



Number

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**FINANCIAL VIABILITY OF
MUNICIPALITIES IS THE
CORNERSTONE OF A SUCCESSFUL
DECENTRALIZATION**

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**THE PROJECT:
MEASURING FISCAL CAPACITY**

DECENTRALIZATION OUR GOAL

CEA expresses the highest gratitude to OSCE Spillover Monitor Mission to Skopje for support in the publishing of this bulletin.

The American people, through USAID, have invested more than \$450 million in Macedonia since 1993. More than 20 projects worth over \$20 million a year are currently being implemented. These projects are designed to support Macedonia's transition to a free market-based, multi-ethnic democracy. They include initiatives to accelerate economic growth, develop democratic institutions, and educate citizens for a modern economy.

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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,



For the policy makers in Macedonia (both at central and local level) it is very much welcomed to define and to quantify what is the fiscal capacity of the Macedonian LSGU to raise revenues in order to meet the needs for a standard basket of goods that should be delivered to the citizens. Also, these calculations can give answers of the local level dependency from the central level. In that regard it is natural to ask if some LSGU do not have the capacity, than how the Government will proceed in order to compensate and equalize the LSGU and to foster balanced regional development or to ask if the system creates high dependence of local level from the central.

All these questions of the level of own revenues, horizontal equalization, fiscal dependency and other cannot be addressed if there is no knowledge of the fiscal capacity of the LSGU.

CEA signed a contract with the MDW (an USAID decentralization project Make Decentralization Work) for measuring fiscal capacity of 15 predetermined LSGU. This is a second project that CEA is conducting in measuring LSGU's fiscal capacity. CEA recognizes that this time the system is more favorable for this on job exercise but it is still too early for setting a firm methodology that will yield an acceptable error in modeling the fiscal capacity of the Macedonian LSGU. The findings are listed in this bulletin.

Best wishes,
Marjan Nikolov, MSc
Editor



Organization for Security and Co-operation in Europe
Spillover Monitor
Mission to Skopje

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.



FINANCIAL VIABILITY OF MUNICIPALITIES IS THE CORNERSTONE OF A SUCCESSFUL DECENTRALIZATION

The Law on financing units of local self-government and the Law on local self-government set the basics of the system of local government financing in the country. They provided for gradual devolution of responsibilities in line with the capacity of the municipalities to undertake those responsibilities and an equitable and adequate provision of the funds for an efficient execution of the transferred competencies.

Financial viability of municipalities is the cornerstone of a successful decentralization. According to the European Charter of Local Self Government, local authorities shall be entitled to adequate financial resources of their own, commensurate with the responsibilities provided for by the law. In frames of this new system, local self-government units in the country are given the opportunity to be their own fiscal policy makers. Fiscal capacity is to be understood as their potential ability to raise revenues from own sources in order to pay for a standardized basket of public goods and

services. They will have to take care of timely execution of all activities in their fiscal calendar, they will have to make efforts to collect own resources to their full extend and they will have to find new ways to increase their own fiscal capacity.

We at the OSCE will continue keeping close eye on the developments in the implementation of fiscal decentralization and provide continuous assistance in upgrading the capacity of the local government tax administration. We do believe that only in this way the decentralization will reach its goal and create well functioning units of local self-government units able to provide quality services to their citizens.

D-r Philipp Stiel,
Head of Public Administration Reform Unit

OSCE Spillover Monitor Mission to Skopje

CEA CORE COMPETENCIES AND SERVICES:

Since its foundation, CEA has been committed to using its human capacities to support those working for an enabling environment for higher investment, accelerated development and growth of the Macedonian economy, and the strengthening of civil society, social capital and trust. As the number of qualified and committed team members increased, CEA has developed a clear organizational structure and has strong capacities in conducting projects and high quality research.



THE PROJECT: MEASURING FISCAL CAPACITY

● Environment

This workshop on Fiscal Capacity Measurement is designed by taking into consideration the following environment:

- The fundamental importance of financial management and properly designed municipal fiscal capacity to match the needs for a standard basket of goods that should be delivered to the citizens;
- The fiscal capacity of a municipality - defined as municipality's own revenue - should ensure that municipalities can perform their competencies with their own revenue sources (property taxes, municipal fees, personal income tax);
- The economic health and the stability of LSGU in Republic of Macedonia and the fact that how well this function is carried out depends at most on the knowledge of the field and ability to perform effectively;
- The need to integrate the most important components of an effective municipal finance system into a coherent set up.

● Objectives

- To explore current financial standing of municipalities in Macedonia;
- To present solutions from the international practice, emphasizing the importance of developing own model of fiscal capacity;
- To identify optimal fiscal capacity measurement model for the Macedonian LSGU;
- To initiate empirical work and studies on fiscal decentralization;
- To provide background for redesign of the horizontal equalization scheme for Macedonian LSGU;
- To provide active participation of LSGU officials.

● Goal

- To prepare participants to understand the concepts of fiscal capacity and fiscal effort which is fundamental to the development of a system of inter-governmental transfers and equalization grants.

