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DECENTRALIZATION OUR GOAL

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CEA expresses the highest gratitude to LGI/OSI for support in the publishing of this bulletin.

The Center for Economic Analyses (CEA) is a think tank of economists who share a common vision for the Republic of Macedonia as an emerging new European economy integrated into the regional and worldwide markets.

The Mission of CEA is to continuously research economic development and economic policy in the Republic of Macedonia and to offer recommendations, suggestions and measures where it is deemed appropriate.

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From the editor

Dear readers,

CEA approached LGI/OSI with an unsolicited proposal for a cross country study on LGU borrowing with an expectation to set out lessons that can be learned by Macedonia. The overall objective of the study on local government borrowing is to accomplish an all-encompassing review that systematically captures the entirety of the fiscal decentralization processes with an emphasis on local government borrowing in each of the three transition countries: Romania, Bulgaria and Macedonia.

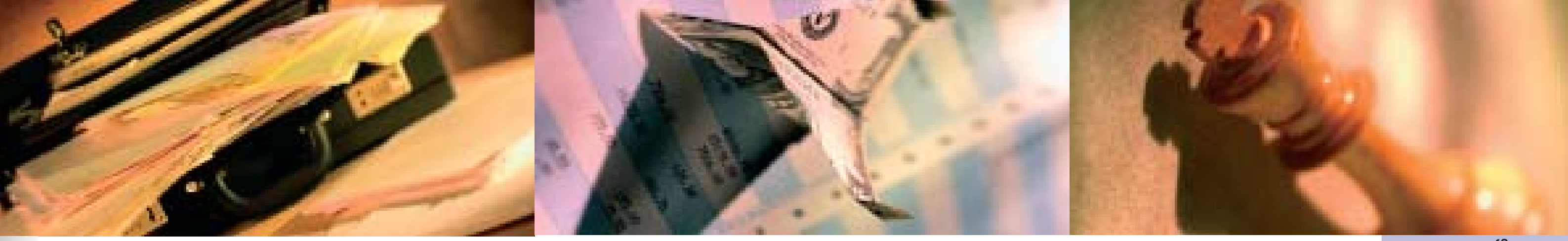
Macedonia is in a position to develop the legal and policy framework now, in anticipation of future development of a municipality credit market Macedonia can learn from the Romanian and Bulgarian experience but also can learn from problems that have become clear in other countries as well. Excessive borrowing by sub-national government or debt issuance in the absence of an adequate legal framework (one that clarifies critical issues like the status of guarantees or the remedies available to lenders in the event of a municipality's non-payment) has exacerbated any national economic crisis. Also, premature borrowing, prior to a municipality establishing its creditworthiness or having identified clear investment priorities, is likely to drain local budget resources and add risk to the fiscal system. The benefit of soundly based local borrowing is large, but the risks involved with poorly prepared borrowing can be great. Stakeholders-LGU, national government, banks, and potential investors in municipal debt share an interest in ensuring that the policy issues surrounding credit market development are well understood and that an appropriate legal framework is in place before the market actually opens.

This issue of the bulletin will present some comparative aspects of the studies carried out in relation to the three countries. The complete reports on Romania, Bulgaria and Macedonia are presented at www.cea.org.mk.

Best wishes,
Marjan Nikolov, MSc
Editor

1) Thanks to the World Learning's (USAID) small grant, that CEA won in a competitive bid, the web page:http://www.lsg-data.org.mk is available for all those in need of data, information and indices related to the LSG. CEA is pioneer among the NGOs in hosting database with LSG data on the Internet and making it available to the larger public with no fee.

Local Government
and Public Service
Reform Initiative



ON LINE E-INTERVIEW WITH MR. GEORGE GUESS FROM LGI/OSI

Why does borrowing benefit LGUs?

■ In principle, it is good for LGUs to borrow for infrastructure (medium-long term) and for short-term (less than one year) fiscal imbalances via cash management from commercial bank accounts. LGUs benefit by increasing their fiscal management capacity, by learning to develop budgets that cover all current obligations but ensure repayment of debt service, and by saving budget funds for capital projects (not having to pay-as-you-go financing. LGU borrowing also deepens local capital markets and strengthens the commercial banking system to learn how to assess creditworthiness of borrowers. It stimulates independent rating agencies both within banks and outside them.

Why does LGI/OSI sponsor this project?

■ LGI wants to know the comparative models and experiences of debt financing in this region. It needs to know the determinants of success in order to transfer lessons from successful cities to others. It needs to be able to advise central governments in particular countries as to what they should include in their municipal borrowing frameworks. LGI should also be able to advise LGUs what to include in local fiscal policies that pertain to debt, borrowing, and capital planning/budgeting.

