

THE CHALLENGE OF FISCAL DECENTRALIZATION AND EVALUATION OF AUTONOMY INDICATORS IN ALBANIA

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Abstract

Fiscal Decentralization is a key problem nowadays. Fiscal Decentralization means devolution of the power and responsibilities of national (central), government towards sub-national (local) governments. And this policy (decentralization) is introduced for an offset problem that has caused dissatisfaction with the current centralized system of governance. This paper tries to have a look on the decentralization process theoretically first, and then to find indicators adaptable for Albania. The focus is on the theory of fiscal decentralization, analyzing the pros and cons of this difficult process, and an evaluation of this process in Albania. This paper also sets up some hypotheses for the revenue and the expenditure autonomy, considering its scale in relation to political factors or other factors associated.

Keywords: fiscal decentralization, expenditure autonomy, revenue autonomy, local governance.

1. Introduction

According to Dabla-Norris [4], the term sound fiscal decentralization refers to the impact of decentralization in macroeconomic stability, while the term efficient decentralization refers to the extent it enhances macroeconomic efficiency in public goods delivery input and output. An efficient system is in accordance also with the paramount of clarity, transparency, stability and well defined rules of accountability.

On the revenue side this involves the authority of sub national government to impose at least one significant tax rate and to own - finance locally provided services at the margin. Autonomy should be well defined and explicit and also circumscribed with

respect to borrowing by sub national authorities. But the borrowing of local government requires a certain balance of market rules, discipline, control, and supervision¹. Summing up: supporting institutions, democratic representation, sound budget process (efficiency and democratic), collection capacity of revenues and accordance between levels of governance are crucial for the economies, and especially for the transition countries, concluding to macroeconomic efficiency and growth, vice

¹ In the absence of discipline and sound problems of borrowing it is evident the risk to the macroeconomic stability, especially where are not well defined as borrowing from central government, as it was the case of Brazil, Argentina and India.

versa will have a lack on this variable. Fiscal Decentralization may have high impact in economy especially in macroeconomic performance and management. Prud'homme [13], Tanzi [17] talk about the aggravation that fiscal decentralization has in the fiscal imbalances, except the cases where the second tier of governance has a high discipline and takes care about management of expenditure as well of the deficits. So the first opinions, empirical ones shown from these authors, were those of the adverse link between the fiscal decentralization and the macroeconomic imbalances. So the general idea, also according to Fornasari et al [11] is that an increase of deficits in the sub national level of governance will lead to an increase in the deficits in the central level. But of course this was just the first edge of the literature. There are other opinions showing the positive link existing in the fiscal decentralization process and inflation or deficits.

2. A measure of autonomy

2.1 Institutions of fiscal decentralization

The first base of a democratic fiscal decentralization is election of the representatives of the sub national levels of any kinds. This is a normal practice for quite all countries. Lack of democracy may lead to responsiveness of officials and problems between defining local preferences and central policies that in many cases are politically orientated, which is a source of corruption.

International experience has shown efficient multi-tier governments need the presence and cooperation between different levels of governance, transparency, comprehensive exchanges of information and vice versa assistance.

For sure in almost all countries there is this lack of cooperation between line ministries and local units associated with unrealistic regulations, proliferation unfunded mandates, ineffective supervision and weak supports.

Another role in this context is the tax administration; in many countries this process is carried out by a central agency that collects taxes for all levels. Sub national levels do not have their own tax administration. Even in this case we have a double cooperation in the sense of supervision of the local official responsible for tax collection that are more interested in viability of their local enterprises (provide employment, tax base), rather than ensuring that federal taxes get paid. In addition these officials may press tax administrators to employ more resources to the collection rather than to low yield these taxes may merit.

2.2 Expenditure autonomy

Having in mind the sound and efficient decentralization, we have to consider as relevant in this context even the expenditure side. According to OECD [12] in some of the transition countries of the sample taken into consideration, there has been restrictive

expenditure autonomy. For example, only 10 per cent of local expenditure in Bulgaria was in control from local authorities, and 5-10 per cent was in control from local authorities in Albania. This is something that seems to be contradicted with the cases of Hungary, Poland, Estonia, Latvia and Czech Republic where, local authorities have a larger area of expenditure assignment given by law, and associated with a high flexibility of service delivery, ways and modes depending on the requirements². Also there are local governments that are free to decide even for the quality and quantity of service or good delivered even for specific sectors like education, welfare and environment³. Another element of lack of autonomy is even setting of wages. For example in Armenia and Kazakhstan the wages fund for the local government employees, combined with dependence in deficits from central government, lack of control and management has eroded accountability and fiscal discipline. According to Ebel and Yilmaz [7] this area remains one of the constraints of the expenditure autonomy for quite all countries, even for the advanced reformers.

