



A STATUS REPORT OF LOCAL GOVERNMENT FINANCES IN 2015

What numbers say at the end of Year 1 of the TAR?

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1. 2015: The year of Local Governance - Some background facts and figures

Why does 2015 matter for local governance? Well, a response could be because the Territorial and Administrative Reform (TAR) which took effect in mid 2015, constitutes a great change to Albania's system of local government since the first decentralization reform, undertaken in 2000. But let's see in how this is important:

- *First*, because it consolidates the number of Local Government Units (LGUs) in just 61 larger Municipalities from 373 very fragmented Communes and Municipalities, creating thus the preconditions to enhance the technical and administrative capacity of local governments enabling them to deliver more and better day-to-day services to citizens, while allowing the central government to focus on its' more strategic functions.
- *Second*, the TAR has contributed to increasing citizens' demands and expectations for more and better services and value for money in the use of their tax money.
- *Third*, by increasing citizens' expectations, the TAR also provides for the basic preconditions of local democracy, which starts from citizens' commitment and engagement in the management of the Municipality.
- *Fourth*, the TAR creates the opportunity for a more balanced territorial and economic development, through better-coordinated and targeted interventions in public infrastructure and investments.
- *Fifth*, because in 2015, Albania adopted also a new national policy development framework for decentralization and local governance, the National Crosscutting Strategy for Decentralization and Local Governance which sets Albania's decentralization roadmap for the next five years. As a document that has been anticipated from at least a decade, this new Strategy's main goals are to enhance the overall efficiency of local government structures, strengthen local finances and increase fiscal autonomy, strengthen good governance at local level and foster sustainable development.
- *Sixth*, because both the TAR and the Strategy were followed, in late December 2015, by the adoption of a new Law on Local Self-Governance (LLSG) which sets forth both the responsibility and authority of Albania's 61 newly created municipalities and further decentralizes a number of *new* and costly functions to local governments.
- *Seventh*, because the Government of Albania promised to improve also the fiscal autonomy of local governments. In December 2015 a new formula for the allocation of unconditional intergovernmental transfers was adopted, providing for a more equitable, transparent and predictable allocation of funds across municipalities with differences in expenditure needs and fiscal capacities. Nevertheless, the new formula, in and by itself, cannot compensate for the current systemic weaknesses of local government finances. In fact, in Albania the fiscal decentralization dimension remains particularly weak: local governments continue to be hampered by inadequate transfers from the central government and from restraints imposed on various revenue-generating options. To overcome these difficulties the Government has promised the development and discussion of a comprehensive Law on Local Government Finances (LLGF), which would eliminate the current systemic weaknesses in local finances and would increase local governments' fiscal autonomy.

- *Eighth*, because year 2015 constitutes also the baseline year for measuring progress. as the first year of the implementation of the TAR, year 2015 figures on revenues and expenditures would serve also as a baseline against which progress in future years would be measured in terms of better governance and services, more fiscal autonomy and a better balanced economic development.

Thus, there are a number of good reasons to consider 2015 particularly important for Albanians: more than any other year in the last two decades, 2015, brings together local governance and citizens: that is reorganization of governance to improve service delivery and foster sustainable local development. The next and very important question is: how are we going to achieve the strategic objectives of the TAR and the Strategy? Well, the predominant theory says that the **key issue here is fiscal autonomy - the control over sufficient resources to plan and manage the provision of local public services according to citizens' preferences without continuous interference from higher authorities.** One of the underlying ideas is that if local governments raise substantial amounts of revenue from on their own local areas they are likely to be subjected to increased demands for downward accountability and for increased citizen participation in deciding how the resources will be used.

Thus fiscal autonomy results to be quite an important thing, and a precondition for the successful implementation of the TAR's and the Strategy's overarching goals of improved services, better governance and a more balanced territorial and economic development. It therefore is important that we enquire further on the level of fiscal autonomy Albanian local governments have, what are their spending patterns and revenue raising options right at the dawn of the enactment of the TAR. These three types of analyses will provide us with a baseline against which progress shall be measured in future years. Not least, this type of analysis should also help policymakers identify the key fiscal decentralization issues faced by Albanian local governments and facilitate thus evidence-based policy making.

2. Methodological Note

In developing this snapshot on local government finances, we have used the data provided by the Albanian Government Financial Information System (the Treasury System) and data generated through the Local Finance Web-Portal www.financatvendore.al for the period 2010-2015. Further, we have built on work done previously by the USAID's Planning and Local Governance Project through various policy papers and in particular the Statistical Brief on Local government Finances in Albania, 2002-2015, and reports and analytical documents of the Ministry of Finance on local governance and local finances.

This analysis takes into consideration actual end-year figures on local revenues and expenditures. Revenues and expenditures are reported as defined in Law no. 9936/2008 "On the management of the budgetary system in the Republic of Albania", as amended", (Organic Budget Law – OBL). Using the detailed data provided by the Treasury System, this report, presents local government revenues and expenditures following all possible classifications prescribed in the OBL: the administrative, economic, functional, programme and financing source classifications. In other words, this Report provides data on all Local Government Units and their subordinated institutions, categorizing transactions based on: their

economic nature (i.e. salaries, operating, investments); functions of the government (i.e. Education, Social Welfare, Economic Affairs); broken down by budgetary programmes (i.e. primary and secondary education, Poverty Alleviation and Civil Emergencies, Agriculture and Transport etc.); and the source of financing (i.e. revenues raised on their own or received from the government, and expenditures financed through own revenues or conditional transfers from the government).

As a general rule, conditional transfers from the central government include all revenues flowing from line ministries to local governments for shared or delegated responsibilities and functions. Although the term shared functions has been abrogated with the new Law on Local Self-Governance, there are in fact, a number of functions over which the national and local government continue to share responsibilities such as Social Welfare. In this report these revenues are considered “conditional revenues/expenditures from the central government”. Conditional revenues/expenditures include also transfers from the Regional Development Fund (RDF), with the exception of funds financing local road transport infrastructure. As the financing of transport infrastructure projects from the RDF cannot be identified in the Treasury System, at least not in a consolidated manner for each individual LGU; and, as these funds and carryovers from previous years constitute – by law – the only potential explanation in case actual local expenditures result higher than actual local revenues, they are aggregated in a single revenue column labelled “Carryovers and other funds from the RDF”. The law does not allow LGUs to incur any budget deficit and the actual expenditures are strictly linked to actual revenues collected or received by the LGU. Actual expenditures should not be confused with commitments or contingent liabilities which can be higher than local government revenues.

The report consolidates the financial data for the 373 LGUs into the respective 61 new Municipalities. For the production of per capita figures were used the population numbers according to the Civil Status Register offices.

3. Local government finances at the dawn of the TAR: What do numbers say about the degree of fiscal autonomy of local governments?

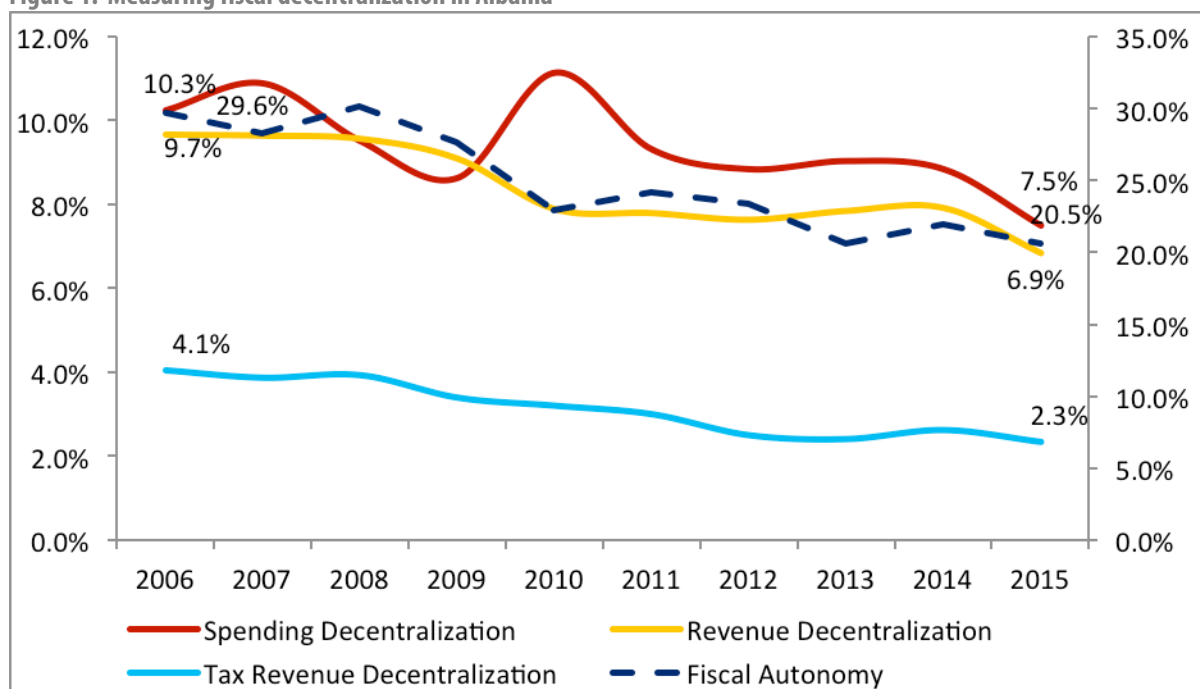
Accurately measuring the degree of fiscal decentralization and autonomy is a quite difficult endeavour. Nonetheless, scholars agree on a common set of indicators that capture the degree of fiscal decentralization and fiscal autonomy of local governments. Usually these indicators measure the share of local government revenues (expenditures) over total public revenues (expenditures) or GDP, and the degree of control of local governments over the resources spent for the provision of local public services.

