

“DECENTRALIZATION AND REVENUES ISSUES IN ALBANIAN LOCAL GOVERNANCE”

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Abstract:

The decentralization process has been and yet is the most contested one even nowadays, independently from the political consensus performance shown until now. This is not a simple issue it is deeper and more complex. Albanian case is very interesting to be studied especially in the context of amendments done to the law of Local Government in the aspect of assuring proper revenues by local government to better meet the needs and please the citizens. The following study tries to give an overview of the decentralization process in revenues context in order to conclude with some recommendation on a better and more productive decentralization process. Through an overview of the amendments on the law of Local taxes it is come u with the idea that these amendments will have a negative impact on the Local Government Unit budget.

Key words: Fiscal Decentralization, Taxability Politics, Budgetary system

JEL classification: H71, H72, H73, H74, H75, H76

1. The territorial organization of Local Government:

Referring to the law of Local Government since October 2000, the Albanian Local Government can be divided as:

First level: The basic units of local government are communes and municipalities, which are considered its first level. They have the same public responsibility and possess the same types of authorities/competencies. The only difference comes from the fact that they act respectively in rural and urban areas. The organs municipalities/communes are representative authorities and executive authorities. The representative authority of commune/municipality is the Council of Commune/Municipality and the executive authority is the Mayor/Head of Commune.

- **Commune**, represent a territorial-administrative unit and community, settled as a rule in rural areas and in specific cases in urban areas. Territory, name and center of commune are determined by law. Subdivisions of commune are called villages and in some special cases they are called towns. Council of Commune determines every subdivision's territory. Head of the commune and the council of Commune members are elected by voters.

- **Municipality**, represent a territorial-administrative unit and community in urban area and in specific cases in rural areas. Divisions of municipality in urban areas are quarters. Territory and name of municipality are determined by law No 8653. Head of the Municipality and the council of municipality members are elected by voters.

Actually, the organization and functioning of Tirana Municipality (capital city) is based on a special law, which defines the division of Tirana in 11 sub-municipal units, whose Mayors and councils are elected directly by the peoples vote. The structuring of these units is the same as that of municipality - Unit Council and Unit head. All these units are under the authority of Mayor of Tirana.

The second level: Region

Region is the second level unit of Local Government. It represents a territorial-administrative unit compound from some communes and municipalities with geographic, traditional, economic, social ties and joint interests. The borders of region fit with the borders of communes and municipalities that compound it. The representative organ

of region is the Council of Region that is created with the representatives from elected organs of communes and municipalities in proportion of inhabitants' number, but in any case at least one representative. Mayor and heads of communes are always member of council of region. The other members are appointed from each municipal/communal council among the counselors. The head of the region is called the Prefect and is appointed by Central Government.

Mayors of larger municipalities, in particular, are unwilling to accept regional guidance, or intermediation in their dialogue with the central authorities, since they are usually capable of gathering a large enough audience of their own. In addition, central and line ministers are accustomed to operating locally under the old paradigm of de-concentrated services in the territory and seemingly prefer to continue doing so. Although Albania is a small country (about the size of the state of Maryland and with only about 3 million inhabitants), based on the law on "Territorial-administrative division of local government units in Republic of Albania" No.8653, dated 31.7.2000, defines all the regions, municipalities and communes in Republic of Albania in a specific format. According to the same law the total number of regions in Albania is 12, districts (sub-division of region) 36, municipalities 65 and communes 309. This entails a situation in which 48 percent of these self-governing units, representing 17 percent of the country's population, are made up of communities of less than 5,000 inhabitants—or 54 percent and 30 percent, respectively, in the case of the communes. As with many other European countries in transition, this fragmentation raises concerns that go beyond economic efficiency arguments (e.g., economies of scale and externality spillovers) to include considerations of a political and an administrative nature. On the one hand, fragmentation means that the decision-makers are closer to the voters, which increases democratic representation, and, depending on the design of the decentralization of powers and incentives may increase fiduciary and political accountability. On the other hand, excessive fragmentation tends to leave the smaller communities short of the administrative and technical capacities necessary to implement policies effectively and

operate public services efficiently—an argument which runs against decentralization.

