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**INSTABILITY OF FINANCE IN LOCAL
GOVERNMENT CASE OF ALBANIA**

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Instability of Finance in Local Government Case of Albania

Fatbardha KADIU¹

Abstract

The aim of the paper is to analyse the instability of revenues in local government of Albania. Also it would identify the modes of revenues distribution and the possible implications of tax system structural changes.

The analysis includes 48 local units from which 27 of them are municipalities. The selection is based on average population and revenues on each region according to the Ministry of Finance. First it will be presented the main principles governing the intergovernmental transfers; also it will present the challenges of recourse mobilization and management of local revenues. The paper also will analyse the main sources of revenues in local level, the local autonomy on defining the taxes. The paper will show the possible policies for the improvement of defining and administrating the tax system.

At the end the paper undermines the causes of the weak performance of taxation in local governments and it tries to understand the most important factors that support the tax administration in different periods, by including efficiency, risk of trust and availability of the taxpayers' data.

Keywords

local revenues, grant, tax, distribution of revenues;

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Introduction

1.1. The Importance of Good Management of Public Revenues

In this part of the paper it will be described briefly the main principles that leads intergovernmental transfers. One of the main challenges of local government is to meet the expectations for services and good governance. Decentralization and urbanization resulted in an increasing pressure for local government in order to offer public services and economic development. So the financial level of local government closely related with their functions for which they are mandated.

Local governments in Albania are financed by a combination of conditional and unconditional grant, taxes and fees. The design of transfer system seems to be appropriate for actual condition of the country and realizes the horizontal equality².(Local Financial Policies in Albania, 2008).

Regarding to vertical equality, expenditure level of local government in Albania remains low, less than 3% of GDP³. (Fiscal Decentralization in Albania, 2012).

The main serviced related to local government on Albania refers to infrastructure maintenance, water supply, sanitation, urban public transport and urban planning. In theory, system allows local government to increase its revenues in order to finance most of those services. Other services, including education, social protection are partially or totally financed by central government, through conditional grants and transfers.

It is worth to mention that the most of the funding does not look like adequate for major needs and for infrastructure improvement. Especially the infrastructure sector and water supply physically are missing or outdated because of deferred maintenance.

When economic conditions change, income distribution may have less vertical and horizontal equality. Frequent changes on the funding system of local government, like unconditional grant reduction,

² Albania Local Finance Policy Note, World Bank, 2008, pg 26.

³ Fiscal Decentralization in Albania, USAID, 2012, pg 12.

have damaged the finance and operations consolidation of local government.

1.1. Main Principles of Transfer System

Intergovernmental transfer system should be based on efficiency and equality of local service supply. Boadway and Shah⁴ argued some of the main principles that should lead the system, as follow:

Autonomy: Local government should have full autonomy and flexibility in defining the priorities. They should not be limited and depended on central government decision making.

Forecasting: Grant forecasting system should be published in a long run of five years, so that local government can manage its assets. Max and min annual fluctuations should be included in the formula of the grant system.

Transparency and efficiency: grant system should be neutral in decision making of local government regarding to the sectors that will be funded.

Clarity on grant's objectives: They should be very specific and they should be related to the whole strategy.

Adequacy of income: Local government should have adequate revenues to fulfil the certain responsibilities.

Fairness: Addressed funds should be changed directly according to fiscal needs and vice versa with the taxpayer's capacity.

1.2. Qualitative Aspects of Public Income System

One of the main characteristics of each income source is its potential of providing more revenues than its administrative cost. Despite this, taxation equality and incentives created by tax system are very important factors. Tax burden and the excess burden caused by tax system should be that not effect negatively on tax payer behaviour, where as tax payer with almost similar conditions should be taxed equally.

Tax administration procedures have e crucial aspect on the success or failure of any tax, because of transition conditions. Not only

⁴ Intergovernmental Fiscal Transfers Principles and practices, edited by Robin Boadway and Anwar Shah, World Bank, 2010, pg. 2.

evasion through the tax payers and tax administration during declare and evaluation process, but also the underground economy do effect on the excess tax burden and inequality.