Still, nowadays the first problem that the sample of countries has faced since the beginning of transition, is shifting down

² In Latvia for example, the local authorities has no control in the service delivery.

³ Things that seems to be a little bit contradictive with some of the South East Europe countries where such sectors are mainly in the constitute of the central government, especially the education.

subsidies and social services to local level. With the intervention of central government, these local units have to cope⁴ with their own revenues such services and goods, which lead to constraint of budget for these local units. Another indicator to measure such expenditure side is the setting of local spending level and priorities. There is a high level of such determination in Hungary, Czech Republic, Poland and Moldova, while in Albania, Kyrgyz Republic, Bulgaria and Moldova this portion is determined by the central government.

2.3 Revenue Autonomy

On the side of the revenue, imposing of tax rate and basis remains one of the main challenges and difficulties for local government in general.

The low level of revenue autonomy reflects directly the weak administrative capacity, political constraint, and also low (or no significant) control over the tax rate, base, in one word the revenue control of local government. The problem of revenue autonomy is narrowed not only on the tax rate, but even in the tax base. Very important in the context of revenue autonomy side are the tax-sharing arrangements, which in quite all transition countries is more than 50 per cent.

2.4 Transfers

⁴ Bulgaria has to cope 50 per cent for the social welfare payment

The transfer in Eastern Europe and Baltic's generally is like an equalization transfer system, while in Czech Republic is more like formula-based features in tax sharing, anyway leading to problems with transparency and stability [21]. The problems stays not only on the side of the formula-based features, but also in the equalization grants, like weakness in goal achieving for gap reducing. Beside of the problems associated in the last one, the tendency has been toward the use of such equalization grants, while the volume is either small or counts for a small share of total transfers (like Russia that has equalization transfers 1.1 per cent of GDP).

The main common problem in this context for all the countries of the sample, especially for the South East Europe, is the allocation of transfers associated with uneven subjective and subject of long delays.

2.5 Sub national Borrowing

The borrowing of local unit includes borrowing from: central government, national/sub-national financial institutions and from domestic or international financial markets with the help of bonds or Eurobonds. In the sample some of the countries are not even allowed to borrow abroad like FYR of Macedonia, Russia and Kazakhstan.

In countries with relatively undeveloped financial markets, the type of borrowing is that from the central government (Belarus, Bulgaria, Moldova and all central Asian countries). While in Rumania and Albania

for example the market for municipal debt is underdeveloped because of the lack of worthiness, moral hazard [21]

Meanwhile there were cases where these kinds of loans faced a risk to the macroeconomic stability. This is the case of Russia with the promissory notes which have been disallowed since 1997.

A number of countries have nowadays gained the access to the domestic and international markets such as Czech Republic, Hungary, Poland, Russia, Ukraine and Estonia, but anyway forcing and having attention on market discipline for the ex post affects.

3. Pro and cons of Fiscal decentralization

3.1 Main Pro of fiscal decentralization in economy

When we talk about fiscal decentralization, we should have in mind all sides, its positive and negative impacts in the economy in general. It is not just the macroeconomic view of the impacts in the stability in economy, but also in micro level. According to Shah [14,15,16] vital is also the governance near to people and vice versa that is one of the democratic pillars of decentralization for the higher quality and quantity of services and goods delivered in the economy. Another aspect is the efficiency of public sector. Here the discussion is opened and in our opinion will remain always open because of non specified field of services offered locally and of a good definition of efficiency and problems of

measuring it. There are authors like Bird and Vaillancourt [2] that see as a chain the efficiency, like if we have efficiency in services offered by local governments than this will lead to efficiency even for central government for the goods it offers and not overloading of her capacity. Also another aspect is the mobilization of revenues and expenditure that also measures the degree of the local autonomy. Bahl and Vazques [1] propose these as a solution even for incentive from local governments to collect more rigidly tax revenues, and with an additional reason the revenues and with a well defined expenditure will have a high mobilization of both parameters. One of the sensitive topics in this area is of course the distribution of goods in the community. Having in mind the contribution and influence of community and the mobilization of revenues, than the problem of the distribution of goods will be easier. Since the whole economy is a chain, if all the first steps are well done as a consequence we will have a higher local development that may lead to a general development.

3.2 Main Cons of fiscal decentralization in economy

One of the main negative effects as mentioned before is in macroeconomic balances and growth consequently. In addition to this, to be mentioned is also the attention that the whole governance should pay to the dependency of local debt to the public one. Generally high local debt brings

high central debt and a high dependency of local to central.

