

AN ANALYSIS OF THE FISCAL ADMINISTRATIVE- TERRITORIAL DECENTRALIZATION REFORM IMPACT IN ALBANIA

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Abstract: *In the age of economic globalization, the need for independence in important economic decisions individually and collectively is evident. Decentralization and fiscal decentralization are trends for political and economic reform in recent decades around the world. Albania began the process of transition from a centralized economy to a free economy in the early 1990s. Numerous reforms followed this process in almost all sectors. This process is accompanied by transforming existing economic mechanisms and infrastructure to better function the free-markets model, but above all, with the need to develop and create new legal, institutional, economic, and social instruments and spaces to increase the allocation and efficiency of public and private resources. The latest reform in terms of decentralization is the Territorial Administrative reform of 2014. We try to answer the research question through this study: What has been the impact of decentralization reforms on the local government's public services' performance? The research methodology used is a descriptive analysis of data obtained from the Ministry of Finance and Economic and local municipalities on the reforms' impact. Data analysis shows that some improvements and progress has been made in advancing decentralization reform, but there are still many challenges ahead, such as the lack of a clear legal and regulatory framework. Adding to that concern is local governments' financial autonomy, which remains a challenge for the future.*

Keywords: *fiscal decentralization, local government unit, Territorial Administrative Reform, public expenses*

JEL Classification: *H50, H71, H72*

Introduction

Decentralization can be defined as the transfer of responsibilities for planning, leadership, fundraising, and their allocation from national governments and their agencies to lower government levels, closer to the population's needs (The World Bank Group). Throughout the second half of the last century, and in the new century, reforms have been

oriented towards the democratization of world societies, having as a guide primarily human rights and the need for these rights to be implemented worldwide as guarantors of well-being and equality. At the beginning of this century, the "Developed Economies" or some of the most developed countries agreed on a package of reforms and measures called the "Millennium Development Goals," with the main focus on reducing world poverty by 2015. Although indirectly decentralization is at the center of these reforms because it was evident that if governments want to meet the poor's needs, they need to get as close as possible to both individually and collectively economic decision-making with this population. In the last two decades, several countries in the world have implemented fiscal and political decentralization reforms. Different authors show the effect of decentralization in their studies. Garman et al. (2001) analyzed decentralization in developing countries. More than 80% of the seventy-five countries surveyed have experienced some decentralization by the beginning of 2000. The situation is similar in industrialized countries. In our days, these countries have progressed with decentralization reforms. In many of them, it has also been possible to study the impact of these reforms. Indeed the impact has not been symmetrical in terms of the diversity of economic cultures themselves. There are several forms and degrees of decentralization globally, which have begun to receive full and incomplete benefits from decentralization reform after a decade.

Albania is considered a country in transition. The years of transition were accompanied by the rapid rise of local and government financial systems in Eastern and Central European countries. Nevertheless, fiscal decentralization reforms were also undertaken in some developed countries—the reforms aimed to reduce governance inefficiency and ineffectiveness, macroeconomic instability, and low economic growth. Transitional nations have implemented economic systems reforms through the 1990s, focusing on free trade, improving the business environment, and the "business climate." The main focus is on developing the private sector, as previously in these countries, this sector is virtually non-existent. Numerous reforms in this sector accompany the first years of implementing a free-market economy. However, an essential factor in fostering further economic development in these countries is the public sector. During the transitional years, efforts are made to redefine the public sector's role and exceed their outcomes. An essential element of these improvements is the introduction of decentralized policies for government activities. A common characteristic of almost all transitional economies originated from a highly centralized public finance system, with local governments having the primary role of administrative units with slight fiscal responsibility and independence. Although these countries initially had comparable economic systems and political functions, they chose very different paths and approached decentralization.

In terms of implementation and progress of reforms, countries in transition are divided into three categories (European Bank for Reconstruction and Development. Transition Report. 2006):

- Progressive reformers - fast and efficient progress (Czech Republic, Poland, Hungary, Estonia, Lithuania, and Latvia).
- The intermediate reformers have completed a good part of the reforms but slower than the first group. (Albania, Bulgaria, Romania, Ukraine, Moldova, Kazakhstan, and the Kyrgyz Republic).
- Moderate reformers are countries such as Armenia, Azerbaijan, Belarus, Georgia, Tajikistan, Turkmenistan, Uzbekistan, which have been unsuccessful in launching

fiscal organizations, controlling fiscal disproportions, and redefining the role of the state.

The article aims to provide an overview of fiscal decentralization theories, analyze Albania's progress and current fiscal decentralization situation over the years, and assess whether the administrative-territorial reform impacts and further improves the fiscal decentralization process. Some of the research questions in the paper are:

- What are the progress over the years and the current situation of fiscal decentralization in Albania?
- Will the administrative-territorial reform affect the further improvement of the fiscal decentralization process?
- What is the effect of the Covid 19 pandemic on local revenue collections?

Decentralization process in Albania

For about half a century, Albania had a very centralized government. In 1992 the country's first democratic elections are held and took the first steps towards political decentralization. Despite the importance of this initial political movement towards increasing democratic representation, local administrative and fiscal autonomy remained very weak. However, the decentralization process received a second impetus from the late 1990s. The reforms of 1992 set the stage for creating local democratic authorities; however, the nineties' decentralization process received a second impetus. In the period 1990-2000, the most critical decisions regarding providing services to the 3.0 million inhabitants are mainly offered by the central government, which has a significant incidence throughout the state toward its own deconcentrated institutions in all 36 regions supervised by 12 prefectures. During 1998-2000, the country formally ratified the European Charter of Local Self-Government, embodied its core principles in the new Constitution, and adopted legal reforms for local self-government. These years mark the second crucial moment, creating the framework for full administrative and fiscal decentralization. These documents identify as one of the main objectives of decentralization reforms in Albania, the need for Local Government Units to deliver on their functions once performed under the central government's umbrella.