Figure 1 provides a graphical representation of the measure of fiscal decentralization in Albania. The first indicator measures spending decentralization. It can be noted that in 2015, local government expenditures constitute about 7.5% of the total public expenditures (consolidated general government expenditures), while local government freely disposable revenues constitute about 6.9% of total public revenues (revenue decentralization). Another important measure of decentralization is provided by the ability of local governments to tax their constituencies to finance the provision of local public services. In terms of tax revenue decentralization, measured as the ratio between local government tax revenues and national tax revenues, it results that, in 2015, local government tax revenues count for only 2.3% of national tax revenue. This low level might be an indication that local governments are not given that much legal powers to tax and

enforce taxation of households and businesses; or that local governments are not adequately using their taxing powers given by law; or that taxpayers show low levels of tax compliance; or a combination of all the above.

Another important indicator is the fiscal autonomy indicator, measures as the ratio between local government Own Source Revenues and the total amount of resources spent on local functions from the central and local government. In other words, this indicator shows how much resources needed to finance their functions local governments can generate on their own. Also on this indicator Albania does not perform very well. In 2006, local governments controlled the resources necessary to finance about 30% of their budgets, whereas in 2015 this ratio has dropped to only 20.5%.

Figure 1. Measuring fiscal decentralization in Albania



Source: Albanian Government Financial Information System, Own calculations

This downward tendency is a common characteristic of all the four selected indicators. In 2015 they score lower levels than in 2006, which was the year of the adoption of a new Law on Local Tax System that provided local governments with some important taxing powers. If one wanted to extrapolate some message from Figure 1, that message might be that in relative terms, local government fiscal decentralization and autonomy has continuously decreased over time, with 2015 constituting the absolute minimal historical values. In fact, it is widely accepted that, despite the great progress made over the past two decades, in Albania, the fiscal dimension of decentralization remains particularly weak, local governments continue to be hampered by inadequate and unpredictable transfers from the central government and from restraints imposed by the central government on various municipal revenue-generating options.

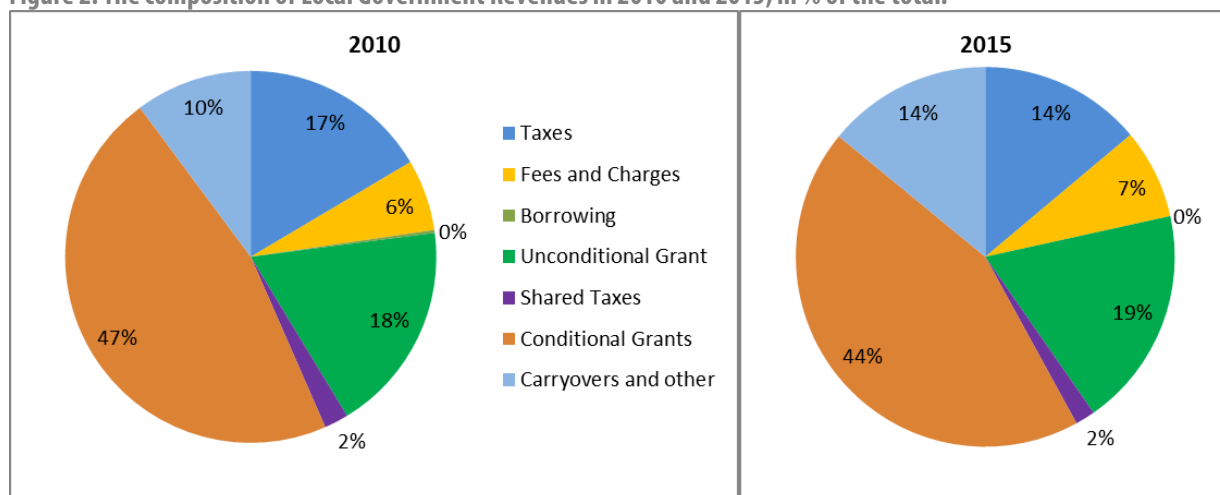
There are however some good news. The Ministry of Finance of Albania has recognised these challenges and in 2015, with the support of USAID’s Planning and Local Governance Project (PLGP), it adopted a new formula for the allocation of unconditional grants from the state budget to local governments. The new formula, designed to provide for an equitable,

transparent and predictable allocation of resources among different LGUs, was adopted in the year 2016 Budget Law. Nevertheless, this new formula is only the first step towards a better system of intergovernmental transfers and the greater challenge that needs to be addressed is the stabilization of the total pool of resources to be allocated through the formula. Hopefully, this and some other important issues would be addressed by the new Law on Local Government Finances, which is being drafted from the Ministry of Finance with the lead support of the USAID’s Planning and Local Governance Project and the Swiss-funded Decentralization and Local Development Programme (DLDP). The general expectation is that this law should provide for a thorough fiscal decentralization reform, sufficient to create the conditions and finance the successful implementation of the TAR. More specifically, this Law is expected to clarify fiscal and financial authorities and the revenue-raising capacities of local governments, improve and stabilize the intergovernmental transfer system, remove administrative restraints and allow for local borrowing, strengthen the rules for the transparent and accountable management of local public financial resources and enhance intergovernmental dialogue and consultation. In terms of timing, it is expected that this law is adopted by the Parliament in late 2016 and be used for the preparation of the 2017 annual budgets.

4. Where does the money come from: How are the new Mayors going to finance the implementation of the TAR?

This section provides an analysis of the revenue raising options of local governments and the intergovernmental transfers they benefit from. The figure attempts to provide a clear picture of where the money to implement the objectives of the TAR comes from. Figure 2 shows the composition of total local revenues from own source revenues and different types of intergovernmental transfers for years 2010 and 2015. As can be noted, in 2015, LGUs generated 21% of total revenues from local taxes and fees, 19% from the unconditional grant, 2% from shared taxes, 44% from conditional transfers from the central government, and finally 14% of expenditures were financed from carryovers and other sources of local financing.

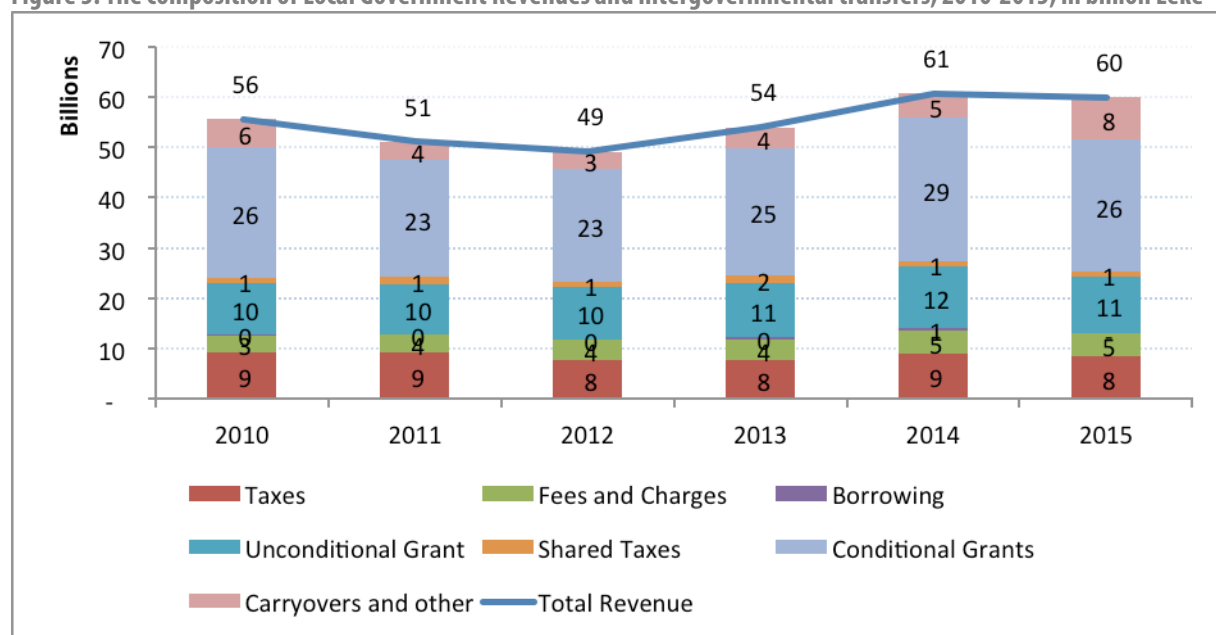
Figure 2. The composition of Local Government Revenues in 2010 and 2015, in % of the total.



