

THE MUNICIPAL BOND AS A WAY OF IMPROVING FINANCING SYSTEM OF THE LOCAL GOVERNMENT,  
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Nevila Kiri**Abstract**

Municipal bonds issued by local governments to finance local infrastructure projects in emerging economies are becoming an important way of helping local governments. This paper analyses the role and importance of municipal bonds as a less expensive way of financing infrastructure by public-private cooperation and maintaining greater public control over projects and services taken by local government. Next to the ordinary financial sources (local and national sources), Municipality of Shkodra needs to increase financial sources as an alternative to accelerate the economic growth of the region. This study investigates how people living in Shkodra appreciate the issuing of municipality bonds by local government. The paper also examines the advantages of municipal bonds and the conditions that Shkodra Municipality must fulfil in order to begin issuing bonds.

**Key words:** Municipal bonds, Municipality of Shkodra, financing system

**Introduction**

A municipal bond is a bond issued by local government for the purpose of raising money for short-term needs and financing long-term infrastructure projects of the issuing municipality. Short-term bonds are usually used by an issuer to cover irregular cash flows and meet unanticipated deficits. Long-term projects can include: streets, highways, schools, bridges, hospitals, water systems, etc.

The two basic types of municipal bonds are:

- *General obligation bonds:* Principal and interest are warranted by the credit of the issuer and supported by either the issuer's unlimited or limited taxing power. In many cases, general obligation bonds are voter-approved.
- *Revenue bonds:* Principal and interest are supported by the revenue generated from a specific project. These revenues can be charges or rents from the facility built with the proceeds of the bond issue. Public projects financed by revenue bonds include roads, bridges, airports, water and sewage treatment facilities, hospitals and other long-term projects. Revenue bonds are only payable from specified revenues.

Urbanization increases the need of local government to attract public savings (James Leigland, 1999). Municipality of Shkodra uses the revenues generated from taxes and grants<sup>1</sup> to finance public projects. The local public administrations authorities have the legal right to raise their financial sources through public loans. During 2010, the sources of financing of Shkodra's Municipality were 55% from taxes and tariffs and 45% from grants. Total revenues were approximately 800 million lek, 466 million were from internal revenues and 334 million were from grants (Municipality of Shkodra, 2010 Budget). A major part of these revenues cover operative expense and the other part is used for capital investment. In response to the community needs, local financial sources have a decisive role in local development, an increase in financial sources accelerates local development. The municipal bonds issuing means an extra step to the local financial decentralisation and an opportunity to the local independence and their success, mostly on the principal market, give a lot of impulse to the local authorities (Moşteanu & Lăcătuş, 2008). The municipal bonds help local government to improve infrastructure of

city, decrease unemployment, stimulate savings, accelerate investments etc. Actually, Municipality of Shkodra doesn't issue municipal bonds as an alternative of financial source to improve its financial conditions.

Local governments in Albania have the right of fiscal autonomy to gather taxes and tariffs. They are allowed to obtain revenues and make expenditures related to the execution of their functions. They set taxes and fees in compliance with the legislation in force and interest of the community. Municipality of Shkodra derives revenues from local financial sources through local taxes, local fees and grants from central government. Local governments have the right to adopt and execute their budget.

The Albanian law for public loan for local government (law 9869, date 04.02.2008) allows the municipalities to increase their revenues by borrowing from community. The aim of the law is to increase the local autonomy through the regulation of borrowing of local governments units and creating the needed space for suitable regulations, ensuring a transparent process, in accordance with development policies.

The objectives of this paper are to analyse the role of municipal bonds as an important alternative for financing local projects, emphasize the advantages of municipal bonds, gather the opinion of a selected group of Shkodra's citizens about the option of municipal bonds issuing and evaluate the potential success of municipal bonds in the future. Our findings are based on a questionnaire conducted among citizens of Shkodra.

**Municipal Bonds-Advantages and Disadvantages**

There are a lot of advantages related to municipal bonds. The most important ones are mentioned below.

*Firstly*, municipal bonds provide relatively large amounts of funds to finance concrete long term projects (even development projects). Municipality of Shkodra, with the collected funds through these emissions, can finance enormous projects supporting city development. We can evidently see that a lot of things have been changed through these years but, there are also other things that can be essentially changed in the future.