According to Albania's laws as a unitary country, the formal adoption of local self-government principles consolidated the political decision for a centralized governance structure. New organic laws "On the organization and functioning of local government" (Law no. 8652 dated 31.07.2000) and "On the administrative-territorial division of local government units in the Republic of Albania" (Law no. 8653 dated 31.07.2000) marked the end of the previous District Councils, thus reducing the direct political influence of the state on the activities of local government. It was clear that this created a stable legal framework that would enable decentralized administrative and fiscal structures, including self-governing counties, municipalities, and communes. The formal approval of the principles of local self-government consolidated the political decision for a decentralized governance structure. Adopting the local government's organization and functioning laws reduces the state's direct political influence on local government activities. It creates a stable legal framework that would enable reorganized administrative and fiscal systems to function and autonomous counties, towns, and communes.

Since 2000, critical institutional amendments and regulations are made:

- the adoption of the National Decentralization Strategy for Local Decentralization and Autonomy;
- allocation of a few notable vital roles to local authorities (including some second-hand services passed to counties);
- creating a mechanism-based of a formula on how to allocate grants unconditionally (which partially replaces conditional, targeted transfers); and
- adopting an essential fiscal reform package in 2002 (including domestic small business tax, a more basic income tax, property tax, and variations to the tax and fee system) that extend local governments' fiscal autonomy. At the same time, the legislature is adopted regarding local borrowing and local budgeting systems.

So we can say that there is a complete legal framework, which makes the legal, fiscal decentralization, and government budgetary relations within a clear framework. In 2014, the Albanian government initiated the Territorial Administrative Reform (RAT), one of its main reforms, and creates the premises for reforming local government and deepening decentralization in the country. The reform generates a new territorial map, reducing the number of first-tier local government units by six times, from 373 municipalities and communes to just 61 municipalities and 12 counties (2nd tier of local self-government). The concept of rural communes was abolished. The new reform was implemented approaching the E.U. legislation. The main criterion that guided the Administrative-Territorial Reform is the concept of "functional areas," which must generate income, create space for commercial development, and a dense economic, institutional, social and cultural interaction between residents. Public Financial Management Strategy 2014-2020 and the Cross-cutting Strategy for Decentralization and Local Government 2015-2020 are the primary public finance reform documents at the local level.

The average population of 1st tier local governments in SEE is over 19,000 and, compared to the E.U. 28 average of 5,100, seems to be very favorable (other things being equal) for decentralization efforts. At the district level, the population ranges from the lowest level of 61,423 in Gjirokastra district to the highest level of 895,160 inhabitants of Tirana county. To continue decentralization effectiveness are designed and adopted into law the following legislations: (i) 'Intersectoral Strategy for Decentralization and Local Government 2015-2020' and an action strategy for its application; (ii) Law nr. 139/2015 'On Local Self-Government,' which, in addition to standard functions exclusively transfers to local municipalities several new functions; (iii) Law nr. 68/2017 'On Local Government Finance,' which was followed by the law nr. 106/2017 'On Some Amendments and Additions' to the Law nr. 9632, date 30.10.2006, 'On the Local Tax System.' The Small Business Tax is finally eliminated between 2014 and 2015. The central government applied the new tax reform in 2016. The new reform abolished the simplified income tax expense for small businesses with annual revenue up to 5 million ALL (€ 40,000). There was an estimation that the companies' number benefitting from the new reform fiscal variations (whose profit tax will be zero) would be at around 85,300. Dropping these businesses' fiscal burdens will enlarge their funds and consequently improve the country's economic growth. The government has recently granted tax exemptions to particular companies' categories without necessarily compensating local governments for this revenue loss.

Even though the past year has been done considerable progress in creating efficient institutions that will enable a fairer implementation of decentralization policies, Albania is

still far from finalizing the political, administrative, and fiscal decentralization overall picture. More decentralization could agreeably bring to an increase in service delivery quality, governance, and responsibility. In terms of the basic legal framework, all necessary for this process's successful continuation is sanctioned by defining the game's rules or better intergovernmental fiscal relations. For example, the share of local expenditures in total government expenditures, a standard unit of decentralization, is, on average, 25 % of the total in transition countries, with variations from 15 % in Albania and Macedonia to over 50 % in Russia and Kazakhstan (Wetzel and Dunn 2001).

Literature review

Increasing fiscal decentralization is an essential tool for better democratic and autonomous representation in policymaking actions while increasing government institutions' responsibilities and transparency. In other Balkan countries, the tendency for preeminent autonomy to govern locally is determined by the necessity for national consistency and the eccentric force's appearance due to ethnic and regional problems or internal conflicts. Decentralization is the process where some of the central government powers are transferred to local institutions. Decentralization comes in two primary forms: democratic decentralization (also called political decentralization or devolution), which involves transfers of power to elected local authorities, and deconcentration (also known as administrative decentralization), which involves transfers of power to regional offices of central government agencies, such as to appointed district officers or local offices of line ministries (Ribot 2004). Different countries implemented different decentralization types, with various characteristics, political consequences, and circumstances to be effective and productive. If local governments and private organizations effectively succeed in decentralized functions, this will bring sufficient revenues (locally realized or transferred from central government) and authority to make spending decisions.