Source: Albanian Government Financial Information System, Own calculations

In other words, LGUs generate on their own only 21% of the total, and they exercise a certain degree of discretion over only 56% of the total pool. In other words, the central government exercises direct control over 44% of the total amounts that are spent at the local level through conditional transfers. If we include also the discretion it has on unconditional grants, shared taxes and local borrowing, the central government controls about 65% of the total amount spent at the local level. This pattern is not specific only to year 2015 as a similar picture is found also for 2010 and the other years in the between.

Figure 3. The composition of Local Government Revenues and intergovernmental transfers, 2010-2015, in billion Lekë



Source: Albanian Government Financial Information System, Own calculations

As can be noted from Figure 3, over the past 6 years, total resources spent at the local level by the local and central government have ranged between 50-60 billion Lekë per year, out of which Local governments raise on their own 8-9 billion Lekë out of taxes and 4-5 billion Lekë out of fees and charges for local services; further, local governments receive from the central government also 11-12 billion Lekë from the unconditional grant, 1 billion Lekë from shared taxes; then the central government spends at the local level for delegated functions, 23-29 billion Lekë in conditional grants; finally local governments finance about 3-8 billion Lekë of their expenses from resources carried over fiscal years and conditional transfers for road infrastructure from the Regional Development Fund (RDF) which is again an intergovernmental transfer.

The previous figures clearly show that when compared to the total of resources spent at the local level, Albanian local governments continue to suffer from low levels of fiscal autonomy, meaning that they exercise little discretion over municipal finances.

Table 1 shows the differences and disparities across LGUs in terms of population, revenues from local taxes and unconditional grant receipts, following the TAR. LGUs have been grouped according to their population in 4 quartiles where Tirana is shown separately. More specifically, in the first quartile are grouped the 16 LGUs (with less than 25.000

inhabitants), which constitutes less than 6% of Albania's total population, which collect only 3% of the total revenues collected from taxes and fees and which receive about 10% of the total pool of the unconditional grant. For each heading we have included data on minimums, maximums and averages to better show the differences of LGUs composing each quartile as well. In the second quartile are grouped 22 LGUs, composing 19% of Albania's population, which raise 12% of the total local revenues from taxes and fees, and receive about 21% of the unconditional grant. **What Table 1 clearly shows is that 72% of the 13 billion Lekë raised in 2015 from local taxes and fees are collected in Albania's 10 largest LGUs (38% is coming from Tirana and 34% from the other nine largest LGUs), whereas the other 51 consolidated LGUs raise only 28% of total revenues from local taxes and fees.**

Table 1. Differences across LGUs in terms of population, revenues and unconditional grants

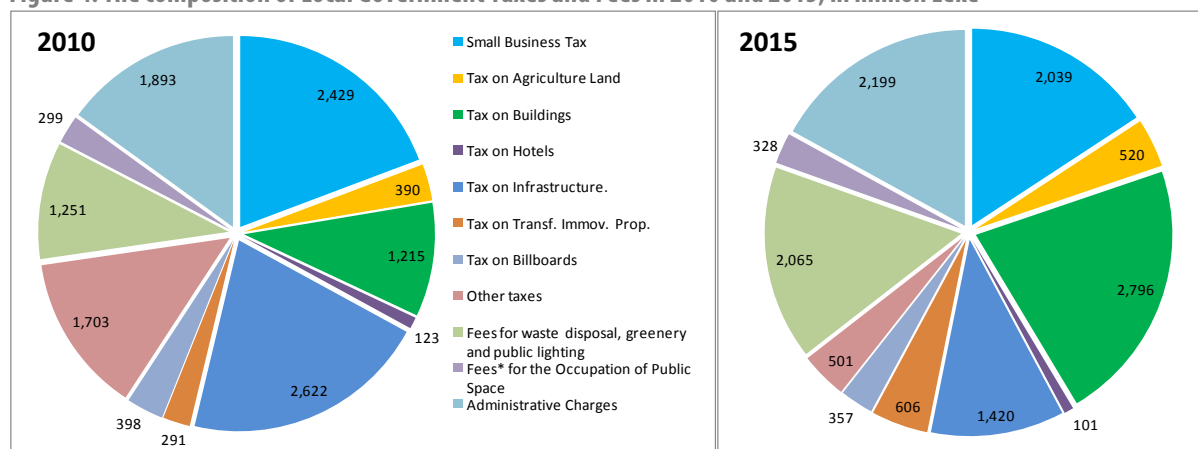
LGUs represented in Quartiles	no. LGUs within Quartile	Population according to the Civil Register, in percentage				Revenues from Taxes and Fees, in percentage				Share of the Unconditional Grant, in percentage			
		sum	min	max	aver.	sum	min	max	aver.	sum	min	max	aver.
Q1 (0-25.000)	16	6	0.1	0.5	0.4	3.0	0.0	0.5	0.2	10.0	0.2	1.0	0.6
Q2 (26-50.000)	22	19	0.6	1.1	0.9	12.0	0.1	2.1	0.6	21.0	0.6	1.7	1.0
Q3 (51-100.000)	13	20	1.2	2.3	1.6	13.0	0.2	2.1	1.0	22.0	1.1	2.5	1.7
Q4 (101-300.000)	9	37	2.4	6.9	4.1	34.0	2.2	9.1	3.8	34.0	2.2	5.6	3.8
Tirana (763.297)	1	18	17.5	17.5	17.5	38	37.9	37.9	37.9	13	13.2	13.2	13.2

Source: Albanian Government Financial Information System, Ministry of Finance, Own calculations

Table 1 contains also data on the averages, minimums and maximums values for each heading within one quartile to better understand also the dynamics internally to the quartile, meaning the differences and disparities of LGUs composing the quartile. On average, each of the 15 LGUs composing the first quartile host 0.4% of the total population, raise 0.2% of total revenues from taxes and fees and receive 0.6% of the total pool of the unconditional grant. The minimum and maximum columns show the smallest and largest LGU within one quartile as regards the number of population, the smallest and largest amount raised in terms of local taxes by the LGUs composing the quartile and the smallest and largest receipt from the unconditional grant within the quartile. In other words, within those 16 LGUs composing the first quartile, which hosted on average 0.4% of Albania's population the smallest one hosts only 0.1% of the country's population, raises about 0.04% of total tax revenue and receives about 0.2% of the total pool of the unconditional grant. Further, the maximum amount of tax revenues raised by LGUs in the second quartile is 2.1% of the total, whereas the maximum allotment received under the unconditional grant is 1.7%.

In the following we are going to present which are the local taxes and fees charged from Municipalities. Figure 4, provides the composition of local government revenues from taxes and fees in 2010 and 2015. As it can be noted the major sources of local taxes are the Small Business Tax levied as a percentage on the annual profit of certain small businesses; the property tax on buildings which is charged on the basis of the square meter area of the property multiplied by an indicative tax level differentiated by the major physical characteristics of the building; and finally the Tax on the Impact on Infrastructure of New Buildings which is levied as a fixed percentage on the value of the new construction and the sale price of real estate; Fees for waste disposal and collection, greenery and public lighting, fees for the occupation of public space and administrative charges, all of which are charged on different basis and at different rates across municipalities.

Figure 4. The composition of Local Government Taxes and Fees in 2010 and 2015, in million Lekë

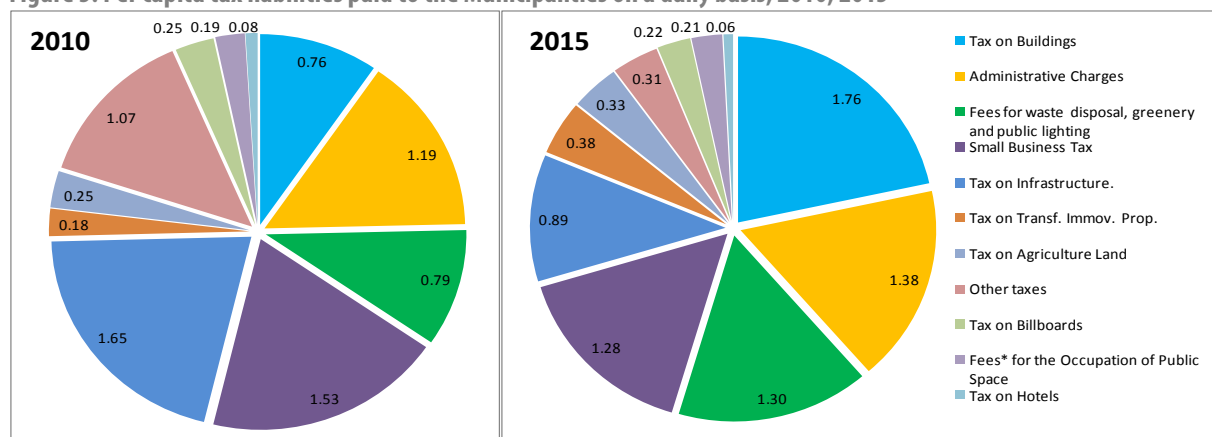


Source: Albanian Government Financial Information System, Own calculations

In 2015, these taxes yielded about 12.9 billion Lekë, up from 12.6 they generated in 2010. Thus there is not any substantial change or increase in the overall level of revenues from taxes and fees. On the other hand, the composition of such revenues has indeed changed: in the last six years we notice the decline in the yield of the Tax on the Impact on Infrastructure of New Buildings (due to the general economic downturn and the new construction moratorium enacted by the government); an increase the share of the property tax from buildings; and an increase in the shares of local fees and charges. There are good reasons to believe that considering the decline in the yield infrastructure impact tax, Municipalities started putting more effort to better administer the property tax and fees for local services. Meanwhile, it can be noticed the shrinking of the small business tax, which constituted about 25% of tax revenues. Unfortunately this tax was almost completely eliminated in late December 2015, without any real form of compensation for the loss.