2. An overview of the revenue structure of Local Government in Albania

From year to year, it is noticed that due to the decentralization reform the local government, is financially strengthened in terms of assuring more funds through an increased numbers of the financial instruments (new taxes, funds allocated by the Central Government (CG), lending instruments etc.) as well as due to the increasing authorities and powers to manage its own revenues.

Nevertheless the local finances are still moderate. In the total of the consolidated budget they make up for only 11% of it or 3.14% of the gross domestic product (compared to 28.5% of the GDP which is the entire state budget) (data of 2009). There are two main sources of revenues for Local Government Unit:

2.1 Own source revenues:

Most notable when reviewing the revenue trends for the period 2000-2009 is the poor performance of local taxes and tariffs. The local units, in compliance with the law on the local tax system, are entitled to apply different taxes defined by this law as well as impose through the local councils' tariffs on the public services they provide. According to the law, the local tax system consists of:

• Local taxes on the small business (since 2007, this tax was transferred completely under the administration of Local Governments Units)(LGU)

- Property tax
- Hotel tax
- Tax on new buildings' impact on infrastructure
- Taxes on the ownership title transfer on real estate
- Tax on the annual vehicle registration
- Tax on the use of public spaces
- Tax on billboards
- Temporary taxes
- Tariff of cleaning and dumping
- Tariff of transportation
- Advertising tariff
- Parking tariff ect

Regarding all these taxes, the law on the local tax system provides their indicative level, while the local units are entitled to impose a tax under or above this level within a defined interval above the basic tax rate (in the case of the small business tax, property tax, etc.). For other temporary taxes, the local units are free to decide the type, tax base, and tax rate. At the moment, the largest source of local tax revenue is the small business tax with revenue over 3 billion Lek for all small businesses throughout the country.

Table 1. LGU's Own Source Revenues, by Year

LGU Budget and Consolidated Budget

Source: Ministry of Finances, Albania

<i>In mln. Leke</i>	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total revenue of State budget	130,642	145,639	154,595	167,224	184,355	204,163	229,444	251,555	291,238	334,82
Total of Local Government own revenues	1,316	2,038	2,676	7,923	9,613	12,019	11,112	9,366	11,307	18,412
<i>Tax on property and land</i>	190	-	-	597	1,057	1,227	1,287	1,336	1,586	3,734
<i>Tax on property (buildings)</i>	190			597	760	897	920	942	1,112	3,734
<i>Tax on agricultural land</i>					298	330	367	394	474	
<i>Tax on small business</i>				2,944	4,060	3,793	2,626	2,232	2,584	3,564
<i>Tax on annual vehicle registration</i>				509	561	573	539	623	655	
<i>Other local taxes</i>	1,126	2,038	2,676	3,873	3,935	6,425	6,660	5,963	7,429	11,114

Generally speaking, the local units apply tariffs on services such as cleaning, landscaping, street lighting, potable water, parking, occupation of public spaces, for the provision of administrative and social services, etc. Attempts have been made to raise the tariff level mainly in the large LGUs in order to reduce the gap between public service costs and the associated revenue. Nevertheless, LGUs still unable fully cover their costs. The poor performance in collecting tariffs stems mainly among families as there are few enforcement measures. In general, the local units (as in the case of certain other local taxes – the property tax and vehicle registration tax) make use of other institutions to play the role of tax agents. As payment, these other institutions retain a percentage of the

revenues collected. This explains the case of the building tax which started to be collected only granting the local units the right to collect the small business tax⁴ thus making it possible for the LGUs to make use of the tax audit for small businesses to collect that tax as well, whereas for families, this tax is enforcement by withholding administrative services that these units provide (primarily through refusal to provide certificates, but with the issuing of identity cards, this enforcement measure will be less effective). leaning, landscaping, potable water, and street lighting constitute the largest source of these tariffs, whereas the type of other tariffs depends on the type of public service provided (e.g. administrative services, cultural activities, educational activities, etc.) as well as on

the type of tariffs the LGU applies. It is worth mentioning that by law, the LG has authority to determine the type and level of local tariffs.

