



Center for Economic Analyses

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LGU Borrowing in Romania, Bulgaria and Macedonia

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Discussion about Macedonia

Case of Macedonia

- Need for debate and discussion
- Topics?

Factors for credit rating procedure

| Factor | Comment |
|--------------------------|---|
| Sovereign Rating Ceiling | The rating of the national government usually sets the top limit on the rating that a subsovereign unit can enjoy. National government set monetary and fiscal policy and usually have first claim on foreign exchange and can change the rules of the game for its junior units of government. Exceptions to this rule can be found if the debt is secured by offshore assets or revenue streams. |
| Economy | Fiscal health is usually closely linked to the health of the local economy and the diversification in activity (which often comes with size) helps balance the economy's performance. Demographics are important. A high dependency population (the very young and very old are negatives) and too rapid growth in population are negatives. Higher-income and more educated population is a plus, as is an acceptable distribution and rate of growth in income. Creditors are also interested in the structure of the local economy. Particularly, how much of it is in private hands, and how dependent it is on a single industry, or a small number of large employers. As a result, local governments should be able to present to creditors accurate information on the distribution of employment across types of firms and industries, as well information on the general economic situation of the largest employers. Of particular value here, is information on the number of enterprises (and in fact individuals) who have substantial tax arrears, because tax arrears are generally a good sign of economic distress and monitoring them is often used by local governments and creditors to anticipate potential economic problems. Indeed, rating agencies typically require local governments to provide them with lists of the largest employers and as well as lists of the firms with the largest tax arrears. For Macedonian LGU individually it is worth estimating whether they depend more on property tax revenues or PIT revenues in the context of economic activity since the PIT revenues are more elastic to economic fluctuations. Here a reasonable long run solution for Macedonian LGU is to improve own tax administration, enforcing, collection. |

Factors for credit rating procedure

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| Structure and Management | <p>An assignment of functional spending responsibilities consistent with revenue resources is a plus. Intergovernmental transfers are looked at for their size and predictability. The willingness and ability of the national government to detect and stem financial emergencies is a positive. The rigor and timeliness of budgetary and financial laws are examined and can be either a plus or negative depending on the flexibility they provide localities. Past performance in achieving budgetary balance are important. Timeliness and comprehensive of financial reporting and following consistent standards are a plus. In Macedonia, LGU were being assigned new expenditure responsibilities without being assigned new sources of adequate revenues especially in the education. Changes in environmental standards, for example, can lead to significant increases in local government costs, while changes in the way businesses are regulated can have an impact on their revenues.</p> |
| Fiscal performance | <p>Revenue composition and trends are considered with ability to set rates at the local level seen as a plus. Tax burdens should be acceptable in comparison to neighboring regions. Effective use of charges and fees are viewed favorably, large transfers of general funds to local enterprises are not. Possible indicators: % of revenues of GDP and % of LGU that have revenues less than nation average. Another important weakness of the current intergovernmental finance system is that Macedonian LGU have limited powers to increase their revenues through their own policy decisions thus, the vast majority of their revenues come from shared taxes and fees, or transfers. This is problematic for creditors for two reasons. On the one hand, it means that local governments have relatively little ability to adjust their revenue policies to meet their debt service needs. On the other hand, it means that their revenues are fundamentally dependent on the tax policies of the central government. Another problem can be adverse effect of poor collection performance of own revenues from property.</p> |

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| Financial position | Liquid assets and marketable real assets are favorable factors, as are healthy reserves in relationship to annual expenditures. Outstanding debt is considered. Short term debt is a concern if not periodically retired. Long-term debt and contingent debt (where there are guarantees to others) is generally a negative unless used in support of productive (self-supporting) activities. Short maturity debt with principal due at the term (bullet maturity) is a negative because of continuing pressure to refinance and potential burden on current revenues. Overlapping debt of other governments that relies on same economic base is considered. Possible indicators: % of investment from total expenditures and % of LGU less than national average. |

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| Legal framework | <p>The lack of clear laws, legal precedent or effective judicial system is major impediments, especially where there is restricted revenue or enterprise-based pledges. A history of repudiations or insolvencies is a large negative. Approval of borrowings by senior units and other restrictions on local borrowing may be a positive if efficient and nonpolitical, but can be a negative if complex, difficult and political. In Macedonia LGU are forbidden from using as collateral any piece of property that is used for the provision of essential public services. This classification requires lenders to set aside higher percentages of their own capital as reserves in case borrowers default. The regulatory requirement that banks "set aside" or reserve different levels of their own capital depending on the risk rating of a credit is designed to protect the banking system as whole. But the high reserve ratio requirements required for high risk credits means that banks can use less of their capital for other loans, a cost that usually is reflected in higher interest rates.</p> |
| Accounting and financial reporting | <p>The basis and quality of financial records is examined, and prompt, consistent reports are a plus. Timely and independent audits are a positive. Cash flow information or cash basis accounting that provides reliable information on cash available to pay debt service is a positive. Evaluation of liquid assets and accounts receivable can be issues in that required investments in government bonds can be risky and accounts may be in arrears. Of special importance is the clear financial relationship between the LGU and the enterprises (like communal ones) that might create hidden debt. Clear relationships between them and possible accrual accounting recording all the accruals will increase the rating of the LGU.</p> |

Success is a journey – not a destination!

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