Figure 5 shows how much, Albanian taxpayers actually pay to Municipalities out of taxes and fees on a daily basis and in per capita terms, in 2010 and 2015.

Figure 5. Per capita tax liabilities paid to the Municipalities on a daily basis, 2010, 2015



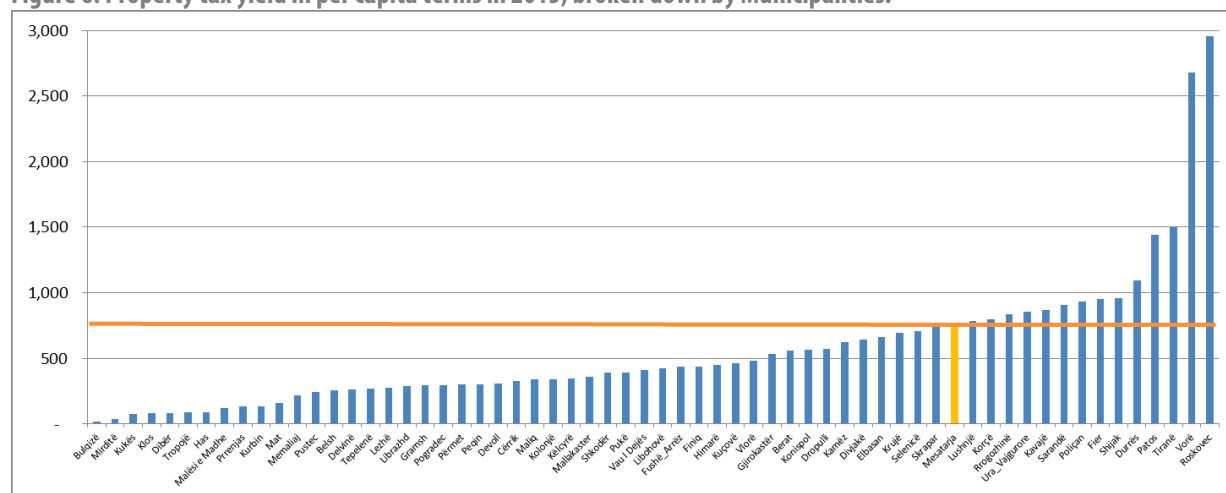
Source: Albanian Government Financial Information System, Own calculations

As it can be noted, in 2015 taxpayers paid to Local Governments on a daily basis about: 1.76 Lekë for the property tax on buildings, up from 0.76 Lekë per day paid in 2010; 1.38 Lekë for administrative services charges; 1.30 Lekë per day in fees for the waste collection and disposal, cleaning and greenery and public lighting; 1.26 Lekë per day for the small business tax; 0.89 Lekë per day for the tax on the impact on infrastructure of new buildings; and about 1.52 Lekë per day in some other minor taxes. Finally, each Albanian citizen pays to the Municipality about 8 Lekë per day, which is about 0.1 Euros per day. In the next section on spending patterns we are going to see how these 8 Lekë per day are used to provide services to citizens.

As regards fiscal policy, municipalities have the right to increase or decrease by a certain margin the indicative tax levels set by law. There are thus municipalities that apply higher tax rates on buildings and municipalities that charge more for the public services they provide. Assuming that there is a uniform tax assessment effort across the country, the best way to capture these differences would be comparing the tax yield in per capita terms. This comparison would show the differences in taxes paid by “each citizen” in every municipality, or put another way, where taxes are higher. From this type of analysis one would be surprised that the general rule of higher taxes in the more dense municipalities does not always apply.

Figure 6 shows the property tax yield in per capita terms across the 61 consolidated Municipalities in 2015. In average, the property tax yield is about 760 Lekë per capita annually. In total, there are about 47 Municipalities with per capita tax yields below the national average. Per capita property tax yields are highest in Tirana, Vora and Roskovec and lowest in Bulqizë, Mirditë and Kukës. More specifically, in 2015, the 31.7 thousands inhabitants in Roskovec paid about 3.000 Lekë each, whereas the 40 thousand inhabitants in Bulqizë paid less than 16 Lekë each, per year. An important question here is: *What causes these huge differences?*

Figure 6: Property tax yield in per capita terms in 2015, broken down by Municipalities.



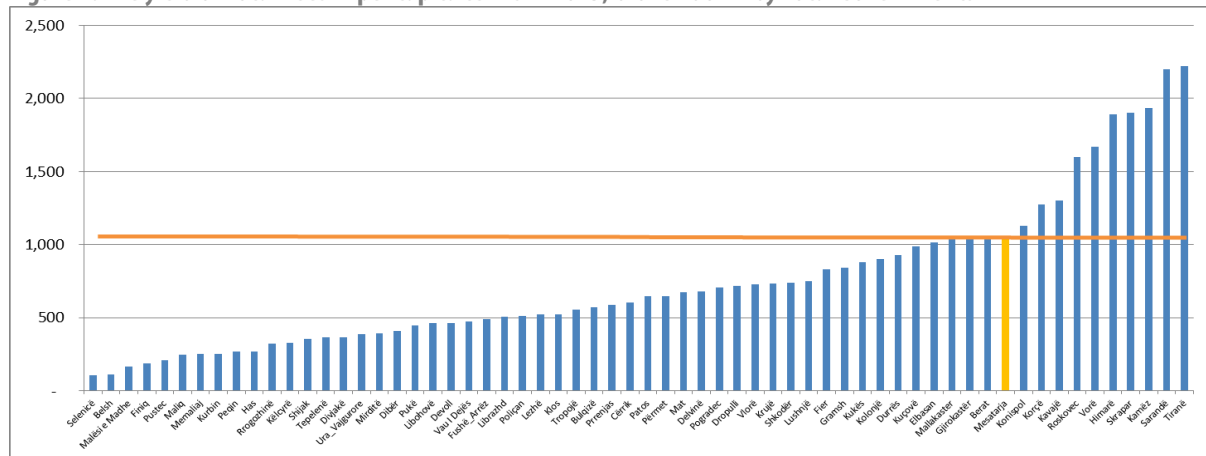
Source: Albanian Government Financial Information System, Own calculations

By looking at the Roskovec annual Budget (published at www.bashkiaroskovec.gov.al) one would notice that the Roskovec Municipal Council has adopted the standard tax rates indicated by law for the property tax. *How is it possible then, that the per capita tax yield in some smaller Municipalities is higher than in Tirana or the other larger Municipalities?* There are a number of factors that might explain these differences: a) tax rates vary significantly, with certain municipalities applying

the highest possible rates and others applying the lowest possible; b) tax collection vary significantly with certain municipalities having higher tax compliance rates than others; c) tax avoidance is higher in certain municipalities than in others; d) the number of operating businesses varies significantly across municipalities; and e) some combination of all the above. The general conclusion that we might draw is that, in practice, Municipalities do not exert the same effort everywhere to tax and collect taxes from all categories of taxpayers. And as a general rule, Municipalities apply higher tax rates and better administer taxes from the business community. And in fact, both in Roskovec and Patos (which has approximately the same per capita yield as Tirana), the companies operating in the oil/gas sector are the ones who contribute most to the municipal budget. But more generally, if we accept that in general there is a higher tax burden on businesses, and that tax collection compliance from businesses is higher than for household taxpayers, than the differences in the per capita yields of property taxes should be a direct consequence of the ration of no. of businesses over number of inhabitants. In other words, in this scenario, municipalities with the larger number of businesses per person would result in higher per capita yields of the property tax: this explains why municipalities with a similar number of inhabitants have completely different outcomes in terms of tax collection.

Figure 7 shows the per capita yield of local fees in 2015 across the 61 Municipalities. As it can be noted there are no major differences when compared to Figure 5. It expected that the actual individual fee levels across municipalities vary much more than what depicted here or at Figure 6, as the legal framework does not provide any indicative fee level. Again, by looking at the local government fiscal systems (which can be found at www.financatvendore.al) one can easily realize that most of the burden from fees and charges again falls on the business community.