2.2 Transfers from the Central Government

on behalf of the local government units are in the form of unconditional grants (based on a distribution formula and possibly a competitive grant for investment projects) and conditional grants to perform the functions delegated by the CG. In order for the local units to execute larger investment projects than their capacities, out of the unconditional grants (composed of their own revenues from taxes and tariffs and other non-fiscal revenues as well as the unconditional central government transfer) in 2006 there was applied for the first time the competing grant (as part of the unconditional transfer). By means of this grant, the local units may apply for investment projects at a CG technical committee. During 2006-2009 the total competitive grant for the LGUs is 13.9 billion Lek. The competitive grant allocated annually has increased significantly; in 2009 it is almost double the amount allocated in the first year (in 2006 it was 2.2 billion Lek and in 2009 it is 5.5 billion Lek). This scheme generally gives a positive impact to the finance possibilities of the LGUs but we have notice some problems related the implementation of the competitive grant scheme such as:

- The competitive grant criteria for accessing funds are very general and create confusion for the evaluation committee members

- Equal criteria for all LGUs create limits for those poor and incapable ones to prepare qualified proposals
- Delay on the funds allocation from the CG during the fiscal year

- Very high political level representatives at the evaluation committee (deputy ministers from MoF; Mol and other line ministries). Although it was initially applied at an amount of 3.4 billion lekë it was quite doubled in the second year of this formula. In the meantime, for the year 2009, the competing grant covers almost 30% of the unconditioned transfer or 15% of the local budgets. The main question is: Have the the LGUs sufficient funds to afford the functions provided by law and whether these funds are efficiently used to carry out the services for the community?

First of all let refer to an analyze of the local budgets as it relates to the state budget. Actually it is very difficult to answer this question as the local units collect funds in various forms (taxes and tariffs; other revenues from the activities and services they provide); funds from the central government (conditional and unconditional) etc., as well as from managing institutions that differ by nature. LGUs would respond that they do not have adequate resources, whereas CG representatives believe there are adequate resources. If we consider the fact that intergovernmental relations that accompany the funds transfer from one level to the other result in political debates of this process, then it becomes more difficult to find an answer to the question.

Table 2. The LG own revenues and central government transfer
Local Government Revenues

In mln. Lekë	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Own Source Revenues (tax and tariffs)	1,316	2,038	2,676	7,923	9,613	12,019	11,112	9,366	11,307	18,412
From the Unconditional transfer:										
Grand	3,643	4,870	9,500	6,300	6,277	7,300	11,700	10,725	12,331	12,923
Competitive Grant							3,414	6,263	3,888	5,500
From the conditional Transfer	31,428	30,791	26,111	29,882	31,542	33,317				
Total revenues to the LG	36,387	37,699	38,287	44,105	47,432	52,635	26,226	26,355	27,526	36,835
Unconditional Revenues	4,959	6,908	12,176	14,223	15,890	19,319	26,226	26,355	27,526	36,835
Unconditional Revenues as % of GDP	0.95	1.18	1.96	2.05	2.12	2.37	2.94	2.68	2.52	3.14
Unconditional Revenues as % of state budget	3.80	4.74	7.88	8.51	8.62	9.46	11.43	10.48	9.45	11.00