What would be general criteria for good practice in LGU borrowing?

■ LGU borrowing frameworks need to contain some form of limit in % of revenue terms (e.g. 10% of past year revenues). The golden rule should also be there-borrowing only for capital projects and not to cover annual fiscal deficits. Cash management borrowing is only to cover temporary timing differences in revenue collections and expenditure obligations-a normal state of affairs for all local governments. There is a comprehensive literature of relevant credit limit laws, e.g. Poland and Romania. There are also model municipal bankruptcy codes that should be disseminated to allow for advance warning of fiscal stress and avoidance of bankruptcy that can destroy good credit ratings and make it difficult to establish credibility with capital markets again.

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LGU BORROWING IN MACEDONIA

The process of decentralization in Macedonia continues with the same speed. Indeed no system of decentralization is complete and efficient if the LGU are not allowed to practice long term borrowing. The investment needs of LGU are large but on the other side creditors don't know much about the specifics of the financial management, budgeting, strategic planning, CIP etc at the LGUs. Of course this will have impact on the interest rates and the high premiums that LGU might have to pay in case of borrowing through loans or by issuing bonds. Because of that, starting next year in accordance with the law on financing LGU the LGU will be allowed to borrow with the central government acting as a regulator, the LGU as the demand side and the investors as the supply side.

We support the CEA effort and the donor from Budapest for the pioneering steps in conducting research about the possibilities for LGU borrowing in Macedonia and by taking into account the experience from Romania and Bulgaria.

Best Regards,
Zoran Konjanovski, Minister of LSG

PREPARATIONS SHOULD START IN TIME

I am glad that the 5th issue of the CEA bulletin is devoted to this important topic for LGU and the city of Skopje - local government borrowing.

The process of decentralization is in its 17th month. This is too short a period to start drawing final conclusions but long enough to allow assessment the progress made in the LSG reforms especially concerning the impact from implementing the Law on financing LGU.

The chronic shortage of financial resources and the large amount of arrears are major problems for the Macedonian LGU and the city of Skopje. For these reasons, the opportunity provided by the Law for borrowing from the capital market domestically and abroad is a good opportunity for the building of capital projects that will improve the quality of life for citizens.

These preparations should start early and that is why we welcome the activities of CEA and Mr. Marjan Nikolov in helping the LGU get closer to the foreign experience in issuing municipal bonds and obtaining loans.

I am expecting the mayors, employees in the LGU administrations and other stakeholders to show interest and to use the opportunity to borrow for the citizen's good in their LGU and in the city of Skopje.

Best Regards,
Ace Kocevski, Mayor of Veles

LGU DEBT IN THE CONTEXT OF THE TOTAL PUBLIC DEBT IN MACEDONIA

Public debt in the Republic of Macedonia comprises the government debt and all financial liabilities created via borrowing by the municipalities and the city of Skopje, as well as borrowing by the public enterprises and companies being fully or predominantly owned by the state. Thus, the issuers of public debt can be LGU and the city of Skopje.

LGU and the city of Skopje differ from the other public debt issuers, since the provisions from the Law on Local Financing (Official Gazette of the Republic of Macedonia, no. 61/2004) apply. In fact, borrowing by the municipalities is treated in the Law in two stages. The first stage applies until 1st July 2007, and before that date, municipalities can borrow only with the consent of the Ministry of Finance and the Government of the Republic of Macedonia, in particular regarding the financing of capital investments in case where the funds are provided by an international financial institution. The second stage commences from 1st July 2007. During this stage, consent by the Government, based on an opinion by the Ministry of Finance, is required for each loan. There are also certain requirements for borrowing on the domestic market. ,In this case it is necessary for the Ministry of Finance to establish that the municipality has submitted regular financial reports that have been positively assessed, for a period of at least 24 months following the application of the Law on Local Financing and that there are no liabilities owing to creditors for this period.

At the same time, each municipality has to adhere to the limits on short- and long-term borrowing compared to the operational and current revenues of the previous year.

This seems to be a complicated system, however justified it may be for a state that is in the initial stage of a process of decentralization,, especially at a time when the municipal capacities for financial planning and management need to be established and upgraded.

Each municipality has a different predisposition whether to meet or not the requirements set in the laws allowing new borrowing. Some municipalities have high share of special revenues and are thus less dependent on transfers from the central government. This provides them with a more stable budget to finance capital investments. Such municipalities meet the preconditions to obtain a credit rating that will enable them to choose in future whether their borrowing is cheaper in the form of credit or securities (municipal bonds).