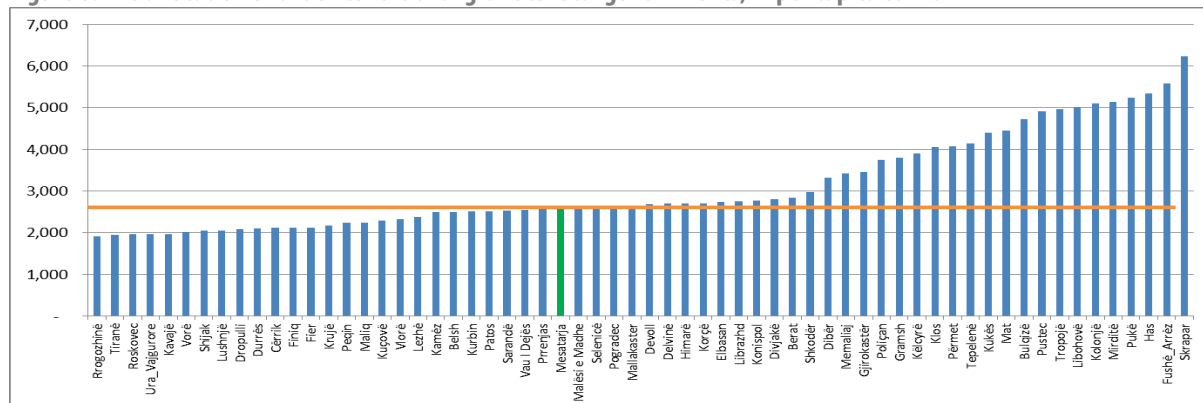
Figure 7. The yield of Local Fees in per capita terms in 2015, broken down by Local Governments



Source: Albanian Government Financial Information System, Own calculations

Figure 8 shows the allocation of the unconditional grant in per capita terms in year 2015, following the new territorial and administrative division. As can be noted, on average, every municipality received from the central government about 2800 Lekë per inhabitant (following the Civil Status Register population data). There are however some important differences across municipalities.

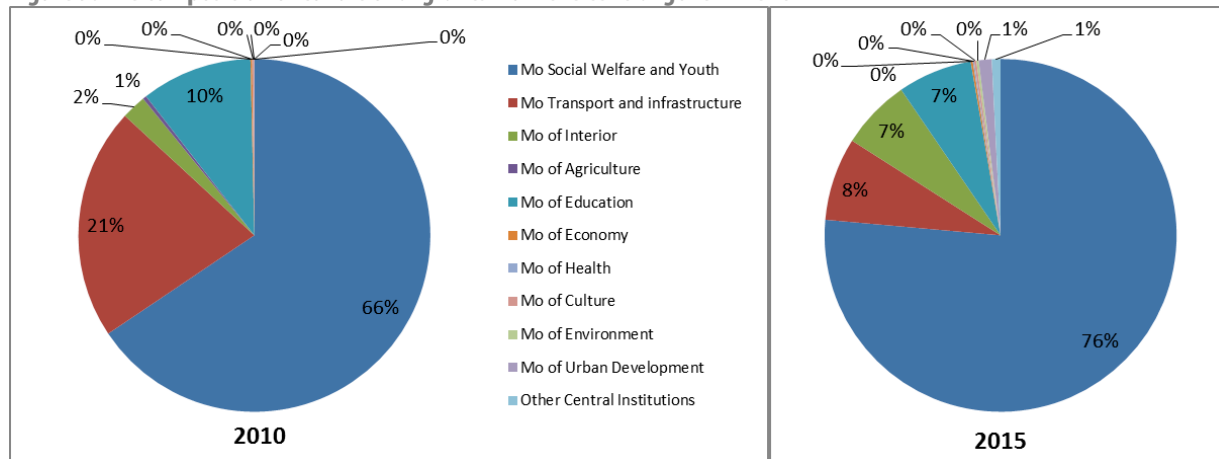
Figure 8. The allocation of the unconditional grant to local governments, in per capita terms



Source: Albanian Government Financial Information System, Own calculations

Figure 9, shows the composition of conditional grants flowing to local governments from the central government mostly for delegated functions and responsibilities that are shared between the two levels of governance. It is clear that these types of conditional resources are dominated by the transfers for poor families or persons with disabilities from the Ministry of Social Welfare and Youth. There is certain level of uncertainty as regards this function. From one side it is considered an exclusive local responsibility under the new law on local self-governance, and on the other hand, it is, in practice exercised as a delegated function.

Figure 9. The composition of conditional grants from the central government



Source: Albanian Government Financial Information System, Own calculations

Municipalities receive resources also from the Ministry of Interior for the operation of the Civil Status Register Offices, the Ministry of Transport (including funds from the RDF) for the road infrastructure and water and sewerage systems; the Ministry of Education (including funds from the RDF) for the maintenance of primary and secondary education facilities. One important element that is worth emphasizing is the low level of transfers from the other important line ministries, with which local government operations and responsibilities cross-cut such as health, culture, environment etc. Local governments have important responsibilities for all these functions.

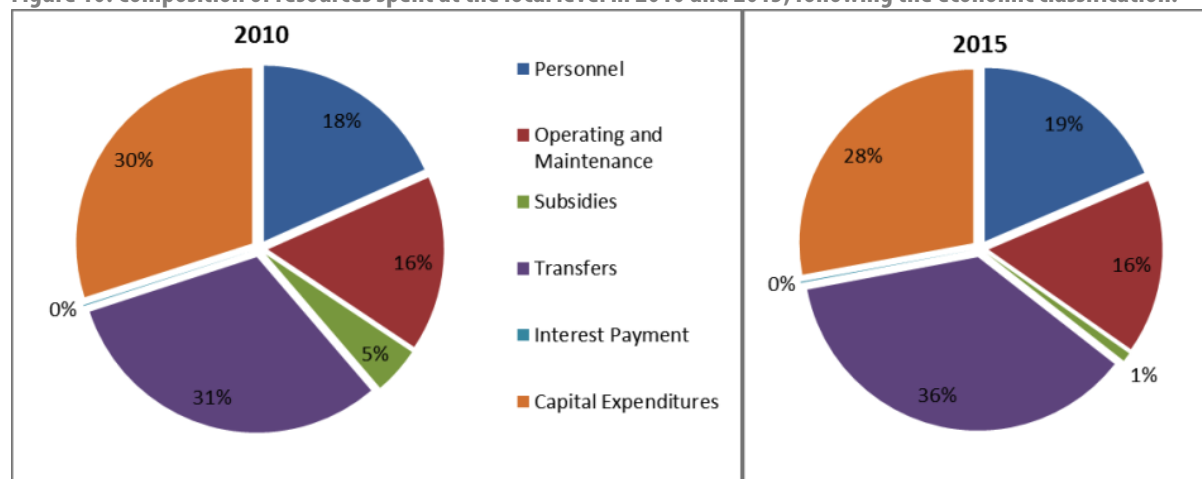
5. Where does the money go: What are the spending patterns of local governments in 2015?

This section provides an analysis of local governments spending patterns. In other words, it attempts to give a clear picture of how and where taxpayers' money and intergovernmental transfers are spent from the Municipality, and further how and where the central government spends more at the local level. We would thus provide an analysis of expenditures following the economic nature of expenses (i.e. personnel salaries, investments etc.) and then following the government functions for which they are incurred (education, infrastructure, social welfare etc.). We would differentiate these by their source of financing and at the end focus on the sectors where the local government invests more.

5.1 How money is spent?

Figure 10 below shows the composition of total resources spent at the local level by local governments and the central government for years 2010 and 2015. In 2015, consolidated expenditure data shows that, out of the total pool 19% is spent for personnel salaries, 16% for operating and maintenance expenditures (such as office materials, travels, heating, fuel etc.), 1% for subsidies to subordinated public utilities, 36% on transfers to individuals (mostly for poverty alleviation from the Ministry of Social Welfare), and 28% on capital investments.

Figure 10. Composition of resources spent at the local level in 2010 and 2015, following the economic classification.



Source: Albanian Government Financial Information System, Own calculations

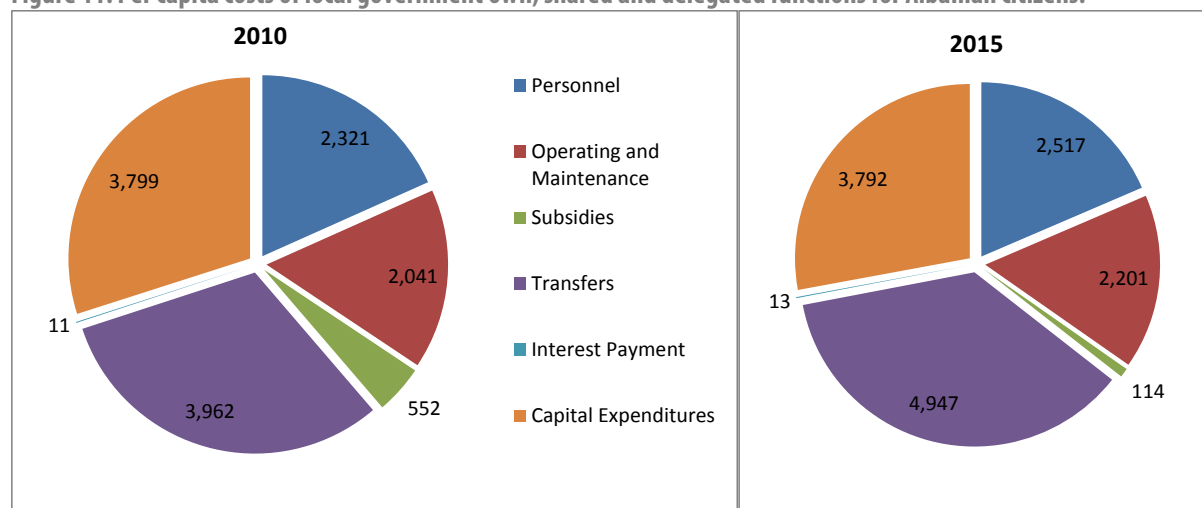
As it can be noted there are no substantial changes in the spending patterns in the two selected years. It is worth mentioning, however that Figure 10 provides consolidated data, meaning expenditures financed both through own and conditional revenues. If we consider local government own and conditional expenditures individually, as depicted in Figure 13 and 14, we would notice a slightly different situation.