Source: Ministry of Finances, Albania

2.3 Other sources of revenues

2.3.1 Immovable Properties

The efficient utilization of the local unit property is important as through the property these units may (i) reform certain functions granted by law regarding the execution of administrative responsibilities; (ii) better manage the assets by better planning the administrative organization of the LGUs, supporting the business and (iii) generate revenues for the local budget. The first step to enable the implementation of this new financial mechanism is the finalization of the process of transferring and registering of these public properties; and then their classification according to the needs of the LGU to carry out the public services it should provide by law. If the assets, being a considerable resource of revenues as well as an instrument for local economic development, are used effectively, they

may contribute in decreasing budget expenses and increase the revenues while improving the quality and quantity of the services provided to the local community. After identifying the excessive assets, they are analyzed in order to the related decision of how to consider them in the future (e.g. improving their conditions, lending or selling them, implementing PPP / Concessionary etc.) These decisions are taken only after considering the needs for the service provision by the LGUs and the future needs; population trends and the financial needs for different projects. The asset evaluation should take into consideration the evaluation of its physical status, the economic value (according to the market) and the operational needs for its maintaining. In this moment, the local units passively make use of their properties (they lend public building spaces) and the

revenues from this source are very small (as they do not fill any considerable share in their budget). Out of ten municipalities studies (Lezhe, Shkoder, Grash, Fier, Korce ect), the revenues from property selling or lending are covered different percentages ranging from 1.5% of its own revenues in the municipality of Fier; 3.5% in Lezhë and over 20% in Gramsh. An innovation that is boldly being implemented in the decisions for a more efficient management of the local assets of the LGUs in Albania, despite the fact that there is no finalized example so far, is the forging of agreements of public private partnership or concessionaries.

2.3.2 Loan from Financial Market

Since February 2008, the local government units may make use of a new financial instrument that of a loan from the financial market to be used for covering their financial needs for their exclusive or delegated functions. The law on "Local Government Borrowing" is another step in the financial decentralization process which dramatically increases the LGU financial capacities in order to implement investment projects, which cannot be executed through the annual budget of these units.

Even though this is a new law, sometimes labeled as "enterprising" for the actual capacities of the LGU necessary for its implementation, the law is considered as rigid and is considered as one that would not hamper the administration of local finances. Whereas due to the legal limits of the debt, the needs of the LGUs will not be satisfied for the implementation of larger investment projects. Although it is considered to be conservative for the reasons listed above, this new financial instrument compared to the present structure of the local unit budget, translated in money terms, might be considered as an important financial instrument. Although this instrument is available to the local government units in Albania from one year and a half now, to date, only one municipality has taken the initiative to enter this market. The municipality of Fushe Kruja managed to sign on June 4 of this year, the agreement of the first commercial loan received by a local government unit. This delay/hesitation to access funds from the financial markets comes as a result of lack of information of the interested stakeholders on this new opportunity; lack of confidence by local government units in their financial capacity to repay the loan; and in addition lack of confidence by financial institutions and banks to enter this segment of the lending market (lending to local Government units).

What still remains to improve is the capacity building of technical staff of LGUs to submit successful applications to

financial institutions and banks, which from the only previous experience has resulted to be a difficult challenge. This means inclusion by local government units of a wide group of specialists; application of participatory methods while making the decision to take a loan by involving the local community and other groups of interest; pre selection of the investment project; taking of all the necessary approval by competent authorities; completion of an assessment of the financial capacities of the local government; negotiations with the banks etc.

3. Legal framework of Local Taxes and Tariff system

Initially, the local taxes were defined in the law of the tax system of the Republic of Albania. In 1992 this law comprised a short list of 5 local taxes. In 2002, there was drafted a specific law on local taxes "On the System of Local Taxes", which clearly divided the national taxes from the local taxes while serving as regulatory for the local taxes and tariffs and procedures; the fiscal agents and the respective exclusions for all local taxes and tariffs.

This law marked a milestone in the strengthening of the financial competences and capacities of the local government. It also increased the level of discretion of the decision-making authorities (local councils) in determining the tax level (from +/-20% to +/-30% for the small business tax and the immovable property tax, while revoking the provision for the other local taxes). In the same year, there came another tax under the LG authority, the small business tax which was administered by the CG and was transferred through the Ministry of Finances to the LG according to the situation of its collection.