The theoretical and empirical literature based on the relationship between decentralization and government efficiency is divided into two broad groups:

- Classical theory. The classical theory of fiscal decentralization refers to three main elements: economic efficiency, macroeconomic stability, and income distribution (Musgrave 1959, Oates 1972). Among some of the most important models is the Tiebout (1956) model, which emphasizes the lack of a political solution and that competition through local governments influences competitive taxes and public goods. The providing of taxes, public goods, and services by the local government units will affect citizens' mobility and preferences for their place of residence local, and the public services will be offered at an efficient level. Musgrave 1959 emphasizes that central governments are responsible for macroeconomic stability and revenue distribution, while local governments should focus on public good distribution efficiency in their jurisdictions. Oates (1972), thru the decentralization theorem, saw the government as a benevolent agent, and the theorem depends on the essential assumptions where governments must act in such a way as to make the best use of social welfare and in the event of centralization, there be an even delivery of public goods this does te lead to increased citizen welfare. Brennan and Buchanan (1980) made an essential contribution to the public election perspective of fiscal federalism. In the "Strong Restriction Hypothesis" proposed by Brennan and Buchanan (1980), budgetary decentralization promotes economic growth. This hypothesis ascertains

the fact that governments behave as revenue maximizers to the detriment of taxpayers. According to this theory, central administrations do not capitalize on social welfare and act as monopolists to controller the economy's possessions. However, decentralization is not an automatic remedy. Prud'homme (1995) estimates that fiscal decentralization can turn into both adverse and dangerous effects as excessive decentralization makes it impossible for governments to ensure macroeconomic stability and revenue distribution, especially in times of crisis when financial resources are insufficient. Different authors have pursued the deviation of funds in decentralized situations (Reinikka and Svensson 2004), although other studies have advised the local elite's capture fears (Bardhan and Mookherjee 2000).

• Second generation theory. The classical theory evolved along with fiscal federalism's theory into the second-generation theory (Oates, 2005). In this second-generation literature, the fiscal decentralization impact represents the political actions and the opportunity of unequal information through political representatives. Unlike in classical theories, governments are supposed to maximize their unbiased functions, which does not mean maximizing social welfare (Porcelli, 2009). Porcelli (2009) states that fiscal decentralization is defined as the decentralization of expenditures when local governments take responsibility for implementing expenditure funds. Essentially, the community (citizens) are the managers, while officials are the representatives, and the existence of asymmetric information is the primary motivation why government performs ineffectively. Kinka (2017) estimates that macroeconomic stability could be weaker if the local government can borrow in the market and does not have the necessary resources to repay it. The consequences are an increase in the country's debt and the destabilization of the economy. Nevertheless, the negative impact of decentralization on macroeconomic stabilization can be reduced if there are constraints on local government structures in borrowing in private capital markets. International Monetary Fund and a few authors (e.g., Tanzi 1995, Prud'homme 1995) have advised regarding decentralized administrations' macro risks, but other authors (McLure 1995, Sewell 1996) have underestimated these affirmations, even with no empirical justification. The government can serve as a regulator and increase efficiency in redistributing revenues through their transition from rich to more impoverished regions. The efficiency of decentralization increases when the central government distributes wealth by preventing inequality in its territories. Essential elements in revenue redistribution are the calculation process and policy solution. Another vital component is the existence and implementation of the legal and institutional framework in transition countries.

There is a branch of the growing second-generation literature, the theory of "public choice," recognized as market preserving federalism, emphasizes government executives' stimuli to not deviate from reasonable conduct. They highlight the decentralization role used to dominate an intrusive, extensive public sector and support critical private markets (Weingast 1995, McKinnon 1997). Kardar (2006) show that fiscal decentralization effectiveness depends on a) appropriate spending assignments - with the division of roles between government various levels depending upon their comparative advantage; b) applicable tax or revenue projects; and c) the efficient design of a system of allocations and its proper implementation. In this way, decentralization leads to minimal vertical imbalances and shortens the distance between the recipients and suppliers of public goods and services.

Fiscal decentralization related to economic growth is a topic that is interesting for many economists. The motivation for fiscal decentralization to strengthen economic productivity may affect its dynamic setting (Oates 1993). Davoodi and Zou (1998) studied economic growth and fiscal decentralization connections, viewed as the subnational portion of total government expenditure, and claim that fiscal decentralization is related to slower economic successes. Different researchers acknowledge that fiscal decentralization directly affects economic growth (Feld et al. 2004 for Switzerland, Liu and Lin 2000, Qiao et al. 2008 for China, Gemmill et al. 2013 for OECD countries). Many studies from the 1990s show that fiscal decentralization has a positive effect only up to some optimal level, and these levels are different from country to country. Thiessen (2003) shows a positive relationship when fiscal decentralization increases from bottom levels, but it fluctuates and turns negative after peaking. Brueckner, 2006 stated that theoretically, a considerable fiscal autonomy is related to a higher output per unit of labor and higher growth rates. Some other authors assume a vice versa relation: economic development increases demand decentralization. Martinez (2001) shows that economic growth causes decentralization, but it seems that decentralization problems in developing countries are related to local governments' low-efficiency issues. Davoodi and Zou (1998), Wooler and Philips (1998) have found that there are adverse effects from fiscal decentralization on economic growth in developing countries, but meanwhile, these effects are positive in developed countries. The results negative or positive in most cross-country studies depended on the particular decentralization measure estimation method.

Albania is a country that has a relatively new democracy and aspires to become a member of the E.U., therefore strengthening local governance and democracy is an essential element to study. Muharremi (2020) states that significant financial autonomy or unconditional transfers in higher amounts to local government levels will increase the effectiveness in allocating and using funds and bring economic growth for the whole country. Kapidani (2015) shows that Albania's new reform has effectively provided proper planning for local economic development and decreased difficulties between administrative restrictions and the effect of adjacent local government units' services. Guga (2018), based on the analysis of three indicators for the fiscal decentralization effect in Albania, acknowledged that the territorial and administrative reform had not made the projected outcomes. Toska and Bejko (2018) found a lack of real vertical decentralization, high financial dependence on the central government, and a high inequality between municipalities. Their research showed that districts did not capitalize effectively on the informational advantages based on the top-down approach.