The rest of the municipalities have limited capacity to perform their main functions stipulated by law. Due to high insecurity and risk, these municipalities do not meet the requirements for borrowing, considering their fiscal stability and the question of debt sustainability.

However, in future each municipality should understand its capabilities and on this basis to define its medium-term development policy.

Best Regards,
Maja Parnardzieva, Head of Public Debt Department;
Ministry of finance

COMPARATIVE INSOLVENCY MATRIX IN ESTONIA, MACEDONIA, ROMANIA AND BULGARIA

	Insolvency Criteria	**Initiator**	**Method of Initiation/Cert.**	**Administration of Proceeding**	**Tasks of Trustee**	**Restrictions for Municipality and Creditors**	**Support for Insolvent Municipalities**	**State Guarantee Debt Relief or reduction**	**Exiting**	**Unmet Claims**
Estonia	No clear threshold; "Failure to demonstrate financial discipline."	Court or Creditor	Proclamation Filing by creditor	Appointed Board (Oversight Committee: Representatives of the creditors and the states) Does not include municipal representatives	Manage all financial issues Formulate recovery plan in cooperation with Oversight Committee	Lose all financial issues create stabilization plan three year projection replaces municipal budget	Funds from the state budget may be requested to fulfill portions of the recovery plan	No guarantee for the municipal debt	After recovery period is maintained and creditor's claims are paid. LGU could be consolidated into another LGU	NA
Macedonia	Lack of insolvency definition and procedure. Only financial crises definition	NA	NA	NA	NA	NA	NA	No guarantee for the municipal debt	NA	NA
Romania	If it is unable to pay the matured debts exceeding 50% of its budget for a period of 120 consecutive days or salary payments as planned in the budget are more than 120 days in arrear	Any creditor or group of creditors	File with the Court of Law in the territory the unit is located, an application for opening the proceedings of insolvency of that administrative--territorial unit	The manager/administrator will administrate the insolvency recovering procedure of the administrative-territorial unit.	Develop recovery plan	No finance-involving attributions whatsoever may be exercised by the primary spending authority and deliberative authority during the management of the insolvency situation	NA	NA	If the state of insolvency is found to have ended, the official receiver will, at manager's proposal, issue an order to end insolvency proceedings for the administrative unit. The manager shall notify the end of insolvency order to the primary spending authority, creditors and any interested persons. Continue with financial recovery plan.	NA
Bulgaria	Municipal Debt Act does not define the insolvency	NA	NA	NA	NA	NA	NA	NA	NA	NA

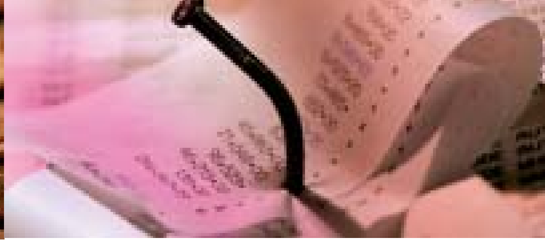
REFORM PRIORITIES FOR LGU BORROWING AND INFRASTRUCTURE DEVELOPMENT BY COUNTRY

	(A) Overall policy stance and policy effectiveness	**(B) Constitutional & legal framework**	**(C) Central govt institutional and regulatory framework**	**(D) Local gov't institutional and regulatory framework**	**(E) Participation by civil society and private sector**
MACEDONIA	Development of a viable solution for the arrears; Development of insolvency law.	Law on insolvency development; Law on balanced regional development developed	Debt management body of the ministry of finance to build capacity to manage LGU debt in the future; Commission for financing of decentralization should consider more in depth monitoring.	Capacity building for the financial management; Develop credit rating procedures. Developing a capacity for asset management.	Securities commission, banks, credit ratings agencies etc. intensify their activities. Independent/private consulting companies to start contracting with sub-national governments to provide TA.
ROMANIA	Separate insolvency law.	Working groups for the decentralization of competences are set up within ministries and other specialized central government bodies	Further developing in accordance with best practices	Further developing in accordance with best practices	Further developing in accordance with best practices
BULGARIA		To find co-financing for borrowing on infrastructure financed by the EU funds.			

