EUROPEAN ACADEMIC RESEARCH, VOL. I, ISSUE 8/ NOVEMBER 2013
ISSN 2286-4822, www.euacademic.org
IMPACT FACTOR: 0.485 (GIF)
DRJI VALUE: 5.9 (B+)

Decentralization and Financial Revenues of Local Government Units in Albania

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Abstract:

For over a decade the local government units in Albania are facing a series of complex issues related to the functions they have to carry and their financial capacities versus needs. Over the past 20 years, Albania has made significant progress on decentralization. There were adopted several important documents and legislation. Yet challenges to advancing the decentralization process and strengthening local governance remain. One of the most tormenting issues is their capacity to collect revenues and afford the increasing community needs. Particularly important is the dimension of fiscal decentralization and ensuring that local governments have a predictable and equitable financial basis.

Aim of the paper *– to give an idea of local government financial capacities and trend of the decentralization and challenges in Albania.*

Expected result *– is to give guidance into the actual context of the Albanian decentralization process and impact to the local government units' financial capacities.*

Key words: local government units, financial capacities, local borrowing, creditworthiness assessment

JEL classification: H71

Introduction

Key indicators provide that Albania is still far from the real decentralization reform, even lots of laws and financial instruments already transferred from Central Government to the Local Government Units. Comparing to the region's countries Albania is much below, such as being: (i) the last one in the region with regard of local government revenues per GDP (2.2%) and LGU revenues per capita (670 Euro); share of property tax within the local government revenues and GDP (0.18% of GDP Albania living only Croatia behind by 0.13% of GDP); the last one with regard of local government investment per GDP (0.9% of GDP). Albania ranks second, behind Moldova, in terms of outstanding local government debt per capita at 23 euros per capita.

The Albanian intergovernmental finance system has rested on two pillars, (i) transfers from Central Government and (ii) own source revenues. This is unusual because most European countries make fairly extensive use of a third pillar, shared taxes. Indeed, Albanian legislation contains provisions (since year 2000) that foresee giving local governments' national tax shares, but these provisions have never been used. To date Albania along with Kosovo and Bulgaria are the only countries not to use at all the share tax mechanism as one of the most important revenue source for LGUs within Europe and region.

Revenue structure and decentralisation impact to local government financial capacities

Local government revenues have increased in nominal terms every year since 2000 and that over the entire period they have nearly tripled. Total local government revenues as percentage of both GDP and the State Budget show modest, upward trends over the entire period, though both dipped greatly between from 2010 onwards. More precisely, the local government revenues bot as percentage of GDP and of total public revenues increased very substantially between 2002 and 2007, with variations in 2007-2009, than declining in 2010 – 2012. This upward trend and the relative stability around it are positive indicators and suggest that the national government has been trying to improve the situation of local governments.

Despite this very good trend of local government own source revenues, the share of local government revenues to both the state budget and the GDP are low by European, and even regional standards. There are no précised norms to this regard, but in countries where local governments are responsible for the provision of basic urban services such as local infrastructure, basic public services (potable water, waste water treatment, greening, cleaning and street lightening etc.), but not responsible for social sector functions such as elementary and pre university education (particularly teachers' salaries) local government revenues are about 12% to 15% of overall state budget and 5% to 7% of the GDP. This is the case, for example, in Slovenia, Montenegro, and Serbia etc. When compare to EU countries (all 27 as an average) this indicators are much higher: local government revenues as a percentage of state budget (in 2010) were 27% while as percentage of GDP were 14%. We have to take into consideration also the share of the public sector for EU countries that reaches more than 51% in 2010.

In Albania, however, local government revenues represent only 8% of the state budget and are thus still much below the EU and regional countries comparative "norm". Local government revenues at 2.2% as a share of GDP are still very low. This however must be understood in the context of a larger problem: In short, the total government sector in Albania is small in relationship to the GDP at about 25%, when compared to European norms of 51% because still the central government is week on administering fiscal revenues (taxes).

The structure of local government own revenues has changed radically during the last decade (2003-2013). Until 2005 the single most important local government own revenue was the small business tax (SBT). Since 2010 the Infrastructure impact tax has replaced the SBT as the single largest source of own revenue. This is in part because of the halving of the base of the SBT by the end of 2005, but also because the Infrastructure Impact Tax and the Property tax have proven a robust and reliable source of local government income. These two taxes seem to be growing as more and more local governments expand registration of immovable properties and increase collections / improve tax administration. One another important feature of revenue structure for local governments in Albania is the extremely rapid growth of the local fees which has almost doubled since 2005 and now (2012) represents more than 45% of all own-revenue.

During 2000-2002, local government derived almost 45% of their revenues from conditional grants. As such local government units in Albania were not only dependent on the central government to a large degree of their revenues, but extremely constrained in their spending decisions.