2. Evaluation Of Public Income From 2008

In this section it will be presented a brief description of income system evaluation during last year's. Also it will be included an analysis of how different sources of income are changed during years.

2.1. Defining Income

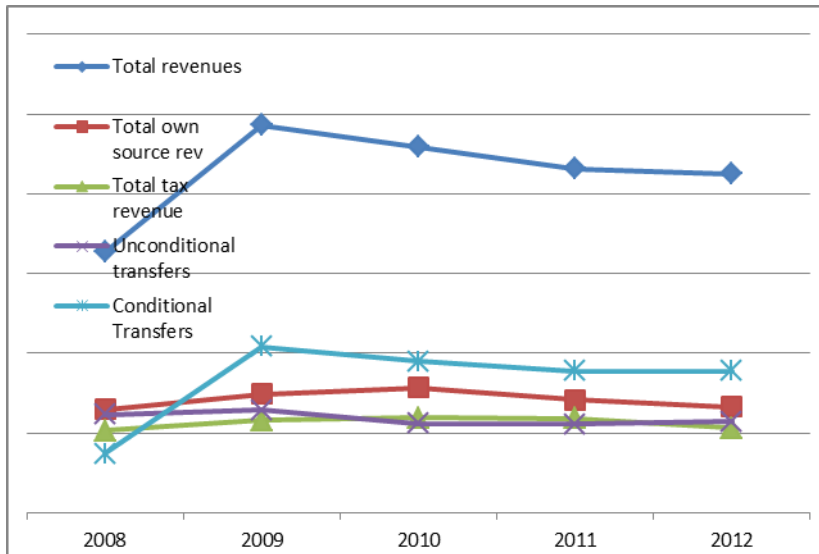
Organic Law of Local Government Nr. 8652.(2000) define a group of principles that tend to support the financial autonomy of local government. By this law the local governments has the possibility of:

- Diversification of fiscal income sources for their own management
- Independent income collection for taxes and fees
- Transfers from national taxes
- Uniform consolidated local budget

Local fiscal revenues are composed of “income from local sources” and “income from national sources”. During the first period of fiscal decentralization (till 2002), the focus was on developing an unconditional transfer. By the fiscal decentralization reform a set of taxes and fees were settled, local tax administration got a wider range of competences, also local government got the authority of deciding the level local tax and fees. As a result local government income increased in a considerable manner. Changes of local government legislation in 2009 and 2010 resulted in a dramatic effect on the fiscal potential of the local government. Local financial situation become very difficult by the reduction of local fiscal potential and all the other restrictive fiscal policies⁵.

⁵ Network of Associations of Local Authorities of South-East Europe Discussion on the changed context and trend in fiscal decentralization, 2013, pg 108.

Table 1 Revenues of Local Government 2008-2012



Source: Ministry of Finance

The percentage of revenues from local taxes on the total revenues of local government decreased from 31% in 2008 to 26% in 2012. In absolute values tax collection in local level has almost being the same between 2008 and 2012. Conditional transfers decreased for the first time in 2009, the unconditional ones are always increasing from 2005, and most of this increase is for poor and the individuals with limited abilities. Most of the incomes for local governments remain the income from national taxes.

From table 1 it can be noticed that in 2012 there has been a tendency of decrease in local government revenues. Especially the part of the fund which is generated from unconditional grant has been decreased. In unconditional grant it is included the revenues which are generated on local level. Even it is decreased it does not necessarily means that the authority of local governed has been worsening.

2.2. Inequality of Public Income per Capita

There exist many differences in fiscal revenues collection between local governments. The capital city and other seven largest cities

(Durrës, Elbasan, Kamz, Fier, Korce, Shkoder), generate most of their own revenues, relatively 73% in 2012. There is an increase from 2006 that was 53%. This means that large local governments have done well with the actual system.