*Secondly*, municipal bonds stimulate indirect participation of community in city development. Investing in these bonds gives the opportunity to everyone to be an indirect creditor

<sup>1</sup>Are funds disbursed from central government

for big and important projects for the city. In this way, every investor can be a potential participant in city development process. Social welfare reaches maximum, only if the public services are managed at the closer administration level to the citizen (Dascălu, 2006).

Thirdly, this way of financing engages non invested funds and use them in an effective manner with a minimum cost. Investing in these securitites gives the chance to the investors (public) to divesify their portfolios with an alternative low risk investment instrument. Municipality of Shkodra would give an appreciable contribution in increasing the number of financial instruments inside the albanian financial system.

Fourthly, municipal bonds emission increases the confidence of the taxpayers in funds administration because municipality is obligated to pay regularly the interest and nominal value of the bonds. In this way, Municipality of Shkodra increases the transparency and the responsibility for the usage of the funds that it has and also local taxes administration.

Fifthly, municipal bonds pay their interest twice a year and at the same time stimulate development of the secondary market.

There are also some disadvantages related to municipal bonds.

One real disadvantage of municipal bonds is that they carry relatively low interest rates compared to other types of securities and sometimes this is a reason why they aren't very attractive to the investors. Another disadvantage is that municipal bonds can be difficult to be converted into cash if the issuer is a smaller municipality because the securities market isn't developed.

Before starting to issue the municipal bonds the Municipality of Shkodra must achieve some pre-conditions like following: Firsty, be ensured for paying regularly the interest twice a year. It is essential and critical to be regular in interest payments in order to maintain the confidence of the investor. Later, at the maturity date the nominal value payment can be done through riinvestment again in municipal bonds.

Secondly, "increasing responsibility" in tax administration and the funds disbursed from central government in order to eliminate the cases with liquidity problems in interest paying.

In order to fulfil the conditions mentioned above, Municipality of Shkodra needs to look through the annual revenues that generates to conclude if it has disposal funds to pay the interest and to fulfil the obligation derived from the emission. In addition, the municipality must prepare a summary of funds that are needed to finance capital projects through bonds emissions and a project with all the future plans that can be realized for the next 3-5 years.

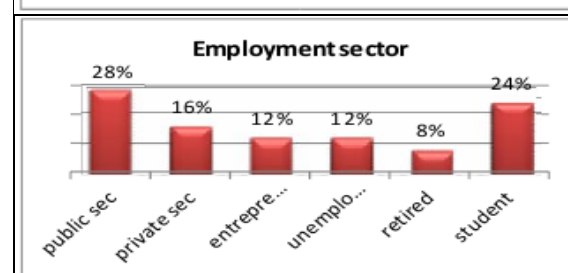
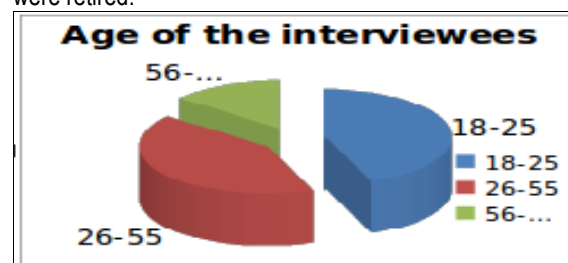
### Questionnaire Analyses

We have conducted a questionnaire among the citizens of Shkodra during the period March-April 2011. The sample number was 50 and it was a random choice.

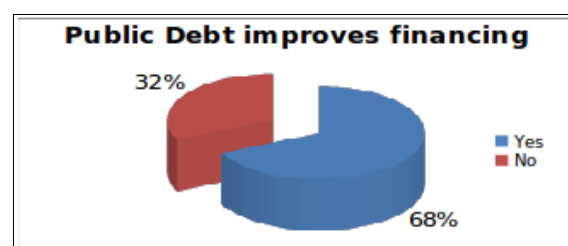
44% of people that took part in this questionnaire were 18-25 years old from which 54.6% were students, 22.7% were employees in the private sector 22.7% were unemployed.

42% were 26-55 years old. From these, 62% were employees of the public sector, 33% were either employees of the private sector or entrepreneurs and 5% were unemployed.<sup>2</sup>

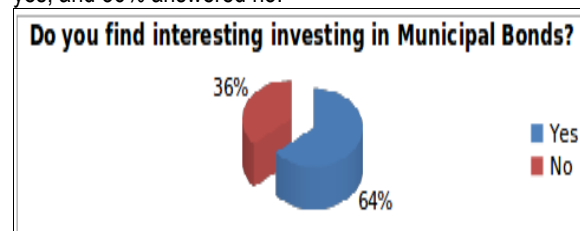
14% were more than 55 years old. From these, 14% were employees of the public sector, 28.5% were either employees of the private sector or entrepreneurs and 57.5% were retired.