Also according to Dabla Norris [4] with the including of local elites in public resources, more power to local governance will lead to opportunities of corruption and as consequence misuse of general funds. Also another aspect that will help us get a better view of decentralization is the power assigned to local governments and the kind of misinterpretation that they can do to it, especially with the tax assignment. According to Ebel Yilmaz [7] local capacity in tax collection is generally low, bringing to a reduce effectiveness especially in the case where local officials of collecting taxes are selective in the collection. This due to the interest of these officials in vitality of the local enterprises (for example as the main taxpayers) rather than the payment of the tax. Local officials are closer to the community and so might have a high responsibility in tax collection and so more vigilant to the affects in the economic agents.

4. Measuring Albanian Autonomy

4.1 Institutionally

Institutionally and legally, Albania has made a lot of progress especially having in mind that she has signed the European Charter for Local Government units and also laws that promoting such autonomy.

Important is also to emphasize that Albania has a Multi Year Strategy for Local government units since 2007. Besides the legal side, one of the main unclear or not well

defined institutions, is the Council of Regions . This council is not elected by the citizens, in a democratic way.

4.2 Expenditure Autonomy in Albania

The main problem of the Albanian expenditure autonomy is that the major portion of the local budget is spending for wages, even though they have a significant voice in the budget. When we talk of the expenditure autonomy we should ask if we as a local unit have the right to spend the money according to the local needs and community or not. Obviously the remaining part of the money is not sufficient and before February 2009 the local budget should have been clarified before the expenditure. As the figure 1 shows the local expenditure of Albania is too low compared to the developing

countries average and also Hungary, the representative of the advanced reformers mentioned before. The difference is too high, about nine times, so the difference is less compared with the difference of the revenues. Anyway the problem consisting here is the function, not the delegated one, but the own function of the local government in Albania. For the shared functions according to Duka [5] the decentralization process is not clear or is at the starting point. Even here in the expenditure side the tendency is good, with high rate of increasing, but anyway there is not a lot to do with such low pool of money, since the local unit does not have sufficient money and so cannot number the priorities of the expenditure.

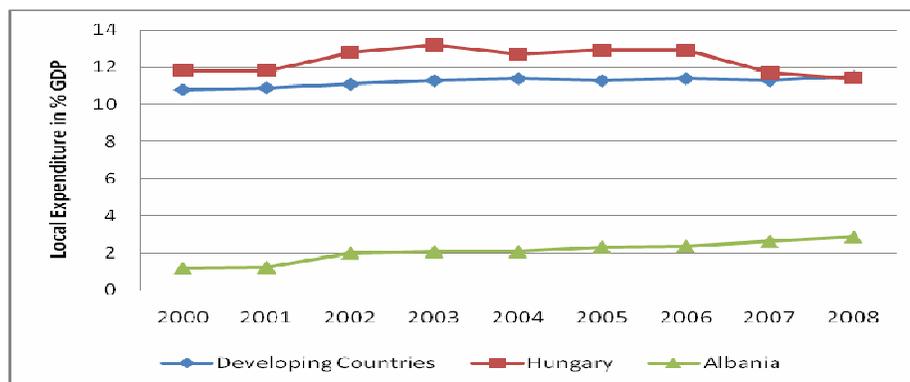


Figure 1. Development over time of Local expenditure in % of GDP

Source: Eurostat (2008), Ministry of Finance Albania (2008) *Note:* the expression developing countries here in this paper means EU (27) countries, or the advanced reformers part of the Western European reformers [8]

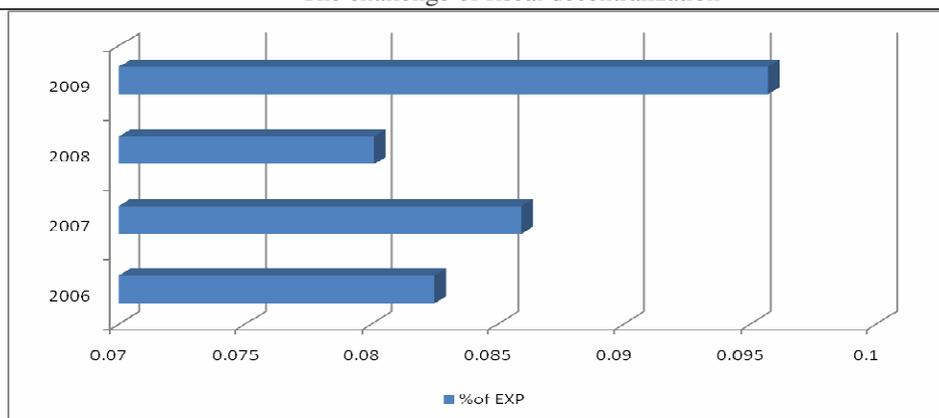


Figure 2. Local expenditure to Total Expenditure in Albania

Source: Ministry of Finance (2009) [10]

One of the nowadays concerns is the use of the local budget for purposes not mentioned as priority, for example for political issues. Let consider the expenditure in detail during the years 2004-2009.