Data analysis

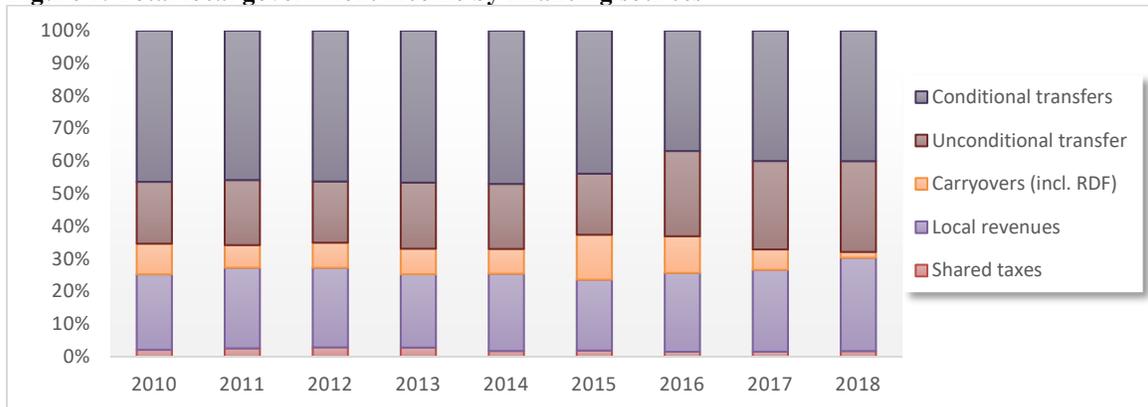
In this paper, we have used the data for the first tier local government units (municipalities), the Government Financial Information System (the Treasury System) at the Ministry of Finance and Economics, which have been processed then published www.financatvendore.al. The data are cumulative, and they are expressed in the domestic currency (ALL, Albanian Lek) and only refer to the 61 municipalities. The sources of financing the budget of the Municipalities in the analyzed years come from two sources:

- From its own source, including revenue from local taxes, fees, loans, and other sources, donations and inherited revenues; and shared taxes according to the provisions of Law No. 68/2017 "On local self-government finances";
- From central sources, unconditional and specific transfers for new functions, and carryovers from the previous year, including Regional Development Fund (RDF), and conditional transfers from line ministries for delegated functions.

In the last five years, the Albanian government has continued to operate several vital projects that have been conceived and implemented in cooperation with local government bodies and strategic international partners in continuation of the administrative-territorial division and fiscal decentralization as USAID. Chronologically, in September 2015, the application of a new formula for the allocation of unconditional transfer to local self-government units began. In April 2017, the Law on Local Self-Government Finance was adopted, a vital law for the successful progress of reforms as its implementation is expected to bring improvements in financial management at the local level and an increase in autonomy and fiscal discipline. In 2017 and 2018, regarding the taxation of real estate, the legal framework was improved, implementing a taxation system that is in line with the market value of properties, and a fiscal cadastre was created that operates as a unified local fiscal register. All these reforms and changes regarding the legal framework led to concrete results. Local government bodies have made numerous efforts to improve fiscal administration, and as a result, the available revenues directly controlled by the local government have increased steadily from year to year.

Figure 1 shows data regarding total local income from financing sources from 2010-2018. The administrative-territorial reform consolidated small local government units into more effective and broad organizations to improve access and increase public service quality. 2015 is the first year of a fully implemented territorial reform and gave the local level the right to new functions. In 2016 we had an increase of 25% compared to a year ago. The upward trend of local budgets has continued in 2017 and 2018 but at lower rates. The increase has been 7% in annual terms. The increase in local government revenues is mainly due to the increase in the unconditional transfer size - the primary funding source for the vast majority of local self-government units. Revenue from unconditional and specific transfers is a vital source for financing functions and exercising competencies by municipalities. Government data show that for 2019, the unconditional transfer is 42% higher than in 2015, as a result of legal changes related to Local Self-Government Finances law, which decided to link the size of the unconditional transfer with a variable macroeconomic (not less than 1% of Gross Domestic Product) in line with good international practice. The reform of the unconditional transfer and the beginning of the reform of the real estate tax has laid the foundations for a better system of intergovernmental finances, based on the principle of sufficiency and financial predictability, reducing the continuous downward volatility that has accompanied the unconditional transfer amounts in years.

Figure 1. Total local government income by financing sources



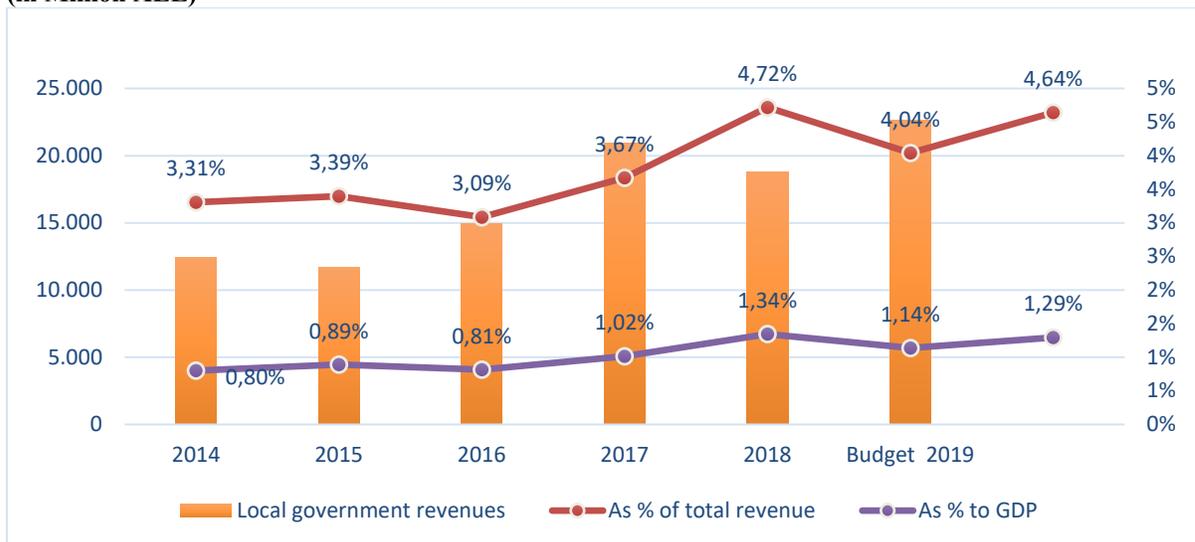
Source: <http://financatvendore.al/data/revenues>