FISCAL PERFORMANCE INDICATORS FOR 2006

LGU Fiscal performance indicators	% of revenues of GDP*	LGU revenues over LGU average=1; under LGU average=0	% of own revenues over transfers	% of CAPEX over operational expenditures
ARACINOVO	0.00%	0	55.08%	26.99%
BEROVO	0.05%	1	9.85%	308.09%
BITOLA	0.15%	1	149.56%	39.48%
BOGDANCI	0.01%	0	44.45%	85.78%
BOGOVINJE	0.03%	0	37.55%	172.43%
BOSILOVO	0.02%	0	27.31%	167.33%
BRVENICA	0.01%	0	53.75%	52.90%
VALANDOVO	0.02%	0	54.42%	29.47%
VASILEVO	0.01%	0	30.90%	82.33%
VEVCANI	0.00%	0	43.14%	87.51%
VELES	0.07%	1	115.94%	39.17%
VINICA	0.04%	0	26.41%	105.80%
VRANETICA	0.00%	0	89.91%	28.23%
VRAPCISTE	0.02%	0	285.40%	59.78%
GEVGELIJA	0.07%	1	57.76%	137.58%
GOSTIVAR	0.09%	1	81.45%	77.87%
GRADSKO	0.01%	0	33.93%	128.23%
DEBAR	0.04%	0	93.99%	117.32%
DEBARCA	0.01%	0	23.18%	63.00%
DELCEVO	0.03%	0	60.85%	51.20%
DEMIR KAPIJA	0.01%	0	28.55%	132.96%
DEMIR HISAR	0.02%	0	21.81%	81.25%
DOJRAN	0.01%	0	107.04%	65.72%
DOLNENI	0.01%	0	32.16%	26.71%
DRUGOVO	0.01%	0	38.94%	25.23%
ZELINO	0.02%	0	48.54%	88.22%
ZAJAS	0.01%	0	35.50%	40.15%
ZELENIKOVO	0.01%	0	149.47%	40.52%
ZRNOVCI	0.00%	0	29.93%	101.18%
ILINDEN	0.02%	0	140.58%	41.59%
JEGUNOVCE	0.01%	0	51.80%	29.93%
KAVADARCI	0.07%	1	224.48%	96.79%
KARBINCI	0.01%	0	11.40%	85.77%
KICEVO	0.04%	0	137.13%	41.64%
KONCE	0.01%	0	38.10%	81.61%
KOCANI	0.04%	0	77.06%	41.03%
KRATOVO	0.01%	0	35.82%	100.30%
KRIVA PALANKA	0.04%	0	32.03%	18.38%
KRIVOGASTANI	0.00%	0	69.34%	22.20%
KRUSEVO	0.01%	0	43.99%	58.66%
KUMANOVO	0.12%	1	92.11%	25.10%
LIPKOVO	0.01%	0	30.12%	302.05%
LOZOVO	0.01%	0	14.38%	10.10%
MAVROVO I ROSTUSE	0.01%	0	29.44%	25.91%
MAKEDONSKI BROD	0.01%	0	33.93%	114.34%
MAKEDONSKA KAMENICA	0.01%	0	46.16%	62.83%
MOGILA	0.01%	0	61.67%	65.16%
NEGOTINO	0.03%	0	111.20%	37.61%
NOVACI	0.01%	0	40.79%	110.30%
NOVO SELO	0.02%	0	22.06%	26.51%
OSLOMEJ	0.01%	0	19.99%	108.11%
OHRID	0.12%	1	374.38%	38.27%
PETROVEC	0.01%	0	60.70%	140.87%
PEHCEVO	0.01%	0	18.63%	186.67%
PLASNICA	0.01%	0	11.81%	42.02%
PRILEP	0.10%	1	167.96%	127.95%
PROBISTIP	0.04%	0	48.30%	168.00%
RADOVIS	0.06%	1	170.29%	90.86%
RANKOVCE	0.01%	0	14.91%	36.49%
RESEN	0.03%	0	62.82%	125.09%

* GDP taken as projection for the whole 2006 year.


ROSOMAN	0.01%	0	59.44%	91.78%
STARO NAGORICANE	0.01%	0	31.73%	124.35%
SVETI NIKOLE	0.05%	1	64.02%	52.49%
SOPISTE	0.01%	0	179.65%	48.48%
STRUGA	0.14%	1	234.63%	52.83%
STRUMICA	0.08%	1	149.60%	14.42%
STUDENICANI	0.01%	0	117.15%	51.23%
TEARCE	0.02%	0	76.53%	37.24%
TETOVO	0.09%	1	172.90%	19.79%
CENTAR ZUPA	0.01%	0	97.78%	23.29%
CAJKA	0.01%	0	18.47%	80.35%
ZESINOVO I OBLESVO	0.01%	0	141.68%	102.43%
CUCER SANDEVO	0.03%	0	228.39%	27.86%
STIP	0.05%	1	130.32%	116.47%
AERODROM	0.17%	1	349.64%	78.08%
BUTEL	0.05%	1	167.77%	55.19%
GAZI BABA	0.10%	1	109.93%	50.76%
GORCE PETROV	0.05%	1	236.50%	89.11%
KARPOS	0.13%	1	280.09%	56.98%
KISELA VODA	0.10%	1	269.96%	47.08%
SARAJ	0.02%	0	91.32%	104.44%
CENTAR	0.17%	1	477.38%	33.36%
CAIR	0.07%	1	146.15%	28.23%
SUTO ORIZARI	0.01%	0	127.30%	120.37%
CITY OF SKOPJE	0.87%	1	657.50%	26.99%
TOTAL:	**3.93%**		**351.01%**	**79.79 %**

