues.
6. Income from public institutions of local government units.

<sup>5</sup> Facts sheets on fiscal decentralization in the Western Balkans

Chart 1. Revenues by types in years /000 leke



Source: Municipality of Shkodra

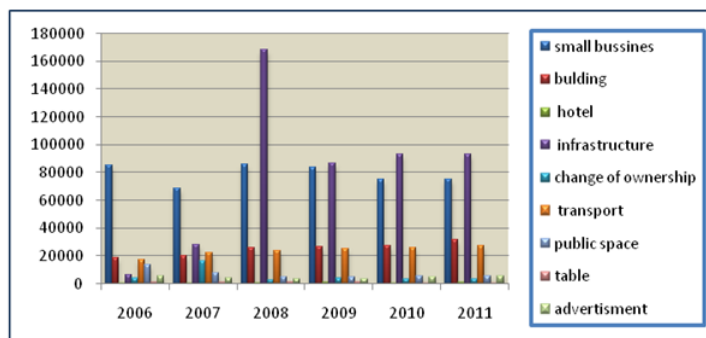
The most important changes begin after 2005, mainly after 2006, when finally we have the transfer of local taxes and fees, according the Law "For Local System Taxes".

### 3.1.2 Local tax revenues consist in:

- A. Local tax on small business.
2. Tax on real estate.
3. Taxes on hotel accommodation.
4. Tax impact on infrastructure.
5. Tax on transfer of property rights.
6. Annual registration fee of vehicles.
7. Occupation tax of public spaces.
8. Fee table.

We can see the chart below to demonstrate which tax has had the most impact on the increase of local incomes.

Chart 2. Revenues from tax after 2006 /000 leke



Source: Municipality of Shkodra

For 2010, incomes from business represent the mainly part of own incomes, about 55%.

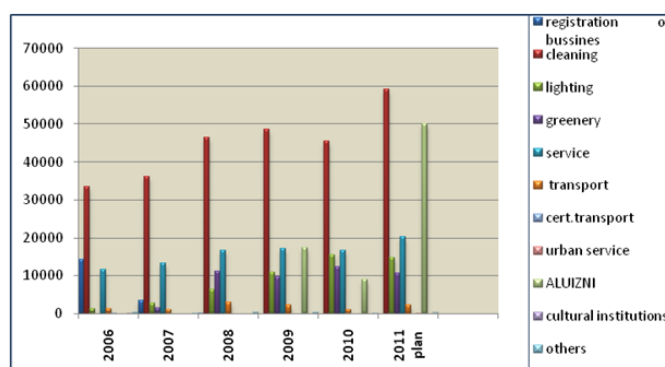
### 3.1.3 Income from fees.

These revenues comprise 20% to total revenue of the Municipality of Shkodra. In 2010 family tariffs were unified, while planning for 2011 is based on the division by the nature of services they cover. These revenues consist of:

1. Registration fees for various activities.
2. Cleaning fee and disposal.
3. Lighting fee.
4. Advertising fee.
5. Fee for a permit and veterinary service.
6. Permit fees for ambulatory activity.

7. Service fee for hunting and fishing.
8. Vehicle parking fee.
9. Licensing fees to transport activities.
10. Service fee for certificates of transportation.
11. License fee for fuel.
12. Service fee for issuing professional licenses.
13. Fee for services performed Planning Department.
14. Service fee for legalization, urbanization and integration of illegal constructions.
15. Service fee for the regions.
16. Service fee for a duplicate archive.
17. Service fee from institutions of culture and sport.
18. Other fees.

**Chart 3. Income from fees / 000 leke**

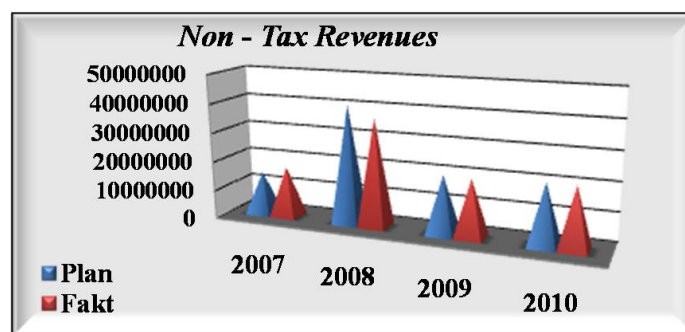


Source: Municipality of Shkodra

### 3.1.4 The non-tax revenues.

In this group include: 1. Revenues from privatization. 2. Income from rents. 3. Income from land sales. 4. Income from tenders. 5. Proceeds from the registry. 6. Proceeds from sale of stamps (5% participation). 7. Income from scholarships. 8. Income from gardens. 9. Income from nests. 10. Revenue from administrative violations (fine locally). 11. Income from housing documents.