Figure 2 shows that revenues collected from the local self-government units during 2015-2018 have an upward trend, reflecting the increase in weight these shares have on revenue as a percent of total resources of the state budget and revenue income overall GDP. There are revenue improvements for municipalities, especially after 2015, directly linked to increased local tax proceeds. Local taxes include:

Income from local taxes and fees such as infrastructure impact tax from new constructions, building taxes, hotel accommodation tax, land taxes, administrative fees, parking fees, and regional asset management income.

Revenues from local tariffs include yearly fees for waste collection and disposal services, Local fees for occupying public spaces, cleaning and hygiene fee, and local green tax.

Figure 2. The specific weight of Local Government Revenue to Central Government Revenue and GDP (in Million ALL)



Source: Directorate of Local Finance, Ministry of Finance and Economy

During 2018, all local self-government units have managed to collect fiscal revenues from local taxes and fees for 24.2 billion ALL, 3.9 billion ALL, or almost 19% higher than in 2017. In 2018, Local government fiscal revenues were 11.1 billion ALL

more or 85% higher than in 2015. The upward trend is a significant indicator of the effects of implementing the territorial administrative reform. It conveys the improvements in fiscal management processes at the local level. Although part of the increase in revenue may also be due to the increased number of fees that the taxpayer is required to pay, the central part of the rise comes from expanding the taxable base or increasing the number of taxpayers and more effective administrative procedures. Fees from building permits are an essential source of funding for municipalities. This fee's income is directly related to the demand for land development and new construction and tends to be very volatile from year to year. In 2018, approved applications and building permits were high, reaching ALL 6.9 billion (€ 56 million). Proceeds from this fee should go towards financing the public infrastructure needed to serve and integrate new development zones with the rest of the territory.

Table 1 shows data related to income from the local government units based on sources. The small business tax is a local tax that has been reformed more times than any other tax type on local government units. The tax reform implementation of 2016 reduced small business tax revenues by 71% compared to 2015, and in 2017 it was reduced by 51% compared to 2015. In 2018, revenues from this tax amounted to ALL 301 million (€ 247 million), with a slight increase of only 2% compared to the previous year. This income source's share for the local self-government units is currently insufficient and is considered a separate tax. The central government, after collecting its share, fully shares it with municipalities.

Table 1. Local government units income based on sources

		2013	2014	2015	2016	2017	2018	2019
	Income from Local Government	10,825	12,447	11,700	14,951	18,447	16,964	22,661
	The pace of change in local revenue		15%	-6%	28%	23%	-8%	34%
1	Property Tax (Buildings)	2,454	3,682	3,921	4,678	4,879	4,484	6,915
	The pace of change in property tax		50%	6%	19%	4%	-8%	54%
2	Small Business Tax	1,975	1,709	2,033	598	296	301	640
	The pace of small business tax change		-13%	19%	-71%	-51%	2%	112%
3	Local tax	6,396	7,056	5,746	9,675	13,273	12,178	15,106
	The pace of local task change		10%	-19%	68%	37%	-8%	24%

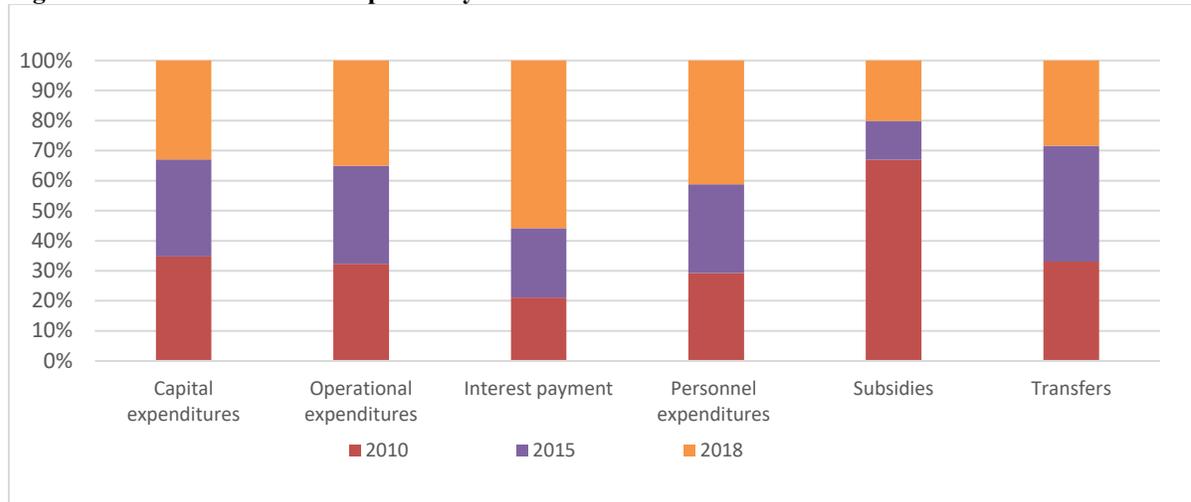
Source: Directorate of Local Finance, Ministry of Finance and Economy

It should be borne in mind that while the revenues that municipalities themselves collect from local taxes, fees, and assets have increased in these at the national level compared to the year, there are undoubtedly significant differences in individual municipalities' performance. The increase in revenue collection for some about two-thirds of the total municipalities has resulted from improvements in the collection and fiscal administration of real estate taxes and service fees and increased demand for new construction. 33% of municipalities have had difficulties in collecting local tax revenues. These results are due because there has been volatility in revenues collected from the Infrastructure impact tax on new construction, which is directly dependent on the issuance of permits and the demand for new construction.

