



Urban Rural Consulting - URC

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**REPORT ON THE FISCAL
DECENTRALISATION PROCESS IN THE
REPUBLIC OF MACEDONIA**

Skopje, October, 2007

“Report for the process of fiscal decentralisation in Macedonia”

Publisher: Urban Rural Consulting – URC, Skopje
In the frame of the project: Making successful the process of decentralisation in Macedonia
Supported by: OSCE Spillover Mission to Skopje
Authors: Zoran Sapuric, Ace Kocevski, Maksim Acevski, Kire Kitevski, Lefkija Gazovska, Evgenija Gramatikova, Abdulmenaf Bexheti, Ismaili Murtezan, Marjan Nikolov, Saso Manasov, Goran Angelov

Technical design: Dijana Veljanoska, Igor Slavkoski

The report is published on Macedonian, Albanian and English language.

Skopje, October 2007



The content of this publication does not always convey the opinions or stands of the OSCE Spillover Mission to Skopje

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PROJECT OVERVIEW

A review of annual balance sheets of municipalities in RM for 2003, 2004, 2005 and 2006 has been carried out in the recent two years by OSCE, mediated by Urban Rural Consulting (URC) from Skopje.

The first stage of this review operation was being carried out during 2006; municipalities' annual financial statements were being processed relating to the 2003, 2004 and 2005 fiscal years. This resulted in a comprehensive database and as such being very useful in the process of studying the matter and generating specific recommendations and conclusions regarding the fiscal system of the country's local self-government. The findings of this research were sent to the Ministry of Local Self-Government. Whereas in the course of 2003 and 2004, and in the first half of 2005, no enactment took place of most of the provisions referred to in the Law on Financing of Local Self-Government Units, and taking into consideration that the implementation of major part of the competences of the local self-government commenced after 1 July 2005, it will be necessary to survey 2006 as well, and the tendency being to pursue such surveys in the future.

At the second stage of this project, the 2006 fiscal year was surveyed, with annual financial statements having been processed of all local self-government units in the country. In addition, an expert group was established¹, to which presentation was made of previously obtained parameters for the 2003, 2004 and 2005 fiscal years and of newly-obtained results from a survey on the 2006 annual financial statements. The expert group drafted a complex questionnaire which represented an additional tool in the survey process. The survey covered 17 Macedonian municipalities², in all 8 (eight) statistical regions of the country. The combination of general surveys on the annual balance sheets of all local self-government units in the Republic of Macedonia on one side and more specific surveys conducted in 17 Macedonian municipalities on the other – generated optimal results being of great use to the improving of the financial system of the local self-government in the Republic of Macedonia.

The present Report also contains several examples from the database, obtained by means of surveys conducted in the course of recent 4 (four) fiscal years.

In the process of processing data from municipalities' annual balance sheets, the *Arc View* software solution was applied³.

Activities undertaken by Urban Rural Consulting – Skopje in cooperation with the OSCE Monitoring Mission in Skopje within the project on Successful Second Stage of the Decentralisation Process do not as such represent a denial of an evaluation effort conducted by LSGUs and of its results having met the requirements for entering the second stage of decentralisation; these activities only determine the state of affairs in the field, detected “bottlenecks” involved, and issue appropriate recommendations regarding the creation of pre-conditions for good governance and for transparent and accountable local level power.

The methodological approach to detailed work in the field mentioned is based on several steps, in particular:

¹ 10 experts: Mr. Abdulmenaf Behxeti PhD, Mr. Maksim Acevski, Ms. Evgenija Gramatikova, Mr. Murtezan Ismaili PhD, Mr. Marjan Nikolov M.A., Mr. Ace Kocevski, Ms. Lefkija Gazovska, Mr. Zoran Sapuric PhD, Mr. Kire Kitevski and Mr. Goran Angelov.

² Skopje-City, Saraj, Bitola, Dolneni, Kriva Palanka, Kumanovo, Stip, Makedonska Kamenica, Veles, Rosoman, Kisela Voda, Plasnica, Ohrid, Tetovo, Vrapciste, Strumica and Bogdanci.

³ The database was developed by Mr. Saso Manasov M.A.

- Identifying criteria representing the basis of the processes of budgeting, accounting record keeping, treasury operation, reporting, internal control, and auditing;
- Studying criteria identified; analyses and statements,
- Survey questionnaire designing,
- Questionnaire distribution,
- Visiting selected LSGUs/municipalities;
- Fact-finding on the ground at LSGUs;
- Determining specific risk areas;
- Issuing suggestions and carrying out adequate activities to minimize risk within already determined risk areas.

The relevant database, accounting records, accounting documents and other documentation maintained by the Local Self-Government Units represent data sources.