As we see from the graph number 2 the year 2007⁵ has an increase in its expenditure, also according to level of covering of expenditure in the same year the rate has decreased, and consequently it needed high transfer from state, means high dependency. In this context we may see that local expenditure is politically derived. But what concerned mostly us is the year 2009, is such a sudden increase, without any specific reason. During this year, there is no increase of social aid or other services delegated to people, but hypotheses are that either our local government is driven from a central political orientation, or the country is just

facing the effects of financial crises? Anyway such a doubt remains waiting to be clarified.

4.3 Revenue autonomy

To measure the revenue autonomy, we may use a lot of indicators. The main ones are those of: Legal Explanation, Development over time of the revenues, Local Revenue to Total one and also comparison with developing countries with a high degree of decentralization. Parallelizing with former approach of Dabla-Norris [5], we will try to analyze legally and then on more practice side what is the type of revenue autonomy.

First of all the right to change the tax rate it is not in the hands of the local unit, but to the council of region in collaboration to the central government. What local government can do is to set rate of local fees, but till now not significant taxes. Anyway to be mentioned is a progress in this context, the shift of small business tax to the local

⁵ Election for municipality

governance, but this as a share tax. Besides this tendency, what is important it is not just the shift of a tax, even for authority collection but the support such action has to gather. Recently there is by law another tax to be collected by local government, that of the small business taxes, but apparently produces too much difficulty for local governments, especially because of non training staff and suddenly being unprepared from this transfer of this tax to the sub national levels.

According to the practice side of the autonomy we will try to analyze the degree of the autonomy of Albania compared to the developing countries, the advanced reformers. Since some of those are now in European Union it is wise to take an average of all those country taken from the sample of the advanced reformers.

As we see from the figure 3 the selected countries are developing countries, the European countries, or the advanced reformers as explained even in Dabla-Norris [5]. The more important think to distinguish in this graph is the difference between the lines that shows the big difference of the revenues of local government. Respectively the difference is around nine time higher in Developing countries, Hungary compared with Albania, this due to the inherited fiscal background from the side of Albania and also the speed in the advanced reformers from the side of EU countries, especially Hungary that has higher local government revenues compared to the average of EU. Summing up

all these we may conclude that this figures can be inputted as one of the main revenue autonomy indicators. The higher the scale of local revenues in % of GDP the higher the degree of autonomy. So comparing these two things we may realize this lack in autonomy for Albania. Besides the appearance of the figures we may also see that the trend of local revenues is positive for Albania, so there is a tendency of increasing these revenues, especially with the new shifts of taxes (Small Business tax), compared to EU or Hungary, where the tendency is constant or decreasing. (Decreasing budget, decreasing tax base due to financial crises, Lawrence [9]). So there is a good path, progressive one for Albania, but anyway should be associated with additional steps.

4.4 Transfers in Albania

Albania uses a formula for the transfer of money from central to local government. The idea of this formula is to provide equity, according to some major indicators that distinguish the local units by each other. Since 2002 now local government receive unconditional transfers, so without being asked and conditioned for the use of this money.

According to Ministry of Finance (2009) and having a look to the revenues and expenditure in local governments, the change is not a surprise and so even the transfer are quite most the same, with small differences during the years.

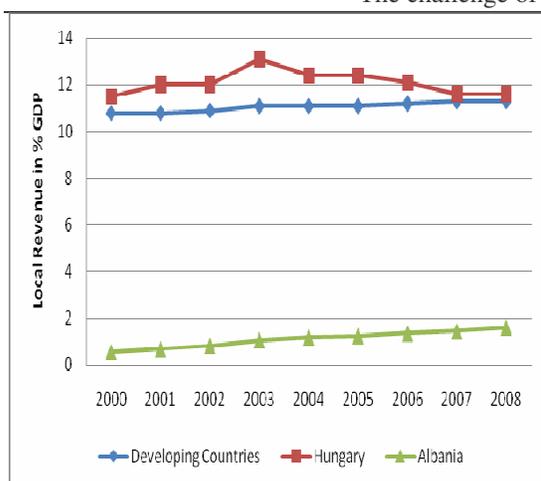


Figure 3. Development over time of Local Government Revenue in % of GDP

Source: Eurostat (2008), Ministry of Finance Albania (2008) *Note:* the expression developing countries here in this paper means EU (27) countries, or the advanced reformers part of the Western European reformers. [8] [10]

A very positive step of Albania is that she now pays attention to the fiscal capacity of each municipality. According to the idea that big municipality need more funds than smaller one, having nowadays a more transparent and predictable system.