Territorial and administrative reform was accompanied by an increase in new functions in the service of residents. However, with some minor changes such as fire departments or academic staff's appointment, other functions were previously offered by

municipalities and communes under law no. 8652 of 2000. Some of the new operations performed by municipalities after the reform are: i) social services; ii) rural road administration; iii) forest and pasture management; iv) management of the secondary and tertiary sewerage system for irrigation and drainage; v) fire rescue centers and vi) education for kindergarten educators and support staff for the pre-university system. There is still uncertainty about the dividing line of responsibilities between local and central government regarding some of these new functions.

Figure 3. Local Government Expenses by economic classification



Source: Directorate of Local Finance, Ministry of Finance and Economy

Expenditures of local government units in Albania, including investment funding from the Regional Development Fund, have been rising. Figure no. 3 shows the structure of domestic expenditures by economic nature. In 2018 capital investments amount to about 14.2 billion ALL (€ 116 million) or 29% of total internal expenses. The local government is continuously placing an increasing emphasis on investments to improve the municipalities' infrastructure. Operating expenses that are very important for local governments in providing daily services to its residents show a slight increase in 2018 compared to the previous year. Operating expenses account for about 29% of local government expenditure for 2018.

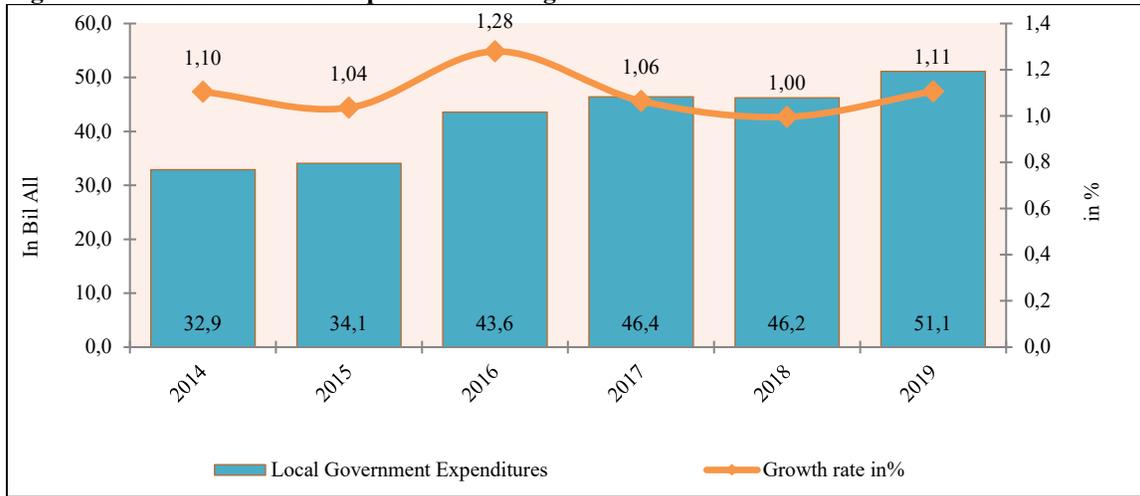
Municipal operating expenditure includes:

- Maintenance costs in public services (such as cleaning, maintenance of green areas, lighting, local road repairs, and constructions)
- Local public transportation
- Pre-university education and training as well as vocational education (dormitories),
- Administration salaries and payroll,
- Social Services (housing, social care, and solidarity)
- Culture, Art and Tourism,
- Sports Activities.

In almost all municipalities, road infrastructure programs have been established to construct, reconstruct, and maintain main roads, road segments, junctions, and residential

blocks' rehabilitation. All these aim to improve the community's conditions by improving the signage, the public lighting, and recreational environments.

Figure 4. Local Government expenditures and growth rate.



Source: Directorate of Local Finance, Ministry of Finance and Economy

Figure 4 shows that there is an upward trend since 2014 in terms of local government expenditures. Expenditures on wages, goods, and services have increased almost every year. The graph shows an increase to 51.1 Billion ALL in 2019 compared to 32.9 billion ALL in 2014. At the end of the first half of 2019, expenditures from 61 municipalities were 43.1 billion ALL, about 8.5% more than in the same period a year ago. Excluding expenses incurred with funds inherited from the previous year, the local expenditures were about 41.8 billion, about 22.2% more than the same period a year ago. During the years in analysis, the Albanian government had made many efforts to improve tax revenue to sustain public expenditure. Nevertheless, as the data shows, the tax-raising abilities were low due to the tax collection system and the large informal economy. In 2018 these expenditures reached about 20.6 billion ALL (€169 million) or 1.5 billion ALL (€ 12.3 million) more than in 2017. These higher levels of spending are inconsistent with the administrative and territorial reform objectives fulfilling the mission to mobilize and effectively use public financial resources, reducing administrative costs. Usually, the general public services require more than half of the local budget, and infrastructure and transportation need around 30%. About 5% of local government expenditure is for sports activities and operational expenses for institutions administrations (day centers, students dormitories, nursing homes, and orphanages).