Table 2 Changes of Revenues per Capita

	Total Revenues	Total Revenues From Taxes	SBT	Wealth Tax (BLG)	Waste Fee
Average	9,382	2,427	460	426	311
Minimum	43	207	0	0	0
Maximum	40,573	19,969	1,399	3,835	1,390
STDEV	6,526	2,961	381	541	277
CV	0.7	1.22	0.83	1.27	0.89
Sum	450,359	116,473	20,454	14,933	14,933
Median	8,159	1,736	320	310	310

Source: Ministry of Finance

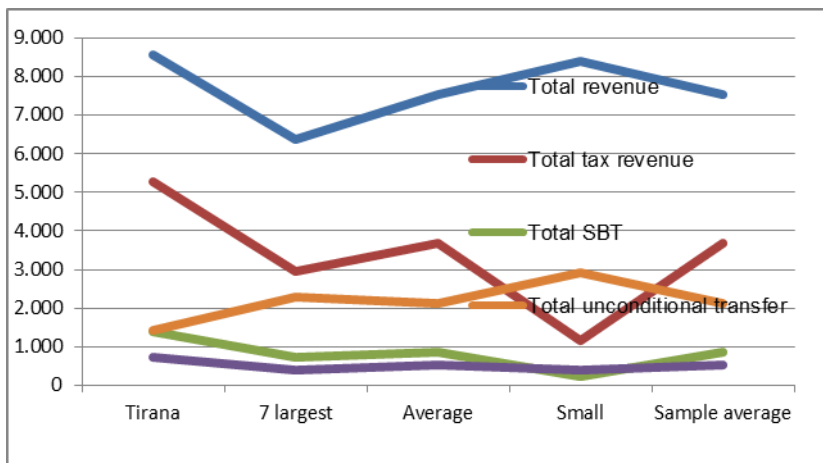
A better parameter in order to evaluate the inequality of local revenues is the income distribution per capita. Also from the above table there can be noticed a high variation in collection.

Table 3 Comparing Local Revenues per Capita and Total Revenues from Unconditional Grants and Transfers

Year: 2012	Population	Total Rev. from Unc. GRANT	Total Rev. from Taxes	Total TBV	Total of WT	Total of Waste Fee	Total of Unc. Transfers
Tirana	30.10%	34.10%	43.30%	48.10%	42.80%	56.40%	20.50%
7 Large LG	40.20%	33.90%	32.40%	32.80%	31.10%	26.90%	43.20%

Average	24.50%	26.20%	22.60	17.80	22.10	15.40	29.00
			%	%	%	%	%
Small	5.30%	5.90%	1.70%	1.40%	3.90%	1.30%	7.30%
Parameters /Capita							
Tirana		8,541	5,287	1,399	737	1,203	1,438
7 Large LG		6,366	2,965	715	401	430	2,276
Average		7,543	3,673	876	518	642	2,115
Small		8,398	1,178	226	386	164	2,929
Average on sample		7,543	3,673	876	518	642	2,115

Table 4 Grants Objective to Achieve Equality



Source: Ministry of Finance

Looking at the performance of local government it can be seen that most of revenues from taxes and fees are collected in large local governments. But within the unconditional transfer the income distribution looks more fair (Table 3, 4).

From its own revenues in the local budget the tax with the highest weight is the tax of small business, 20% of the total revenue. The second one is the wealth tax with 11%, tax on infrastructure with 10% in 2012 with a considerable reduction of 20% from previous years. Tax on the waste is nearly 14% of the budget.