4.5 Local Borrowing in Albania

There has been full 2 years till now that Albania has a law on Borrowing for local governments, Law no. 9869 dated 4 February, 2008. The intention of this law was to provide de jure and de facto autonomy in the field of the financial markets. Beside of this progress, and such autonomy that for the first time it seems like too much, anyway it bullets an oversight of Ministry of Finance

for all local units that takes loan. This law permits the municipality to take loan in private financial markets for cash flow needs and for investments purposes. This means just for capital investment, long run (more than one year).

The first pioneer proving the borrowing was the municipality of Fushë Kruja on June 2009, for capital projects in infrastructure.

Beside of the law and of practicing it there is a lot to be done in this context especially due to the problem of the aptitude of sub national levels to pursue the borrowing procedures and over sighting. Also another problem in this context is the updating of the fiscal decentralization and the shifting of function from central government to local one. Doing this, sometimes the central government may even shift the burden of a loan to local government.

5. Effects and Problems of Decentralization in Albania

Fiscal decentralization especially in Albania will have its impact in the regional, local development. If we take a look to the figures of Ministry of Finance (2008) of Local Development will see the highest decentralized cities are the most developed, and the one with high initiatives economically like Tirana and Durrës)

Also another aspect is the Positive Correlation of FD with General Development [1]. Having these as an assumption and adding the Brahimi [3] overview of phases in Albania, can bring as to a promising result

(unproved) that might have a general development, part of it from Fiscal Decentralization.

Also according to the functions that local government has, we might even consider the importance that these local units have in day life of the individual, from the micro point of view. Local government in Albania has the function of delivering the social, assistance aid to persons that legally can profit from it. Social assistance is the largest single category to local government expenditure [3]. If we consider these as an important voice, and concentrate funds in it, definitely according also to Von Braun and Grote [20] decentralization may serve to this category of individuals and in this context to the local poor.

There are a lot of problems, faced by the local government here in Albania, but we would like to emphasize the most urgent ones belong the others.

The vital changing in the population, changes that determine the flow of revenues and redefining the needs of the population. For example let's compare large local units with small one, Tirana versus Kukës. According to Veliu [19] the same power given and distributed by the law is used in different manner, where large communes has high power, rather than the small one where's power is insignificant, sometime even nonexistent. The same can be said over the professionalism of local administrates and the system of local politics parties. For example in Tirana is obvious the autonomy

that local units has to contradict decision that they think is politically driven. (Mini Municipality no. 10). Having in mind such migration from the small units to the large one, this has created a large range of public services offered from the larger one compared to the others size units.

Training of the officials is another fundamental element emphasized especially in recent years from the small business tax experience, where officials were unprepared additional task, and where they didn't have assistance on how to do this. Not only temporary support, but even long-term training of these employees.

Weak Accountability, transparency [19] and other principle of local governance, but anyway will not be the focus of this paper the supervision and the evaluation of this kind of mechanism.

6. Conclusion

There is no unique design of having fiscal decentralization for all countries in general. The design of each countries of this optimal decentralization is detained on geographical, demographic, institutional factors, as also on transparency, accountability, predictability and efficiency and sound decentralization process.

At least we can agree about the key of this process that is an adequate level of services assigned to local government units and also a sustainable and constant system.

For Albania, the progress of fiscal decentralization is high but anyway the

difference with developing countries is almost nine times higher for revenues and expenditure autonomy. The figures of the revenue autonomy show a good path for Albania autonomy in the fiscal decentralization process, but anyway she has a lot of things to do. The sifting of one tax, or function increase the revenue autonomy, but anyway if it is not done in the appropriate way it may harm the local governance. For this thing and also for the expenditure problem central government should undertake searches, training and additional supports for the local government units.

Besides the good path, Albania still faces major problems that need to be supported by central government.

Also, important for Albania is not only the issues of the revenue and expenditure, but the problem of borrowing and transfer, too. Albania now has the first pioneer in this field, associated with a lot of over sighting.

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