The survey uses the 2006 reporting period and the first six months of 2007. Survey questionnaires were sent to the surveyed Local Self-Government Units which were afterwards visited by experts; during these visits, expert assistance was provided with questionnaire filling-in and additional data was being collected found necessary for the survey itself.

Monitoring/survey units were the following Local Self-Government Units: Kumanovo, Bogdanci, Ohrid, Saraj, Veles, Bitola, Kriva Palanka, Stip, Tetovo, Vrapciste, Dolneni, Strumica, Kisela Voda, Plasnica, Rosoman, and Skopje-City.

Out of the total number of monitored/surveyed Local Self-Government Units, 6 LSGUs (Ohrid, Saraj, Kriva Palanka, Vrapciste, Rosoman and Plasnica) did not qualify during the second fiscal decentralisation stage evaluation; Skopje-City did not apply to enter the second stage of the fiscal decentralisation, representing 43.75% of the total number of samples selected for analysis.

LSGUs selection was done on several bases, in particular:

- LSGUs having qualified to the second stage of the fiscal decentralisation,
- LSGUs not having qualified to the second stage of the fiscal decentralisation;
- Balanced regional representation of LSGUs;
- LSGUs having mixed population composition; etc.

INTRODUCTION

Following its independence on 8 September 1991, the Republic of Macedonia has become highly centralized, now being one of the most centralized countries in Europe. The high level of centralization accompanied competences belonging to local authorities and their not being financially independent. In terms of financing, Macedonian municipalities were for a long time being placed at the bottom of the list of European municipalities in this regard, by almost all parameters⁴. A high level of subordination was thus created of local authorities to central government institutions.

The existence of realistic and genuine decentralisation in the country requires the operation of fiscal decentralisation as well.

The Republic of Macedonia was gaining its independence in the course of 1991. When speaking about municipal financing, four time periods may be determined:

- between 1990 and 1996
- between 1996 and 2005
- as of July 1, 2005
- as of September 1, 2007

In the first period, between 1990 and 1996, there was no special Municipal Finance Law. This particular field was regulated by several laws and by-laws, and this situation created a certain degree of insecurity and non-transparency in the financing of municipalities. Financial transfers were mostly coming from the central Budget and from Ministries, a situation which, as a rule, politicizes and subjectivists the principle of finance distribution in a country.

In this period, the GDP share of all budgets of municipalities in the Republic of Macedonia was not more than 0.5%. The municipal financing system represented a seriously negative indicator to the large-scale centralization in the Republic of Macedonia.

The administration of taxes and fees transferred to local authorities was carried out by central finance institutions, represented by the Ministry of Finance and the Public Revenue Office in the Republic of Macedonia.

The second stage began in 1996; the Law on Local Self-Government was adopted containing special provisions⁵ to further regulate municipal funding sources. The Law set out that municipalities were to be financed from the following sources:

- Allocations from funds collected with the good and service turnover tax, specified by law;
- The property tax, the inheritance and gift tax, and the tax on immovable property and associated entitlement transfer;
- The land fee, communal fees, and service revenues;
- Own property revenues,
- Revenues from donations received from the State and from abroad;

⁴ Local authority revenue share to GDP; Local authority revenue share to public consumption; Administrative capacities to manage local taxes and fees.

⁵ Chapter VIII article 62, 63 and 64

- Profits from public enterprises and public services established by the local self-government unit;
- A part of the profit gained by State-owned public enterprises having their local offices within local self-government units, upon various bases determined by law;
- Revenues gained from penalties issued for violations of local self-government unit regulations;
- Other revenues allocated from local self-government unit budgets on various bases specified by law.

The administration of all taxes and fees was the competence of central financial institutions that afterwards, on the basis of a specific formula, transferred funds to municipalities. Departments administering taxes related with local authorities mostly did not possess sufficient capacity to do so. Most of the funding was expected to be transferred to local authorities from the good and service turnover tax (current VAT); unfortunately, this did not happen in the period between 1996 and 2005. State-owned public enterprises maintaining their local offices in municipal territories not once transferred any funding to municipal budget. This system of local self-government unit funding was powerful on paper, yet in reality it turned out to be not applicable at all, as almost all taxes and fees being in line with the Law on Local Self-Government were supposed to represent a serious and sufficient source of municipal revenues – yet the whole matter never got to genuine implementation. In that period, municipalities administered the construction land arrangement fee independently. Some municipalities administered the so-called urban rents alone or in cooperation with the Public Revenue Office, for which after 2001 no legal basis existed by the adoption of the Law on Construction Land in the Parliament, in which urban rent was simply deleted and did not exist as municipal revenue.