Some activities, such as construction, rehabilitation, and maintenance of local roads, sidewalk parks, and local public squares, lighting systems are financed through local government spending itself, and in some cases, through conditional grants received in the competitive grant scheme. Irrigation and cleaning of drainage canals are financed by funds transfers from the Ministry of agriculture. Irrigation and drainage are among the main factors of sustainable growth of agricultural production in the country, but due to the continuous lack of investment, this sector is still in critical condition and after many investments made in previous years. Report on compliance of performance monitoring at the municipal level October 2019, has identified that in some cases municipalities

performance reporting lacks the format of classification of expenditures according to economic activities, and lacks financial information for investment projects: only 46% of Implementation Monitoring Reports of the Budget include the required financial information related to the realized or ongoing investment projects (Albanian Ministry of Finance and Economy Performance monitoring compliance report at the municipal level, October 2019). Lack of proper communication in this format limits the Local Self-Government Unit and community stakeholders' ability to identify where budget funds are being spent.

The local elections held in June 2019 and the natural disaster that affected 11 municipalities at the end of the year had great relevance for municipalities. The two earthquakes have contributed to a general slowdown of the overall economy and in the own-source revenues growth rate. Own source revenues, especially in the Durrës area, were directly affected by these events in some of its items such as hotel accommodation tax, taxes on immovable property, and local fees (for occupation and public spaces, service fees). Developments in 2019 for the considered municipalities did not have significantly impacted their own-source revenues in 2019 compared with 2018. At the end of 2019, the own-source revenues in nominal terms (local taxes and fees, asset activities, and others) were ALL 25.6 billion, which is a 5.5% increase in annual terms more than the previous year. However, the own-source revenue growth rate was moderate in 2019, compared to the growth rates over the last three years. Referring to the local finance report for the first half of 2020, the category of revenues from its local sources (such as taxes, fees) is an essential element for good and independent municipalities' governance, representing 26.7% of the total incomes. Compared to other categories, and even they have a lower weight, their local sources' revenues are highly sensitive to the local economy's shocks.

The year 2020 is associated with the overlap of the previous year's earthquakes' negative consequences and the COVID-19 pandemic onset. Municipalities faced a challenging and unprecedented situation, where the damage left by the earthquakes in many municipalities was compounded by the immediate effects of the health crisis caused by COVID-19. One of the measures taken to cope with the health crisis was the lockdown, which undoubtedly brought numerous adverse effects on the economy. In total, the financial resources available to municipalities marked an annual decline during the period under review. This decline was primarily determined by the adverse developments in the performance of revenues from their local resources, especially revenues from local taxes and fees. High vulnerability from earthquake shocks was, particularly in 11 municipalities. The earthquakes and COVID-19 pandemic presented reductions on revenues collected from Municipalities related to infrastructure impact tax, local tax, property tax, and cleaning fees. The decrease in revenues from their local sources by 23.8% was determined by the decline in local taxes and fees collections. Revenues in both of these categories turn out to have shortened by about 23.7% and 24.6%, respectively, in annual terms. It is estimated that the curbing of economic activity during the quarantine period (March-May 2020) and the difficulties businesses face, or rising unemployment influence businesses' deterioration and individuals' financial condition. The most affected sector by the COVID-19 pandemic was the tourism sector. At the level local, revenues from local taxes on hotel service activity marked a level of about 37.2 million ALL (the share of local tax revenues is about 0.5%), down by about 44.4% in annual terms. Contrary, the revenues from other local sources (such as asset management, fines, interest on arrears) marked a yearly

increase of about 7% and contributed positively to the performance of revenue from its own local sources. Conditional and unconditional intergovernmental transfers had a positive performance during the analyzed period. In declining financial resources, municipalities reduced expenditures in annual terms, mainly those for investments.

As the closest government units to the community, the municipalities were the first to meet the neediest's needs. The increase in unemployment from many businesses' closure makes the municipalities face difficulties and lack of funds to cope with this unprecedented situation. Municipalities faced difficulty in adapting processes to ensure the continuity of service delivery to citizens. The World Bank has projected that Albania and several other Balkan countries will face an economic downturn in 2021. So the dire situation and consequences of the pandemic that businesses and individuals face will have undesirable impacts on the local economy and trend. The revenue collection from the municipalities will continue in the coming years. This necessitates an immediate intervention to increase financial management care for municipalities to make them able to have the needed financial resources to continue offering local public services to their citizens in the upcoming future.

Discussion

Total local government financial resources recorded a value of 41.7 billion ALL at the end of the first half of 2020, down by about 3.1% compared to the same period in 2019. Specifically, revenues from own domestic sources marked a level of about 11.1 billion ALL, down by about 23.8% compared to the level recorded in the same period a year earlier). The narrowing of revenues to own local resources has occurred at about 72% of municipalities (or 44/61 municipalities) and fluctuates from -2% to -63.7%. There was an increase of funds transferred from the Ministry for Social Welfare of around 21.3% from the previous period. They were mainly conditional transfers for economic assistance and disability payments. There is a substantial increase in funds channeled at the local level through the Ministry of Finance and Economic, which transferred about 1.3 billion ALL, compared to about 308 million ALL in the same period a year ago. Whereas the Ministry of Education, Sports and Youth allocated at the local level about 690 million ALL in the first half of 2020 or about 768 million less than the same period last year. In the period March-July, schools were closed throughout the territory of Albania. Indicators of local fiscal autonomy increased in 2019 compared to previous years and in annual terms. The improvement of indicators such as the ratio of local revenues to total financial resources and the ratio of available resources to unlimited resources have been influenced by the expansion of incomes from own local resources and unconditional and sectoral transfers. Revenues from local sources in 2019 were 31.4% of the total financial resources of municipalities. There was a slight increase of 2.2% compared to the previous year or 5% above the long-term average. This increase was moderate compared to last year's. The municipality with the most considerable impact on the total categories of this income is Tirana's municipality. Revenues from local sources (local taxes and fees, asset activities, and others) were 25.6 billion, or an increase of 5.5% from a year ago. Growth factors are the increase in the level of local taxes and fees in some municipalities and improvements regarding the process of their collection after a part of them was collected using water supply as a tax agent. The data show that the indicators of revenues for local government

from its own local resources, available and total to GDP, after a performance with minimal fluctuations during the years 2010-2015, in the next three years until the end of 2018, had an upward trend. The ratio of revenues from its own sources to nominal GDP has increased from 0.9% in 2015 to 1.5% at the end of 2019. The increase happened mainly from the increase in the infrastructure impact tax rates of new constructions, mostly collected by the Municipality of Tirana. For 2018, local self-government units at the national level have collected their fiscal revenues (tax and non-tax) of 21.8 billion ALL, or almost 19 percent higher than the value of revenues collected during 2017. In 2015, the local government's fiscal revenues were 11.1 billion ALL.