- Topics of the two presentations (power point presentations available at: www.cea.org.mk)

● Introduction

- Fiscal capacity and fiscal effort
- Expenditure needs
- Fiscal capacity
- Fiscal gap
- Measuring fiscal capacity
- The use of revenue collections as a measure of fiscal capacity
- The use of per capita income, the most basic measure of fiscal capacity
- Gross regional product as a measure of fiscal capacity
- The level of total taxable resources
- Representative tax system
- Regression analysis to arrive at a representative tax system
- Examples
- Summary and concluding remarks

● Topics of the hands on work:

- Why do we need to know what is fiscal capacity at LSGU level and how can we measure it;
- Methodology identification;
- Database review;
- Macedonian characteristics implemented;
- Further data requirements;
- Identifying optimal approach for measuring fiscal capacity for Macedonian LSGU;
- Preparation of the participant's power point presentation/word document;
- The importance of fiscal capacity calculation for horizontal equalization.

● Trainers

Center for Economic Analyses (think tank with previous background/experience in Financial Management, high qualified to design and present clear, active training sessions on subject relating to measurement of the Fiscal Capacity) in cooperation with USAID's DP and



USAID's BEA was entrusted with the role of providing the series of trainings which included fifteen (15) selected municipalities plus City of Skopje.

● Format of the workshop

The event was consisted of two sessions per day (two days event).

● First day:

At the first day there were two presentations delivered in the morning session.

First presentation was delivered by Gjorgji Josifov (USAID's Decentralization Project MDW), emphasising the need for measurement of the municipal fiscal capacity. The focus was given to the following:

- Why do we need to know what the fiscal capacity is at LSGU level and how it can be measured
- Introduction and overview of measurement of the fiscal capacity
- Current experience & problems encountered
- Methodology and approaches

The second presenter, Marjan Nikolov from CEA discussed issues related to:

- Data requirements (brief description of each variable available)
- Macedonian characteristics
- Identifying optimal approach for measuring fiscal capacity for Macedonian LSGU

In the afternoon session participants were divided in two working groups and were working on building the model of fiscal capacity for partner municipalities. Marjan Nikolov and Gjorgji Josifov have explained the tasks and monitored the progress. Each working group was consisted of four to five members.

● Second day:

In the morning session of the second day each group was further developing the fiscal capacity models and prepared power point presentations/word documents.

In the afternoon each of the groups presented their opinion and findings. During the presentations the participants have exchanged their views. The representa-

tives from the USAID's Decentralization Project MDW and CEA summarized all the findings and results of the two working groups.

These two working groups have worked on PROS and CONS of the two proposed models and identified the most beneficial one. The conclusions became a part of the final document that should be published along with all of the presentations and materials and will be used as a recommendation to the stakeholders and policy makers.

● Participants

The target group was municipal finance administration (who are currently engaged as heads and deputies of finance departments), coming from fifteen (15) selected partner municipalities to USAID Decentralization Project plus City of Skopje. Attendees included 25 participants from 15 municipalities. Each municipality has been represented by at least one participant.

Training Location	Training Dates	Participating municipalities	Attendees
Strumica	22 - 23 Feb. 07'	4	8
Bitola	01 - 02 Mar. 07'	4	9
Skopje	06 - 07 Mar. 07'	6	8
TOTAL:		14	25

● Results

At the end of the program the participants have:

- Identified optimal model for fiscal capacity measurement of Macedonian LGUs,
- Determined and presented a model of fiscal capacity of the respective municipality (Revenue Collections as a measure of fiscal capacity and Representative Tax System using Regression Analysis)
- Provided recommendations about the measure of fiscal capacity, its strength and weaknesses, and data availability, and
- Improved their skills to design a model for fiscal capacity based on empirical work and studies on fiscal decentralization in Macedonia

According to the results from the exercises, the expectations were met. The groups have been consisted of representatives from different municipalities, which enabled the sharing of experience, knowledge, new

ideas, and considerations. The team work was highly interactive, as each member shared his/her own experience from his/her municipality, which improved understanding for the whole group.

The training did offer not only the theoretical aspects but also such practical matters as the availability, quality, and timelines of data, the appropriateness of specifications and statistical methods.

Determining of the fiscal capacity based on real data from Macedonia's municipalities, will provide worth insight into the whole process and would be an especially valuable source of knowledge in determining the same in remaining local government units. It is common conclusion that an ideal or close to ideal fiscal capacity indicator has not yet been produced.

The timing and topics of the training program were appropriate, as the program was presented before the second phase of fiscal decentralization (planned for after July, 2007).

According to participant's evaluations the program met the needs of municipal officers in presenting an introductory review of the variety of concepts in which fiscal capacity could be measured. The participants have accepted the participative methodology and were very active during the sessions. It was their opinion that theory is very important, but exercises and real case studies is the best way to learn.

Therefore we can conclude that the workshop was successful and influential, and that the goals were met.