5.2 How much does it cost to the citizen?

In Figure 5 in the previous sections we analyzed how much citizens paid on a daily basis in local taxes and fees to the Municipality. Here we are going to show how the incomes from these and the other sources of local finances are spent from the municipality. In other words, here we are going to show how much local governance really costs for Albanian citizens and how resources are used.

Figure 11 shows Per capita costs of local government own, shared and delegated functions for Albanian citizens. In 2015, every Albanian citizen paid for municipal officials’ salaries 2517 Lekë per year, (on average 7 Lekë per day, which is close to what is paid in local taxes and fees per day); 2201 for operating costs of the administration and general maintenance; 4947 Lekë in terms of transfers for poor families (up from 3962 Lekë/person/year in 2010); 13 Lekë for subsidizing municipal public utilities deficits; and 3792 Lekë for investments. In other words local governance costs Albanian citizens 13.584 Lekë per year. Figure 12 shows the costs for Albanian citizens on a daily basis.

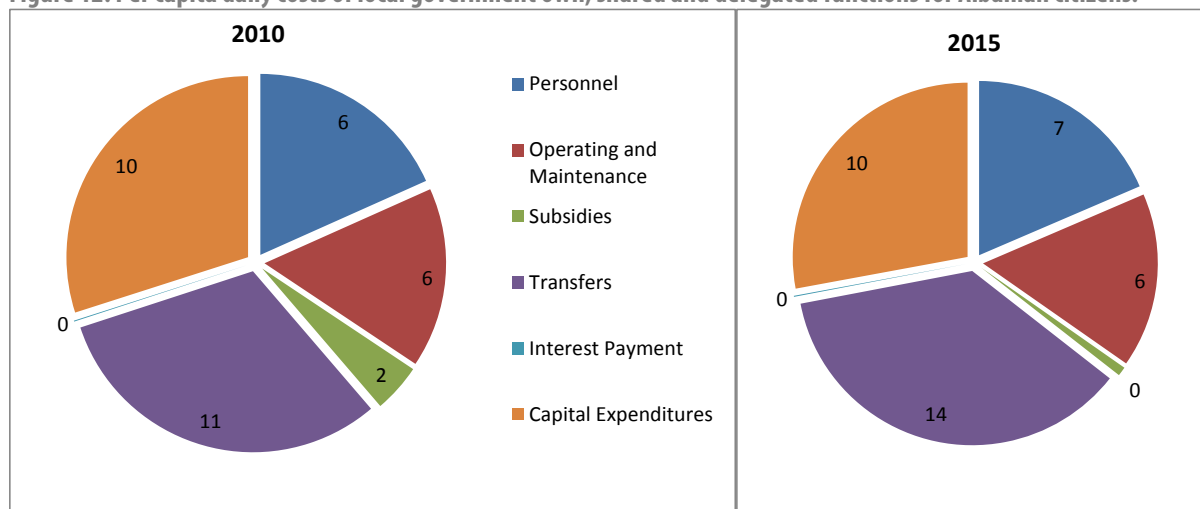
Figure 11. Per capita costs of local government own, shared and delegated functions for Albanian citizens.



Source: Albanian Government Financial Information System, Own calculations

On a daily basis, local government own, shared and delegated functions costs Albanian citizens about or 37 Lekë, or five times more what they pay in local taxes and fees. This is an indication of the low level of fiscal autonomy of local governments in Albania. What it indicates also is that local taxes or fees are very low in Albania; or alternatively that tax compliance is very low. A combination of the two is also possible.

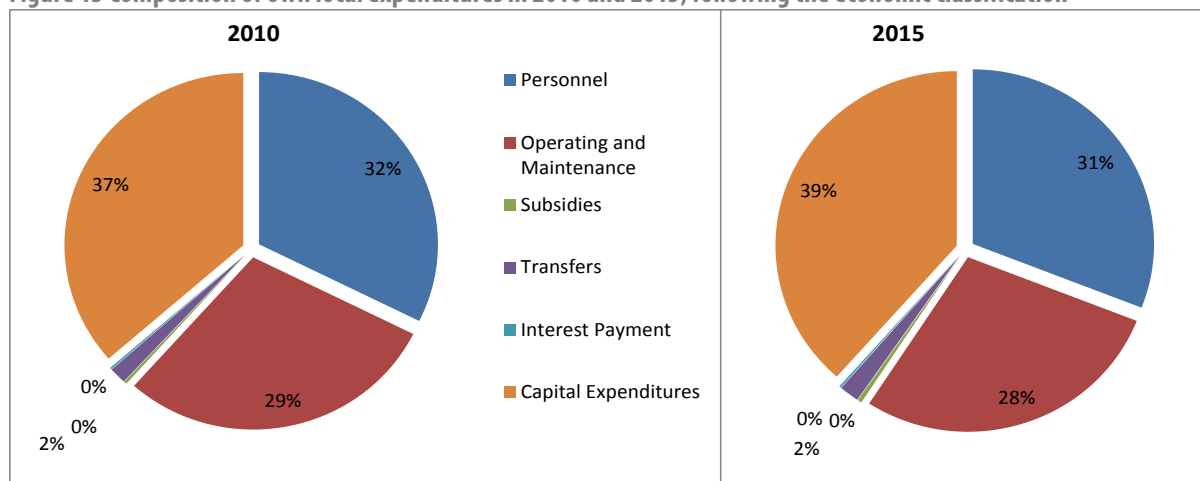
Figure 12. Per capita daily costs of local government own, shared and delegated functions for Albanian citizens.



Source: Albanian Government Financial Information System, Own calculations

We previously mentioned that, figure 10 showed the aggregated data on local government total expenditures and that we would see a different picture if we considered own and conditional local expenditures individually. As it can be noted, Figure 13 shows that in fact, in 2015, Municipalities spent about 31% of their own resources (from taxes, fees, unconditional grant and shared taxes) on salaries for personnel; 28% on operating expenditures; 2% in total for subsidies, transfers to poor families and interest payments for loans; and 39% on capital investments. Again these figures do not show any remarkable change from year 2010. This is an indication of the rigidity of local governments' budget. Another even more important remark that we can make is that, contrary to the general belief, it appears that local governments spend more on capital investments than on salaries.

Figure 13 Composition of own local expenditures in 2010 and 2015, following the economic classification

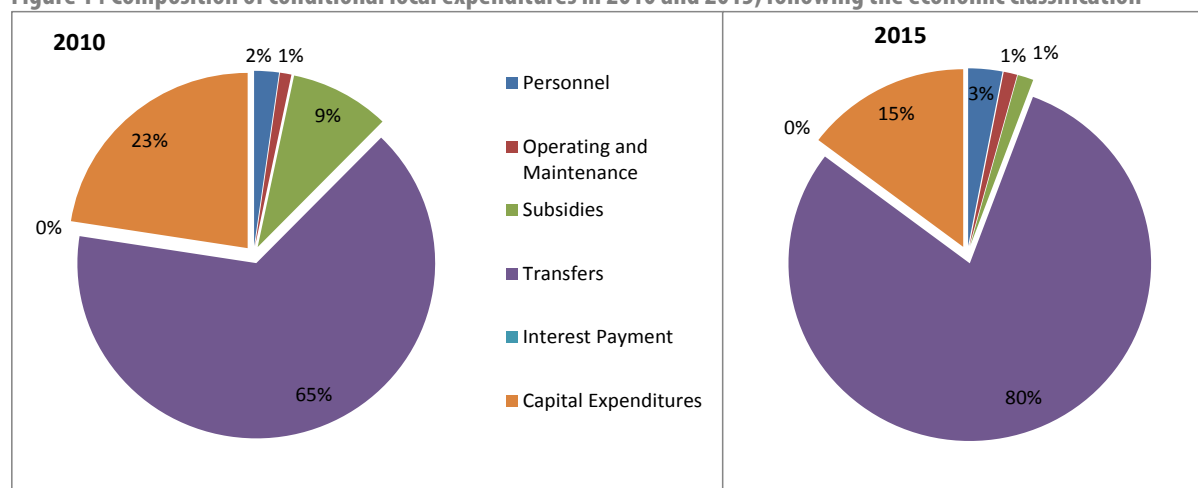


Source: Albanian Government Financial Information System, Own calculations

Figure 14 complements our analysis of spending patterns, in that it shows the breakdown of expenditures financed through conditional grants from the central government. In other words it provides a picture of the nature of expenditure

and functions financed from the national government at the local level for responsibilities shared with local governments or for central government responsibilities delegated at the local level.