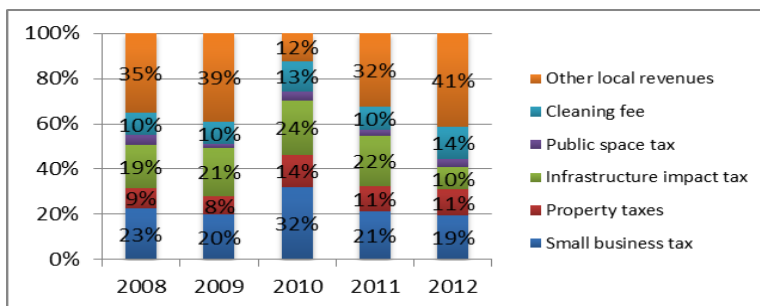
Table 5 Main Revenues (Sample) for 2008-2012

<i>Year</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>
Tax on small business	2,067,359	2,102,799	2,409,418	2,146,272	1,806,312
Wealth tax	807,858	847,747	1,090,472	1,126,330	1,067,736
Tax on infrastructure	1,761,554	2,271,817	1,815,821	2,266,475	926,965
Tax on public space	389,531	175,882	310,049	250,624	338,602
Tarifa e pastrimit	900,395	1,049,903	1,005,476	1,058,264	1,324,188
Other Revenues	3,216,628	4,146,167	942,497	3,277,612	3,846,604
Total	9,145,334	10,596,325	7,575,743	10,127,587	9,312,418

Source: Ministry of Finance

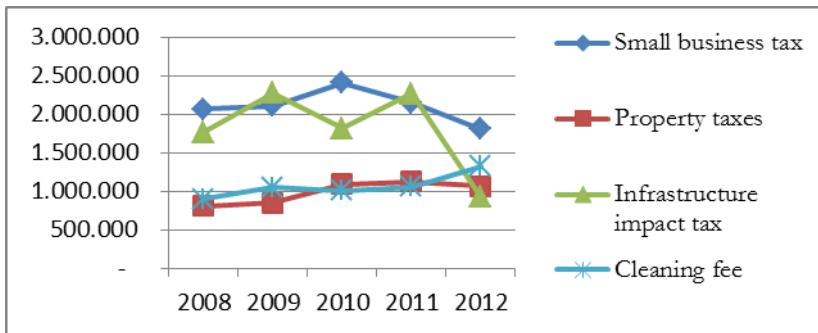
Changes on legislation in December 2013 included both changes in tax rates and also in administration of the taxes. From January 2014 the administration of tax on small businesses was removed from local tax administration to the central tax administration, and the main reason was the poor work of local tax administration. Considering the efficiency this movement can be considered as a good movement.

Table 6 Revenues for the Sample According to their weight in Total Revenues.



Source: Network of Associations of Local Authorities of South-East Europe⁶

Table 7 Performance of Revenues from 2008-2012



Source: Ministry of Finance

But it could be a hard work load for the central administration as they value also the tax on value added for small businesses. The limit of below 8 million lek as turn over for small business brought a kind of deviation in the real declaration of businesses, as the administration had the tendency to consider them as small. The reason of such deviation is the revenues generated from small business passes in local budget.

2.3. Transfer System

After the decentralization reform of 2000, local governments are funded with unconditional transfers from central government. With this kind of grant are used by local governments for the local administration expenditure, and their own functions.

Also local governments till 2005 were funded by conditional transfers from central government which were used for infrastructure, rural and urban roads, in capital investment like education, health care etc.

⁶ *Report on Fiscal Decentralization Indicators*, Network of Associations of Local Authorities of South East Europe. 2006-2012, pg. 100.

2.4. Reliability of Budget

Reliability of budget is a real concern for local governments. Last year the difficult financial situation and restrictive fiscal policies of local governments resulted for many local government in interruption of their operations many of local governments are very near to bankruptcy. On the table below it can be seen very clearly the forecasting and the actual financial situation of the local governments of our sample.

Budget policies of central government had an important impact on the performance of local budgets⁷. Unconditional transfers were decreased for the first time in 2011, without any prior notification.

Also the problems in insolvency with the energetic company, made the Ministry of finance to cut all the last part of the grants, in order to pay the company.

Moreover, fiscal authority of local governments with their capacity for increasing the revenues was damaged by the intervention in the Law of Tax System in 2009. All this factors, including the global economic crises created all preconditions for a poor work of local budget.