Participants of the presentations held 20th of October at the Ministry of Finance premises

Name/surname of the participants	Institution/Organization
Marjan Nikolov	President of CEA
Malgorzata Markiewicz	Economist at CEA
Maja Parnardzieva	Head of department
Alev Sulejmani	Assistant
Darko Blazevski	Senior advisor
Renata Davitkova	Sector Manager
Dejan Nikolovski	Assistant
Biljana Krusharovska	Assistant
Semira Ademi	Assistant
Aferdita Redzepi	Assistant
Miodrag Bogdanovik	Advisor
Sanja Manasijevik-Manceva	Senior advisor
Ana Stojkova	SectorManager

The Debt Management Department within the Ministry of Finance and Marjan Nikolov from CEA

Sadri Elezi and Marjan Nikolov

Participants of the presentations held 26th of October at the CEA premises

Name/surname of the participants	Institution/Organization
Marjan Nikolov	President of CEA
Malgorzata Markiewicz	Economist at CEA
Dragica Todorovska	Head of Financial and LED Department at Gorce Petrov-LGU
Krste Andonovski	Deputy Head of Financial Department at the City of Skopje
Sadri Elezi	Head of Financial and Budget Department at Gostivar-LGU
Zoran Jankulovski	Association of Financial Officers of LGU

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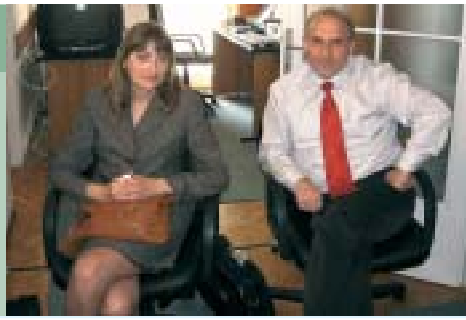
Dragica Todorovska, Krste Andonovski and Zoran Jankulovski

Financial Officers and Malgorzata Markiewicz

Participants of the presentations held 27th of October at the CEA premises	
Name/surname of the participants	**Institution/Organization**
Marjan Nikolov	President of CEA
Malgorzata Markiewicz	Economist at CEA
Ace Kocevski	Mayor of Veles-LGU
Ljubomir Janev	Mayor of Kocani-LGU
Dzelal Ramadani	Mayor of Brvenica-LGU
Dushica Perishich	Executive Director of
	Association of LGU-ZELS



Dushica Perishich and Ace Kocevski

Malgorzata Markiewicz, Dzelal Ramadani and Ljubomir Janev

Marjan Nikolov, Gabriela Matei from CSPD-Romania and Ace Kocevski during visit in Bucharest

List of people interviewed during the field visit to Romania in June 2006		
Interviewee	**Position**	
Sorin Teodoru	Consultant at the World Bank	steodoru@worldbank.org
Radu Dorcioman	Ministry of Administration and Interior Affairs	radu.dorcioman@yahoo.com
Valentin Ionescu	Legal expert at CSPD	vionescu1961@yahoo.com
Victor Giosan	State Secretary at the Romanian General Secretariat	vgiosan@yahoo.co.uk
Casandra Bischoff	Decentralization team at the World Bank	cbischoff@worldbank.org
Gabriela Matei	Director of CSPD	gabriela.matei@cspd.ro
Adrian Oprica	The BRD Bank	adrian.oprica@brd.ro

Visit conducted to Romania by Marjan Nikolov, President of CEA and Ace Kocevski Mayor of Veles

List of people interviewed during the field visit to Bulgaria in September 2006	
Interviewee	**Position Contact**
Valentina Grozdanova	Director of the Local Governments Directorate at the Ministry of Finance
Ljudmila Bojanova	Head of Sector Analyses Division, Government Debt Directorate at the
	Ministry of Finance
Zdravko Sechkov	Financial Director at the Foundation for Local Government Reform
Emil Kaltchev	Senior researcher at the Center for Economic Development

Visit conducted to Bulgaria by Malgorzata Markiewicz, Economist at CEA and Ana Stojkova Ministry of Finance