The third period began on 1 July 2005. The Law on Financing of Local Self-Government Units has been adopted in 2004 and its enactment started as of 1 June, 2005, with the beginning of the so-called “first stage of the fiscal decentralisation process”. During 2005, other laws⁶ were also amended that completed the regulation of the local self-government unit financial system. The Law on Financing of Local Self-Government Units regulated, in a system-based manner, sources of funding and funding competent bodies within local self-government financial system. The Law set out that municipalities were to be financed from several sources, in particular:

- Genuine revenues, the administration of which represents wholly the competence of municipalities; genuine revenues mostly include local taxes, local fees and administrative fees, ownership-related revenues, local voluntary tax revenues, local refunds, revenues from donations, revenues from penalties, and other similar genuine revenues;
- Revenues from the personal income tax, the administration of which is the competence of the central government financial administration;
- Grants from the State Budget and from State-managed funds including Value Added Tax revenues, special purpose grants, block grants, capital grants and delegated competence grants. The allocation of such grants was carried out on the basis of priori defined criteria, mostly transparent and objective.

With the adoption of the Law on Financing of Local Self-Government Units and of other laws in the financial field, a genuine effort was made by the central government towards the achieving of greater financial independence of municipalities. In addition, fiscal

⁶ Law on Property Tax; Law on Communal Tax; Law on Administrative Tax.

decentralisation was to be enabled to increase local authority responsibilities. The Law also envisaged the transfer of staff from the Ministry of Finance and the Public Revenue Office working on municipal tax administration and on communal and administrative fee administration. Staff transfers were accompanied by the transfer of movable and immovable items necessary for the work of staff transferred.

In line with the Law on Financing of Local Self-Government Unit, the fourth stage commenced on 1 July 2007, but actually began as of 1 September 2007. On the basis of relevant recommendations from the LSGU Monitoring and Evaluation Commission, and following specific criteria in the field, the Government of the Republic of Macedonia issued a list of 42 LSGUs eligible to enter the second stage of fiscal decentralisation. This second stage includes the transfer of block grants with municipalities having met the requirements of entering this particular stage of fiscal decentralisation.

The present Report has been drafted on the basis of a standard categorization of the main pillars in the fiscal decentralisation process:

- The structure and scope of competences of authorities in R. Macedonia
- The devolution of competences
- The revenue structure
- Intergovernmental transfers
- Debt entering
- Issues related with financial management
- Monitoring and evaluation

Each section discusses conceptual principles to be taken into consideration when speaking about the issue in question, as well as an evaluation of the current situation in the particular field.

1. STRUCTURE AND SCOPE OF AUTHORITY COMPETENCES IN R. MACEDONIA

1.1. Legal Framework

1.1.1. Law on Local Self-Government

Municipalities' competences have been determined in Chapter Three of the Law on Local Self-Government. According to the Law, municipalities are responsible for the following:

- Urban development (urban and rural) planning;
- Issuing construction permits with structures of local relevance determined by law;
- Spatial arrangement and construction land arrangement;
- Environment and nature protection (measures to protect and to prevent the pollution of water, air, soil; nature conservation; noise protection; protection against non-ionization emissions);
- Local economic development (identifying development and structural priorities, local economic policy managing, supporting the development of small and medium-sized enterprises and entrepreneurship on local level – and, in this context, taking part in the establishing of a local-level network of institutions and agencies, and promoting partnership);
- Utilities (potable water supply, technological water supply; waste water drainage and treatment; public area lightening; local-level public transport organizing; green area maintenance and use; local road and street construction and maintenance; communal and technological waste collection, transport, disposal and processing; parking area construction; open market area construction and maintenance; natural gas and heating energy supply; street traffic signal facility construction and maintenance; as well as many other utilities outlined in the Law);
- Culture (institutional and financial support to culture institutions and projects; cherishing folklore, old traditions and customs (e.g. crafts); culture event organizing etc.);
- Sport and recreation (developing group sports and recreational activities; organizing sport events; constructing and maintaining sport facilities; and sport association supporting);
- Social protection and children protection (kindergartens and facilities to accommodate elderly persons – ownership, financing, investing and maintenance; maintaining social care for persons with disabilities, parentless children and children with special needs); as well as other competences in the social sphere determined by the Law;
- Education (establishing, financing and administering primary and secondary schools in cooperation with the central government and in line with law; as well as transportation, nutrition and accommodation of students in boarding schools);
- Health care (managing the network of public health care organisations and facilities in the primary health care, to include local self-government unit representation to boards of public ownership health care organisations, health care education, preventive activities, environment health care monitoring, contagious and other disease monitoring to be determined by law if appropriate);

- Carrying out preparatory activities and undertaking measures of citizen and material good protection and saving in situations of wartime destructions, nature disasters and other accidents and consequences thereof (civil protection);
- Fire protection carried out by local territory fire units, etc.