Figure 14 Composition of conditional local expenditures in 2010 and 2015, following the economic classification

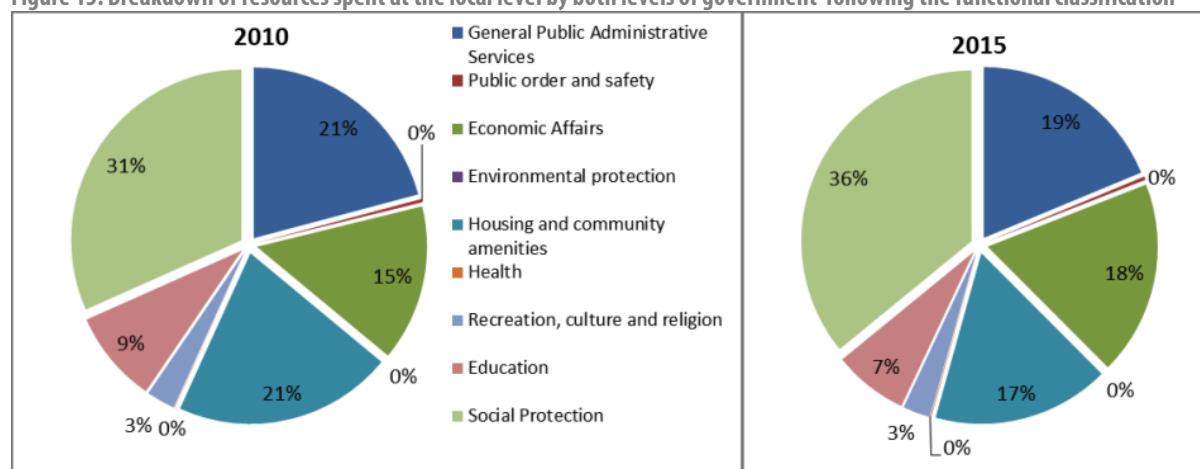


Source: Albanian Government Financial Information System, Own calculations

In 2015, the central governments' transfers at the local level for salaries constituted only 3% of total conditional expenditures, whereas 80% of them constituted transfers for poor families for poverty alleviation and 15% for capital investments. Figure 14 shows this shift in the focus of the central governments' transfers over the last 6 years, from more investments and subsidies for local public utilities (i.e. water companies) to transfers for poverty alleviation. In fact, comparing the figures from 2010 and 2015 it looks like the central governments' expenditures for poverty alleviation have increased when compared to 2010, while the share of transfers for capital investments have decreased from 23% of the total in 2010 to 15% in 2015.

5.3 Where money is spent?

Figure 15 provides the breakdown of total resources spent at the local level by both levels of government following the functional classification of expenditures, or put more simply according to the government functions for which they are incurred. In 2015, 19% of total consolidated expenditures were allocated for general administrative services, 18% for economic affairs, which include (agriculture, forestry, transport and industries), 17% on housing and community amenities (mostly water utilities, sewerage systems), 3% on culture and recreation, 7% on education (both primary and secondary) and 36% on social protection of vulnerable classes of individuals.

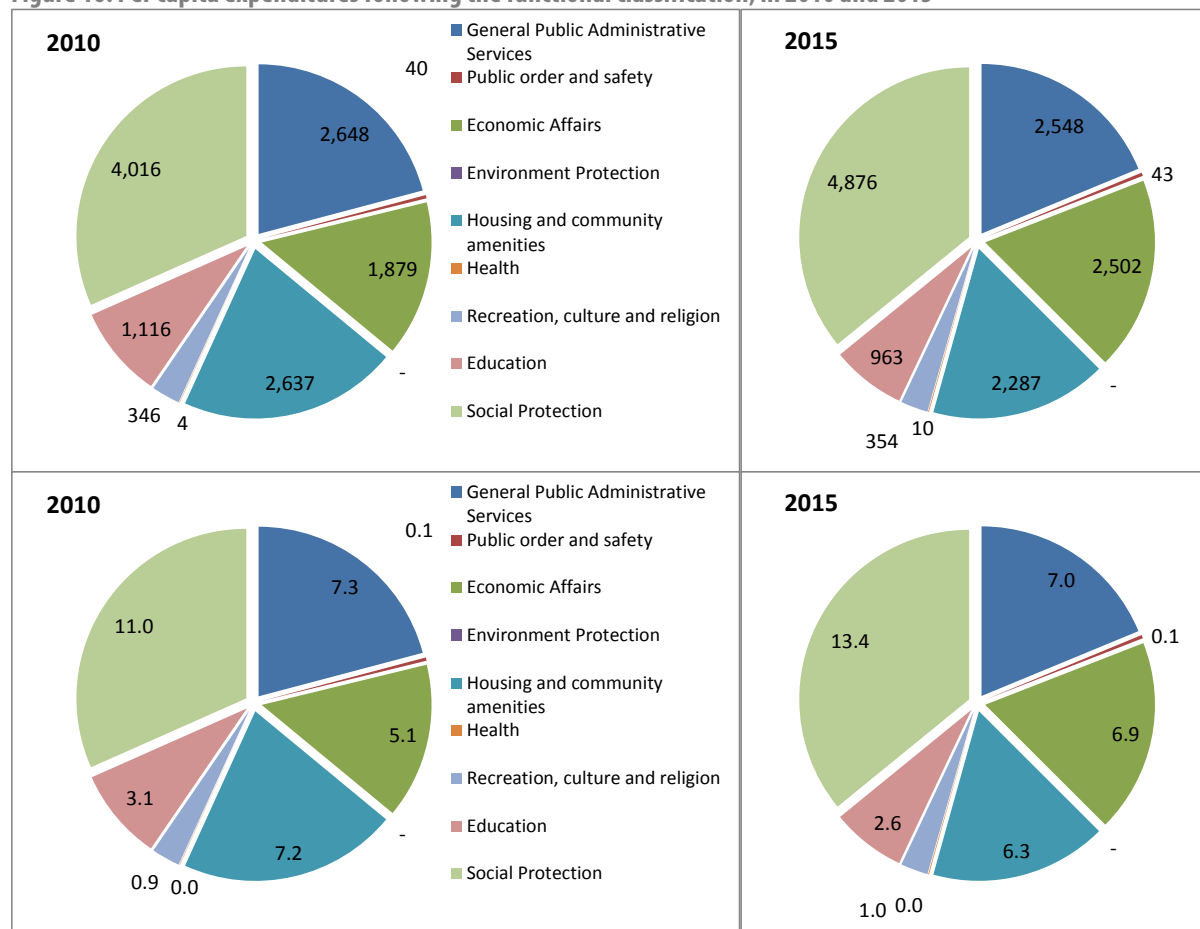
Figure 15. Breakdown of resources spent at the local level by both levels of government following the functional classification

Source: Albanian Government Financial Information System, Own calculations

What Figure 15 shows additionally is that, total spending (financed through own or conditional revenue) on local responsibilities for public order and safety, environmental protection and health is at the zero level. As striking as it is, based on the data registered on the treasury system – that is as inputted from municipalities themselves in expenditure/payment orders- it appears that both the national and local government spend nothing for local responsibilities in public order and safety, health and environment protection despite the fact that they have legal responsibilities for setting up local police forces, providing for the maintenance for certain institutions etc. While there certainly may be a problem of lack of funding, the situation however might be less dramatic than what depicted. In fact, we know that in practice, some municipalities have local police forces. So how it is possible than that public order and safety appear not to have been financed at all? The only possible explanation is thus related to the accuracy of the data inputted in expenditure/payment orders from all finance officials at the municipal level. In other words, when compiling expenditure orders local officials might neglect imputing accurately the fields on the budgetary program (or the function of government for which this expense is being incurred). This brings us to the larger issue of the need to compile timely, accurate and reliable financial statistics and the need to strengthen local governments' financial reporting capacities. It is important that both the national and local government invest more in improving financial reporting capacities as timely, accurate and reliable information is key to the successful design and implementation of any public administration reform.

Figure 16 shows us the functions of governance the annual or daily contribution of Albanian citizens are spent. In 2015, Albanian citizens paid in annual terms about 2548 Lekë (or 7 Lekë per day) to maintain the municipal administration; 2502 Lekë for economic affairs (mostly road transport infrastructure) up from 1879 Lekë per year in 2010; 2287 Lekë (or 6.3 Lekë per day) for the water and sewerage system; 963 Lekë (or 2.6 Lekë per day) for the maintenance of schools (primary and secondary), and 4876 Lekë (13.4 Lekë per day) for transfers to poor families.