In 2006 the law on the system of local taxes was revised again, and the LG gets the small business tax with its two components (the small business local tax and the simplified profit tax). The second component (the simplified profit tax) was an additional source of revenues for the local units because this component, which initially was integrated in the Law on the revenue tax, went totally in the central government budget Based on the recent adjustments to the law on local tax system (April 2009), the total of the below taxes cannot be more than 110% of the indicative level of the small business tax: the small business tax, the tax on the occupation of public spaces, the tax on the advertisement, the hotel tax, the temporary tax and all tariffs (including the cleaning, landscaping, street lighting, and licensing tax). Apart from this, there are reduced the allowed intervals regarding the Immoveable Property Tax and the Small Business Tax. The below table renders a summary of these amendment.

Table 3. Summary of approved adjustments in the Local Tax System

Issue	Existing Law	Approved amendment
Small Business Tax	The LGUs may change the tax level by +/-30%	The LGUs may change the tax level by +10/-30%
Immovable property tax	The LGUs may change the tax level by +/-30%	The LGUs may change the tax level by +10/-30%
Other taxes	The LGUs may change the tax on the occupation of public spaces by +/-30%	The change must not exceed the level of +10% of the indicative level of the small business tax, calculated on the total amount of the tax on the occupation of public spaces and other applicable taxes and tariffs.
Temporary taxes	When necessary, the LGUs might approve temporary taxes	The sum of temporary taxes together with the applicable taxes and tariffs, should not exceed the level of +10% of indicative level of small business tax.
The local tariffs and their administration		The sum of applicable tariffs should in no case exceed the level of 10% of the indicative level of small business tax

As it appears from the table, all recent interventions in the law in question have brought about important adjustments in the level of taxes and tariffs.

What we think on the impact of these amendments done to the law is that they will have a negative impact, such as:

- Considerably reducing the LGU budget estimated to become 10-40% less
- Devaluing the successful decentralization reforms implemented in the recent years due to the elimination fiscal autonomy
- Considerably reducing the available funds for local investments
- Negatively affecting the capital investment plans and the LGUs' ability to implement strategic plans.
- Making it impossible for the covering of the costs through the service tariffs due to the elimination of the link between tariffs and service provision costs
- Reducing the borrowing capacity of the LGUs
- Hampering the precise determination of the individual local tax in the management process
- Reducing the revenues of the municipalities and communes would negatively affect the budget

Conclusions

Throughout the decentralization period the local government units (LGUs) have been going through the important process of restructuring and transformation in several important sectors. The target of this process is to provide the LGUs with sufficient resources and capacities to perform the functions they are responsible for.

The three main pillars of decentralization are: institutional, fiscal, and administrative. These three pillars are equally important in this process but what shows the tangible strengthening of the LGUs is the full performance of the

local competences (provided by law for local authorities) and the financial strengthening of these units.

Regarding the financial strengthening of the local units, the decentralization process has enabled the establishment and implementation, by means of a formula, of a generally consolidated distribution of unconditional transfers from the Central Government to the LGUs; the transfer of public assets to LGUs; unification of the budgeting process through the central institutions; the preparation of mid-term budgets (beginning in 2009); the establishment of new local finance instruments which enable LGUs to access the financial and banking markets, etc. A new tool of assuring revenues is the immovable revenue. It is important to point out that the evaluation and utilization of local public assets should be transparent and open to the community in order to maximize their efficiency while providing the fundamental services the LGU might offer and to increase their quality, in compliance with the market prices. The law on "Local Government Borrowing" is another step in the financial decentralization process which dramatically increases the LGU financial capacities in order to implement investment projects, which cannot be executed through the annual budget of these units. Each level of government should have its own source of tax revenues distinct from the sources at other levels. Where local government has its own tax base distinct from those of higher levels of government, local residents and firms can see clearly the local programs that their taxes finance and have a real sense of the cost of these programs. The implementations of well thought methodologies not only improve the performance of the public services, but also increase the income. Nevertheless, the corruption level goes in the contrary of the decentralization process.

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