These developments illustrate that the decentralization process, mainly in 2016, has had a substantial effect, causing local self-government units to collect more revenue. Seen in this light, the local government's increase in tax collection efficiency ensures a higher level of financial independence, indicating that a new financial management period has already begun for the local self-government units. Also, referring to these revenues' total, the upward trends are evident, where almost all the constituent items of local revenues are increasing, except for the small business tax. This significant increase in total local revenues refers mainly to the local self-government units' local taxes collected. All these positive developments create preconditions for improving the quality of local services.

All functions were transferred closer to the municipalities

- Within the first 2-3 years, there are significant improvements (excluding social service centers)
- Lack of minimum service standard in most services
- The irrigation and drainage system became operational after more than a decade
- Increase the coverage of the territory up to 30% with the fire protection and rescue service
- Increase of forest and pasture fund by 31%
- Improvement of rural public transport (interurban) due to the increase of 29% of transport lines and 67% of vehicles (only for the rural carrier)
- Increase the efficiency in the use of Municipalities budget.

The law "On the bill and the turnover monitoring system," or the law on Fiscalization, entered into force on January 1, 2020, and on September 1, 2020, has started implementation. According to legal provisions, a transitional period was left before implementing the new law to help businesses be informed and prepared on the obligations they must meet. Fiscalization and implementation of the new law have its primary goal to affect the increase of income and the excellent administration and reduce the informal economy.

Conclusions and recommendations

Martinez 2011, states the uncertainty to answer the many questions on the impact of fiscal decentralization, even with the additional research. However, decentralized systems' overall effect is positive and optimistic, mainly when they are well administrated. Different reports and data demonstrated that the framework of a new territorial organization adopted in 2014 had given progress to decentralization. European Union reports state that "substantial efforts are needed to increase local government units' administrative capacity." From February 2014 is implemented a new civil service law. The

2016 E.U. report has positively evaluated the recent reforms' implementation, considering them a critical priority for its integration. Among the most important measures is the adoption and rigorous implementation of the law on local self-government finances and building tax reform to establish unique structures and create a fiscal cadaster. Analyzing the revenues for the past few years, the decentralization process since 2016 and onwards has had a significant effect in allowing local self-government units to collect more money. Comparing this to neighboring countries, local governments in Albania collect less per capita income from local taxes and tariffs than their counterparts. Increasing the efficiency of local government tax collection makes it possible to ensure a higher financial independence level, indicating that a new financial management period has already begun. All constituent items of local income are increasing except for the small business tax. This significant increase in general revenue mainly refers to the gain resulting from local taxes collected by the municipalities. All these positive developments also create the preconditions for improving the quality of local services such as improving rural public transport, improving the irrigation and drainage system, and increasing forests and pastures.

Local government units have had insufficient funding for years. This lack of financing and territorial-administrative fragmentation make it challenging to provide services in line with their residents' needs and expectations. Recent legal changes transfer many of the spending competencies and functions to local units, but the financial resources for their support are still limited. Some services, such as education, health, and social protection, are almost entirely covered through public spending and local government contributions. The provincial government expenditure budget's primary account is around 50% for general public services and about 30% for road infrastructure and transport services. Although recent years show progress and success in improving the regulatory framework, expanding the tax base requires further steps to consolidate local government finances. It is vital that reforms are implemented and that improvements are made to the performance, will, or choices that local government units make regarding the administration of local taxes and tariffs and the public assets they own. There are many differences and inequalities in municipalities' financial capacity, which condition the provision of (quality) local public services and bring a lack of resources in dealing with the consequences of natural disasters (such as the earthquakes of September and November 2019, the pandemic of COVID-19). One of the positive effects of the reform is reducing the administrative and operative expenditures to a considerable level.

The new reform abolished many municipalities and communes, which brings to a decrease in salary payments for positions such as mayors or vice mayors of districts, executives of municipal councils, and commune councils. On the other side, it will be a more centered organization for some other administrative functions such as lawyers, supervisors, engineers, and tax collectors on the newly created entities, which means higher operative expenditures. Overall, new entities' new processes and procedures will increase administration productivity, well-trained staff, and better citizens' services. Reducing administration roles and positions in these new large units will lead to cost savings and monetary revenue to invest in other areas. There are a few complaints from some abolished communes regarding the lack and impossibility to receive services such as economic aid, inspection, and rehabilitation of the territory from big municipalities due to the considerable distance from them.

To increase the local government performance, we recommend:

- Increase the information exchange with the central tax administration units and other central government agencies, the National Business Registration Center, Agency for Legalization of Urban Construction Zones, Agency for Property Restitution and Compensation, National Civil Registry
- Improvement in public expenditure budgeting at the local level to increase the effectiveness and economical use of available public funds
- Increase and improve local taxpayers' information systems regarding their obligations, the payment deadlines, particularly the implementation and maintenance of tax collection information system and local tariffs and digitalization of public administration.
- Improve the skills of the staff that deals with the administration of local funds and taxes on an ongoing basis, management skills as well as institutional and technical capacities, to administer funds properly
- Expand the taxable base, increasing the number of taxpayers, and reduction of evasion elements and informal system

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