● Participant's findings:

1. LSGU Own Source Revenues are not representative in time, structure and as a system. During the workshop it became quite clear that the available data on municipal own source revenues should be carefully analyzed before used for the purpose of measuring municipal fiscal capacity. The 2005 financial data are not representative as it is a start year of fiscal decentralization. Many problems are internalized in the data: transfer of taxpayer's registry data, equipping the tax offices in the LSGU, lack of human resources just to mention few. In that regards the timing is important related to when to measure the fiscal capacity of LSGU

in Macedonia. The volatility, reliability, structure of the tax system should calm and then to try again to measure the fiscal capacity.

2. This is not a criticism. The effort of working with the available data provided participants with a better understanding of the kind of information that will be required in the future in order to develop accurate and credible estimates of municipal fiscal capacity. The fees for construction and infrastructure are earmarked for capital purposes and still are accounted as current revenues even though are capital revenues.

3. Continuing and improving the collection of LSGU financial data is of high importance. Measuring fiscal capacity is an exercise that should involve more LSGU at a time. It is not efficient to do it for only one LSGU at a time due to time consuming in setting up a methodology for only one LSGU. On the other side it requires more LSGU at a time in order to minimize possible statistical errors. In that regards, collection, presentation, dissemination should improve in the ministry of finance. The Ministry should also improve its own capacity for analyses and setting up procedures and standards for measuring fiscal needs, fiscal capacity, and fiscal gap and to set up a proper horizontal equalization system.

4. Importance of reliable and timely data is precondition for measuring fiscal capacity. There are some available estimates of LSGU GDP at Purchasing Power Parity for 2002. In addition, the 2002 census was recently completed in Macedonia. However this is not sufficient as the data are relatively old and do not represent the changed economic-social structure in the LSGU in Macedonia. In this regard the ignorance of the importance of State Statistical Office in pushing it to produce LSGU data cannot be tolerated anymore. The NUTS 4 data are in need as soon as possible. The measure of fiscal capacity in Macedonia is sensitive to methodology and data used as well.

5. Very high level of disparity across Macedonia's LSGU. Indeed the revealed level of disparity is too high to be ignored. The heterogeneity among LSGU has a distorting impact on the results of the measured fiscal capacity.

6. Financial and Fiscal planning is important. Realistic planning at LSGU is of crucial importance for



measuring fiscal capacity especially if the planned and collected revenues are used for calculation of fiscal capacity and fiscal effort for that regards.

7. The competencies between central and local government are still unclear. During the workshop it was stressed that there are legal gaps for LSGU to update and administer properly their database of taxpayers. There are legal entities that are in a court procedure and not working, bankruptcy procedure, in a procedure of closure and exit of the market and the LSGU are still planning them as a source of revenue.

● Selected Participant's Comments

1. The cooperation and coordination between central and local government is important and desirable;
2. The sharing experiences among LSGU is important and desirable;
3. More initiatives from the administration within the LSGU should be encouraged;
4. Citizen's participation, information, compliance are topics to be explored more by the LSGU in future.

● Training Location: Strumica, 22 - 23 Feb. 2007

Name and Surname	Municipality	Position
Dusko Vasilev	Strumica	Head of Tax Administration Unit
Draga Neskova	Strumica	Counselor in Tax Administration Unit
Snezana Paljoskova	Strumica	Budget Counselor
Evgenija Gramatikova	Strumica	Head of Finance Sector
Irina Hadzieva	Kocani	Head of Finance Sector
Goce Manev	Kocani	Budget Counselor
Trajce Cvetkov	Stip	Head of Finance and Budget Sector
Liljana Kicukova	Gevgelija	Finance and Budget Counselor

● Training Location: Bitola, 01 - 02 Mar. 2007

Name and Surname	Municipality	Position
Drage Zvezdakoski	Prilep	Head of Finance Sector
Bosko Taleski	Prilep	Head of Tax Administration Unit
Ljupce Andreevski	Veles	Head of Finance and Budget Unit
Olivera Caneva	Veles	Main Accountant
Slobodan Atanasovski	Veles	Internal Auditor
Meratip Loga	Struga	Head of Tax Administration Unit
Gezim Elmazi	Struga	Counselor in Finance Unit
Elizabeta Cadikovska Gagovska	Struga	Head of Finance and Budget Unit
Vesna Georgievska	Bitola	Tax Counselor

● **Training Location: Skopje,
06 - 07 Mar. 2007**

Name and Surname	Municipality	Position
Dragica Gjurovska	Kumanovo	Main Accountant
Rina Petkovska	City of Skopje	Head of Budget Unit
Ljupka Georgieva	City of Skopje	Head of
Nikola Nikolovski	Karpos	Counselor in Tax Department
Cvetanka KOneska	Gazi Baba	Counselor in Budget Department
Ismet Rusiti	Tetovo	Finance and Budget Counselor
Adnan Neziri	Tetovo	Head of Finance Unit
Farie Aliu	Gostivar	Head of Finance Department



Workshop
Bitola



Workshop
Skopje



Workshop
Strumica