68% agreed that public debt would improve the financing in the Municipality of Shkodra, and 32% did not.

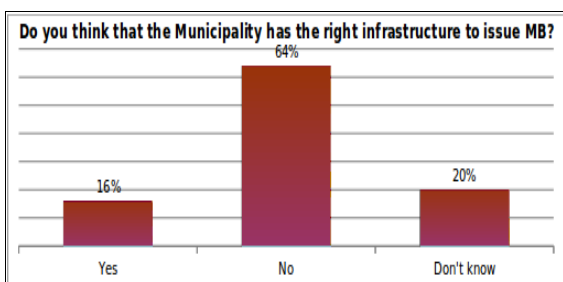


Concerning the question whether the citizens find interesting investing in Municipality Bonds, 64% answered yes, and 36% answered no.



Even though most of the people think that investing in Municipal Bonds is interesting, 64 percent think that Shkodra Municipality still lacks the right infrastructure to issue such a security. 20 percent answered that they did not know, and only 16 percent believe that the Municipality has the right infrastructure.

<sup>2</sup> Some figures are rounded up.

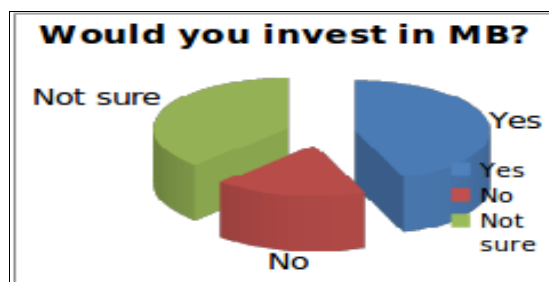


Some of the reasons that people think that the Municipality has still not issued any Municipal Bonds are lack of experience, staff or infrastructure on one side and lack of financial culture and information among the public on the other side. Some people also emphasizes even the fact that Shkodra citizens are poor.

The main advantages (ranking from the most important) of issuing Municipal Bonds are a (1) a mean of making people invest their savings, (2) an increase of financing source which is a good alternative for regional economic development, (3) an increase of financing source which will lead to a better infrastructure of the city, (4) indirect public involvement in the city development, (5) a financing source of low cost.

Despite the advantages that the people are aware of Municipal Bonds, they are still skeptic in such investment opportunity, where 44 percent would invest and the rest would not or are not sure of. At first glance, that looks a good percentage, but if we go further with our analyses, we would see that 45.5 percent of this 44 are of a young age (18-25 years old) which means that they are not potential investors as they are mostly students or have just started a job. This means that they do not have enough savings for such investments. Therefore, of the 44 percent that would invest in Municipal bonds, only 22 percent of the interviewees are potential investors (excluding here even those that are in retirement).

But this is not discouraging as the young investors nowadays would be potential investors in ten years from now, which means that in a near future there will be enough market for Municipal Bonds.



We ended our questionnaire with an open question on how the citizens believed that the municipal bonds would influence the financing sources of the municipality and effect the city development. The results were as expected that all of them answered that the financing sources would increase, thus the municipality would increase the public investments. This would result in an unemployment decrease, better infrastructure, city development etc.

### Conclusions

1. Municipal Bonds emissions would improve financing system and public investments.
2. Municipal bonds would help to stimulate public savings, increase public-private cooperation and responsibility of funds administration on the side of municipality, improve infrastructure projects and develop securities market.
3. In a near future, investing in municipal bonds will be preferable for investors and will be enough market for them. Investors think to use these securities to diversify their portfolios.
4. Lack of the right infrastructure, responsibility and well-prepared staff to issue such a security, asymmetric information, Shkodra's citizens low standart of living are some reasons why Municipality of Shkodra hasn't yet started emission of bonds (according to the public opinion).

### Recommendations

Municipality of Shkodra must:

1. considerate the municipal bonds as a potential alternative to increase the financial sources and to collect public saving with low cost.
2. provide the right infrastructure and staff to start emission of municipal bonds.
3. inform the citizens about the advantages and disadvantages of these investment alternative.

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