This changes radically in 2002 when the amount of Conditional Grants in the system is cut substantially, and the size and share of the Unconditional Transfer increases dramatically. This is an extremely important moment in the history of Albania's decentralization effort and marks the beginning of the second period which runs for four years from 2002 to 2005. This period is characterized by rising own-revenue, particularly after the passage of the 2003 small business tax to local government units' administration and by low shares of Conditional Grants in total revenues. The reformers were doing two things at once: (i) they were reducing the dependency of local governments on conditional grants by transforming most of them into the Unconditional Transfer, (ii) and they were reducing the dependency of local governments on the national government by expanding local governments own tax powers. Both of these are good things and in many ways this second period marks the height of the reforms.

But it also seems that reformers may have expected too much from local government own-revenues. What we mean by this can be seen in figure at the end of this paper. The decentralization instruments impacted initially by a total "conversion" of conditional grants into unconditional ones in 2002, while during the last decade the inversion is halving the vice versa. In 2002 the own source revenues representing only 26% of LG budget, while in 2012 (a decade after) conditional transfers represents almost the same share, owns source revenues almost doubled (representing 50% of LG budget) and unconditional transfers from CG representing 38%. As can be seen from the Figure 2, a decade of decentralization reform is not only marked by the "conversion" of unconditional transfers into the own source revenues but by a substantial increase in total grants.

First impression of this structural change gives an idea of more independence of LG since the share of own source revenues are considerably higher compare to 2002 (base line year of real decentralization in Albania), while comparing own source revenues as percentage of state budget and GDP the situation is the same. In other words LG revenues represent the same share to state budget and GDP while lot of new functions have been transferred to LGUs.

Between 2003 and 2005, however total local government revenues actually increase as they begin to make use of the own-revenue powers. Indeed, it looks like the governments shift away from transfers to own revenues was remarkably successful. However, it is notable very clear that wealthier local government units (municipalities and communes, but especially big and medium municipalities) are always in much better position to take advantage of own-revenue powers than poorer ones. Thus while total local government revenues rise quickly from their low point in 2003 due to the rapid increase in own revenues, most of this growth is undoubtedly concentrated in the larger cities.

Conclusions

Fiscal and financial decentralization process in Albania have been certainly guided by good intensions and based on best experience of other region countries. Even though this reform still need to address important issues such as:

- Substantial improvement in local government revenue source, both in term of source (own source or central government transfers) and fiscal administration.
- Urgent implementation of national share mechanism as an instrument established by law since 2000 but almost never applied. To this stage decrease of own source revenues, especially from small business tax have to be supplemented by national income tax or corporate tax. Albania is the only regional country implementing small business tax and no share tax mechanism.
- Local fees, an important own source revenue, need to be clearly regulated by local government units as an important source with big impact on public services.
- Tax on immovable property, the second most important revenue of LGUs needs to redefine the base and method of calculation. Another way of better administration is pushing immovable properties registration (buildings and agriculture land).
- Implementation of local borrowing instrument as an important tool for financing big local investment plans.

New policies need to seriously take into consideration concrete needs of local government units to implement public functions such as offering basic services to community such as potable water, maintaining the sewages system, cleaning of roads and maintaining of creation area. This means that local government units need to have clear unconditional transfer funds mechanism that insures sustainable financial resources to their budgets. One possible way to achieve such a security financial instruments can be through defining the level of central government transfers to local government units as a percentage of total public revenues. Also central government funds / grants transferred to local governments have to be based on a more transparent, simple and objective criteria.

Figures and schemes

Figure 1. Local Government revenues trend

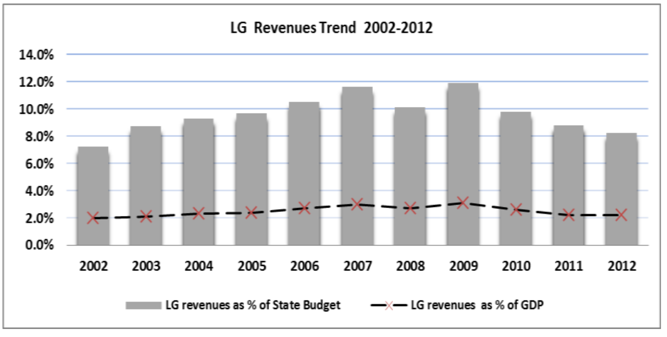
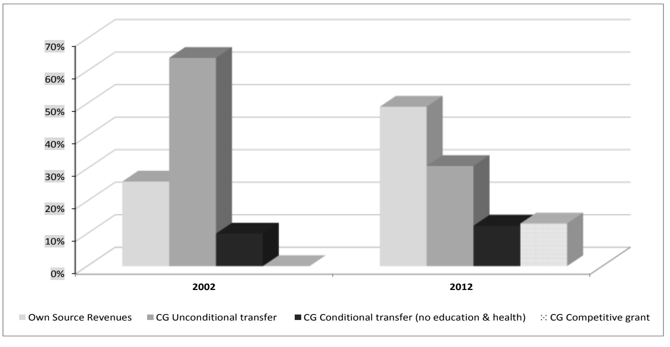


Figure 2. Local Government revenue structure



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