Figure 16. Per capita expenditures following the functional classification, in 2010 and 2015



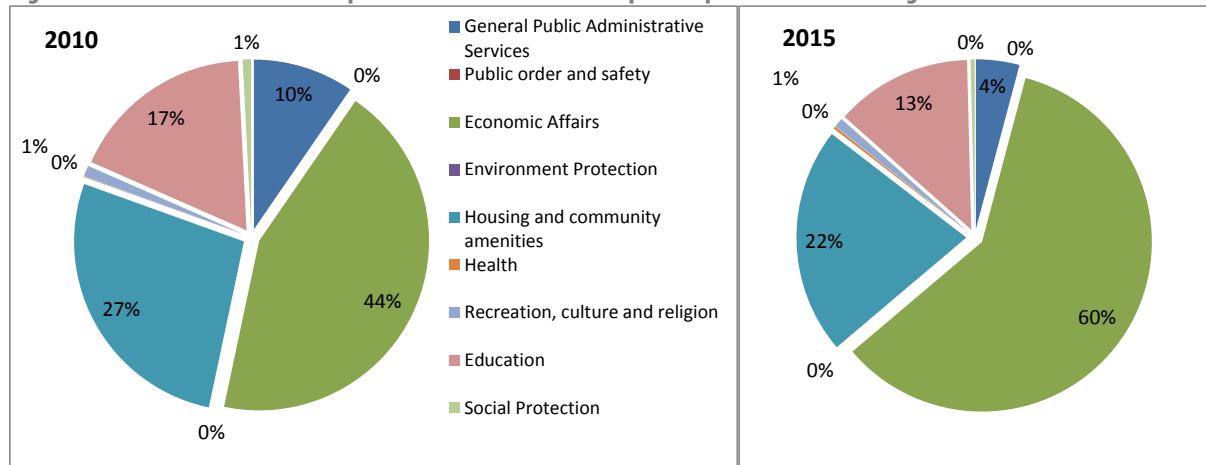
Source: Albanian Government Financial Information System, Own calculations

5.4 Where investments are focused?

Figures 17-19, provide the breakdown of local governments’ total capital expenditure following the functional classification, that is, they show in which local functions municipalities and the central government invest more and how much do investments in these functions cost to citizens.

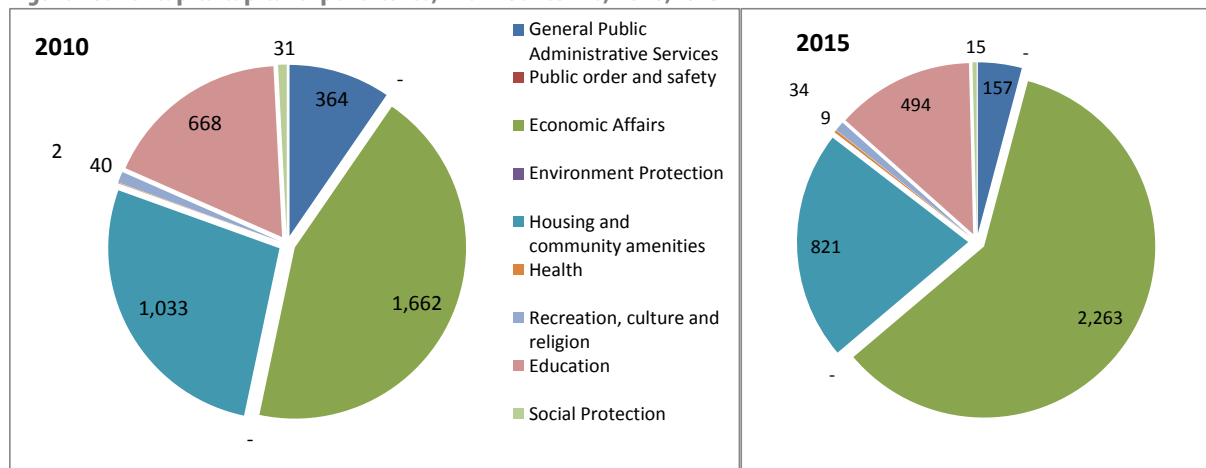
In 2015, 4% of the resources spent at the local level were invested on improving the operations of the administration; 60% of total available resources were dedicated to economic affairs (transport, agriculture, etc.); 22% to Housing and community amenities (water and sewerage systems mostly, street cleaning, public lighting); and 13% were employed to improve the conditions in public schools. As previously mentioned there are some sectors where Municipalities spend (and invest) very few resources, such as public order and safety, environment and health.

Figure 17. Breakdown resources spent at the local level for capital expenditures following the functional classification



Source: Albanian Government Financial Information System, Own calculations

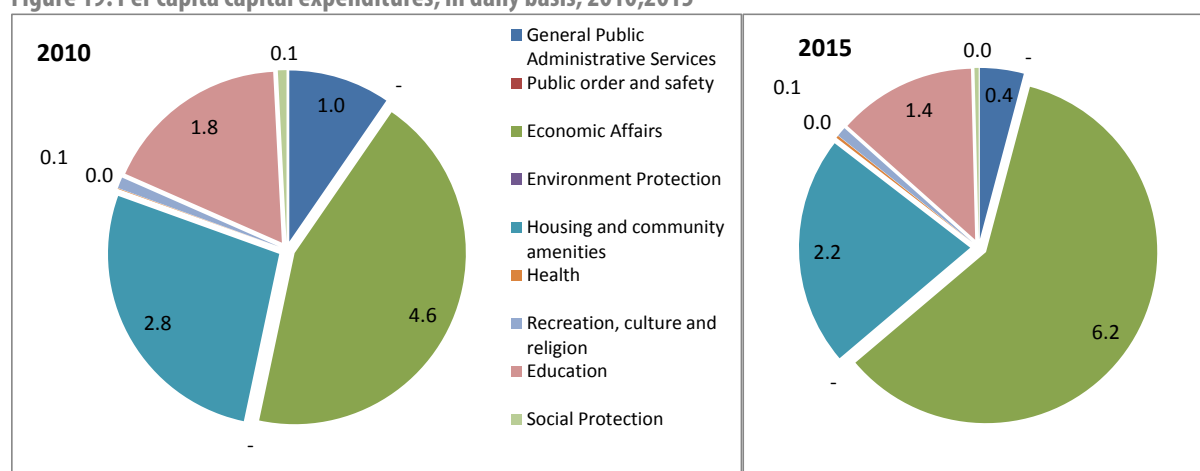
Figure 18. Per capita capital expenditures, in annual terms, 2010,2015



Source: Albanian Government Financial Information System, Own calculations

From a different perspective, investments in the different government functions costed Albanian citizens in total about 3,792 Lekë per year (or 10.4 Lekë per day) broken down as follows: 157 Lekë for creating better working conditions for the administration or to improve their operational efficiency, for example through information technology systems; 2263 for the building and maintenance of public roads, irrigation canals in agriculture etc.; 821 for water and sewerage systems; and 494 Lekë to create better conditions for pupils in public schools.

Figure 19. Per capita capital expenditures, in daily basis, 2010,2015



Source: Albanian Government Financial Information System, Own calculations

6. Concluding Remarks

Fiscal decentralization and fiscal autonomy of local governments is one of the major policy issues facing Albanian authorities in the aftermath of the Territorial and Administrative Reform, the new Decentralization Strategy and the new Law on Local Self-Governance. From local governments' perspective, there is urgency to move forward with more local revenue raising options, increased taxing powers and increased predictability of local financing sources. Failure to recognizing these challenges would result in the failure of the TAR's strategic goals of improved services, better governance and a more balanced territorial and economic development. For the benefits of the TAR to materialize, Albanian local governments need more fiscal autonomy – defined as the control over sufficient resources to plan and manage the provision of local public services according to citizens' preferences without continuous interference from higher authorities. If local governments raise substantial amounts of revenue from on their own local areas they are likely to be subjected to increased demands for downward accountability and for increased citizen participation in deciding how the resources will be used.

Our analysis showed that **in terms of fiscal autonomy Albanian local governments' score quite low: in total they raise on their own in their local areas only 20% of the resources spent for the provision of local public services; the remainder is directly controlled by the central government through intergovernmental transfers taking the form of unconditional or conditional transfers and shares of national taxes, or administrative orders limiting local borrowing capacities.**

The analysis on the revenue raising options and powers and local spending patterns showed that, **in per capita terms, local governance costs to each Albanian citizens about 13.584 Lekë per year (or 37 Lekë per day) in total,**

which is close to five times more than what local governments raise in terms of local governments taxes and fees. Local governments raise on their own about 2.966 Lekë per person annually (8 Lekë per day per person) from taxes and fees for local public services. This figure is very close to *what Albanian citizens pay for the salaries of local public officials (about 7 Lekë per day per citizen); or alternatively to the amounts needed to finance the operating expenditures of the municipality such as (office equipment, electricity, heating, fuel, etc.).* What this means is that with only local taxes, Albanian municipalities could pay their officials a monthly salary but they wouldn't be able to work because in that reality, the Municipality could not afford to pay for their office equipment, electricity and so on. ***The key message is then that local governments need more taxing powers and need to be supported to better administer their taxing powers by providing a better legislation and the necessary tools to make effective use of their increased tax powers.*** Put more simply, the national government needs to ***set up the promised fiscal cadaster and share the fiscal information with local authorities.***

From the analysis of the spending patterns we learned that local governance costs to each Albanian citizen about 13.584 Lekë per year (or 37 Lekë per day). In the analysis we showed that 19% of this amount is spent for salaries, 16% for operating expenses, 1% for subsidies to water public utilities, 36% transfers to individuals (for poverty alleviation) and 28% for capital expenditures. In addition we saw that from the point of view of functions of the government where expenses are incurred, in 2015, Municipalities spent about 19% on the administration, 18% on economic affairs (transport, agriculture, forestry etc), 17% on housing and community amenities, 7% on primary and secondary education and 36% on poverty alleviation. We also noticed that there are a number of functions on which apparently municipalities have not spent any resources such as public order and safety, environmental protection and health. While there certainly are problems of underfunding, we also believe that the presented situation might be **a reflection of inaccurate accounting processes that require more efforts to strengthen municipal officials' financial reporting capacities.**