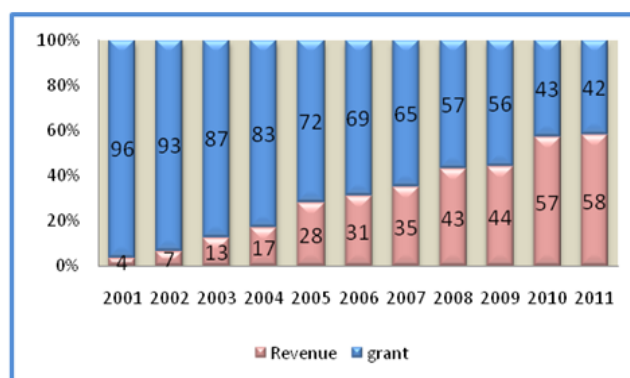
**Chart 4 . Non – Tax revenues**



Source: Municipality of Shkodra

Below is shown Revenue/Grant Ratio. By the graph we see that from year to year grants have been reduced as a percentage of revenue, and increasingly, the Municipality is 'self-financed'.

**Chart 5. Revenue/ Grant Ratio**

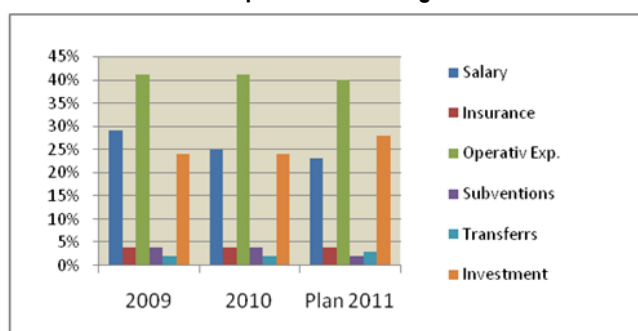


Source: Municipality of Shkodra

### 3.2 Expenses.

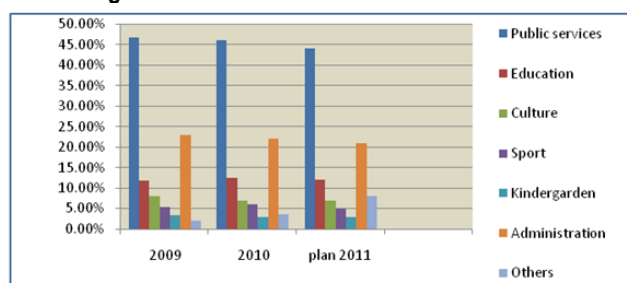
The main characteristic of financing its expenditures is that already most of them should be financed by own resources: If before, wages fully covered by unconditional transfers now only about 20% are financed from this source and the remaining another 80% from revenues from fees and taxes. This 'self financing' allows better control over expenses both by Central Government and from the Municipality. Charts below show expenses according to items and functions.

Chart 6. Expenses according to items



Source: Municipality of Shkodra

Chart 7. Expenses according to functions



Source: Municipality of Shkodra

### Conclusions

1. Local government is an important topic for all citizens of our country, and this because we are affected by it directly or indirectly, not only from local tax, but also through services that we as consumers take from it.
2. Decentralization reform in Albania has increased the responsibilities of local government and local autonomy for the allocation of expenditures, but with a less rapid development of local autonomy of earnings.
3. Just like any other local government unit in Albania, the Municipality of Shkodra after 2000 took the responsibility of new powers in terms of income source and manner of their expenditure.
4. Through close communication with citizens, Municipality of Shkodra has increased its local revenue and improved performance on expenses by paying more attention to investment and public services.
5. The 'self financing' allows better control over expenses both by Central Government and from the Municipality.

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