Table 8 Forecasting versus Actuality

No	Types of Revenues	Forecasting 2012	Actual2012	Actual/Forecast 2012	Forecast/2013	Actual 2013	Actual/Forecast asino 2013 forecasting 2013/	Forecasting Actual 2013/ Actual 2012	
I	Revenues from Taxes	123,900	53,044	43%	131,306	57,645	44%	106%	109%
1	Tax on wealth	13,000	6,844	53%	15,000	5,974	40%	115%	87%
1.1	Tax on Bus.	5,822	5,672	97%	6,500	5,807	89%	112%	102%
1.2	Tax On families	7,178	1,172	16%	8,500	167	2%	118%	14%
2	tax of Small Bus.	30,521	18,199	60%	30,500	17,174	56%	100%	94%

⁷ Albania Association of Municipalities, *Tax and Fees of Local Governments in Albania*, 2010.

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3	Tax on ownership trasn.	6,500	7,605	117%	10,500	9,530	91%	162%	125%
4	Tax on Infrast.	69,000	18,505	27%	70,000	23,489	34%	101%	127%
5	Tax on Public Space	489	298	61%	500	108	22%	102%	36%
6	Taksa e tabelës	3,770	1,593	42%	4,656	1,370	29%	124%	86%
II	Non-Tax Rev.	92,273	50,827	55%	92,180	41,406	45%	100%	81%
A	Fees	22,767	12,187	54%	29,500	12,239	41%	130%	100%
1	Waste Fee	19,667	10,503	53%	25,000	10,423	42%	127%	99%
2	Fee on using P.C.	2,200	1,262	57%	3,500	1,049	30%	159%	83%
3	Licences	900	422	47%	1,000	766	77%	111%	182%
4	Tarifa e parkimit	2,860	1,565	55%	2,900	1,141	39%	101%	73%
B	Reveneus non tax	64,206	32,710	51%	56,330	23,577	42%	88%	72%
6	Other	22,812	16,294	71%	27,000	16,951	63%	118%	104%
Tot		216,174	103,871	48%	223,486	99,051	44%	103%	95%

Source: Ministry of Finance

At the end it can be concluded that fiscal policies in local governments should be reinforced. The only applicable rule for local budget is the balanced budget. For this reason the majors and local administration adapts very optimistic behaviour in expenses incurred, before they receiving the income. As there does not exist a accounting control system in Albania, this approach creates a huge deficit “de facto”.

3. Conclusions

System continues to lack transparency. Despite drastic improvements through allocation of general purpose grants based on a (mostly) tax per capita formula, the formula criteria are not widely distributed and proactively properly. Moreover, the criteria have changed little over the years but often without clear justification on the reasons and results.

It is not yet established a system of national shared taxes. 2000 Law on Local Government defines the Personal Income Tax and Corporate Tax on profit as possible taxes that can be shared between different levels of governments. However, studies showed that the allocation of such tax on a derivation will result in an unequal system as more than 90% of these taxes are concentrated in a handful of major cities.

Intergovernmental transfer system has a strong tie component in order to achieve equal targets. The amount of intergovernmental transfers is greater potential for units with fewer taxes, resulting in a more equal distribution of income per capita at the national level. Principles of efficiency are taken into account: general purpose grant provides no restrictions or guidelines in the distribution sector.

Predictability of local revenue has deteriorated in recent years. Measure unconditional transfers has declined without giving any prior indication; Frequent changes in the tax system were not consulted with local stakeholders and criteria for funding and competitive grants are not made public in advance. However formula unconditional transfers blocking several provisions to protect local governments from dramatic changes in income (negative transition criterion / positive; minimum guarantee of income per capita).

Another way to create a mechanism for sharing tax would be relating the size of the formula set for unconditional grants to a certain percentage of the receipts from a number of taxes. This would increase predictability.

In general, the basis upon which is built the Albanian intergovernmental finance and transfer system is in accordance with general principles of good practices. The legislator has provided sufficient autonomy to local governments by giving them a mix of discretionary funds consisting of the revenue derived from taxes at the local level, as well as general purpose transfers.

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Biodata



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