In addition to genuine competences mentioned above, the Law also envisages delegated competences meaning state administration bodies may delegate the carrying out of certain tasks to municipal mayors in accordance with law.

A comparison of competences maintained by Macedonian municipalities and the ones maintained by other municipalities in Europe reveals the fact that Macedonian municipal competences determined by positive regulations are identical to, and in some cases even greater than, the ones maintained by municipalities of some European countries. For instance, in the Czech Republic, Slovakia and Greece, municipalities are in charge of primary education only, with delegated competences in the secondary education field; in some cases, the State is in charge of secondary education, with municipalities being responsible only for the maintenance of buildings accommodating secondary schools. In Croatia, Latvia and Portugal, municipalities are not responsible for fire protection – the State is. In some countries (Romania, Poland, Denmark), the first instance of local self-government i.e. the municipality is in charge of primary education, with secondary education being the competence of the second instance of local self-government – the district. Portuguese municipalities have no competences in the social sphere; this is a competence belonging wholly to the State.

In addition to common municipal competences (such as utilities i.e. works, spatial and urban development planning etc.), municipalities in European countries are in charge of many other spheres⁷. In Belgium, municipalities are in charge of primary and secondary education, primary health care, several activities in the social sphere, fire protection etc. Belgium is one of the countries where municipalities maintain local police staff such as the case in Great Britain, Germany, Austria, Sweden etc. In the Netherlands, municipal powers are almost identical to the ones in Belgium.

In the Netherlands, municipalities are in charge of primary and secondary education as well as of vocational education and adult education; they also maintain several competences in the social and economic development field. In Finland, Norway and Sweden, in addition to primary health care competences, municipalities have powers in the fields of specialist health care and hospital care; they may establish hospitals, which can be done by States as well.

In the Member States of the European Union, unlike in our country, it is quite common that competences be delegated by the State to municipalities. For instance, in Belgium, as part of their delegated competences, municipalities perform tasks related with issuing ID cards and driver licenses, social assistance allocation on behalf of the State etc. In Finland and Sweden, municipalities are delegated also the tasks in the statistics and cadastre fields. These European experiences clearly show that delegated competences mentioned provide for more efficient and effective delivery of services and for better meeting of citizen needs. In this context, feasibility analyses should be carried out, at least in municipalities having bigger capacities, on the possibility of State's delegating some of its competences to municipalities.

⁷ Of course, the overview of competences of municipalities in some European countries in this section of the Project has been provided in a brief version only.

For the purpose of more comprehensive and more efficient performing of competences in the field of cadastre record keeping, cadastre reform processes should be accelerated. The attaining of this goal requires higher Budget allocations, in addition to foreign donations and current loans from international organisations. In addition, current services responsible for the GIS system, being scattered to several state bodies, should be united to a single body to be more efficient and having improved human and financial capacities. This kind of GIS system organisation would be of great use to local self-government units in the process of spatial development plan drafting. Once these modifications have been introduced, and following relevant European examples, the State may consider the possibility of delegating some of its competences in the cadastre field.

1.1.2. Law on Financing of Local Self-Government Units

In addition to the Law on Financing of Local Self-Government Units, municipal financing sources include own revenue sources, grants from the State Budget and grants from fund budgets.

Municipal own revenue sources are the following:

1. Local taxes determined by law (the property tax, the inheritance and gift tax determined by law, the immovable property turnover tax and taxes determined by law).
2. Local fees determined by law (communal fees, administrative fees and other local-level fees determined by law).
3. Local refunds determined by law (construction land arrangement refunds, utility refunds, refunds from spatial and urban development plans, and other local-level refunds specified by law).
4. Ownership-related revenues (rent revenues, interest rate revenues and real estate sale revenues).
5. Revenues from donations.
6. Revenues from penalties determined by law.
7. Local voluntary contribution revenues.
8. Other revenues determined by law.

In addition to specified revenues in accordance with the above mentioned Law, municipalities also have revenues from personal income taxes collected in the current year, in particular 3% of the personal income tax from personal revenues with salaries of physical persons, collected in the municipality in the territory of which the address of permanent residence or stay of such persons is located; as well as 100% of the income tax with physical persons performing a crafts activity. Municipalities also get 3% of the Value Added Tax collected in the previous fiscal year, allocated to them on the basis of criteria determined in the Decree on the Methodology of Allocation of Property Tax Revenues, adopted by the Government. Municipalities may also introduce local voluntary contributions by means of a referendum determined in a decision issued by the municipal council. Furthermore, municipalities receive grants from the central

Budget including special-purpose, capital and block grants, as well as delegated competence grants.

Comparative examples

If revenue sources of Macedonian municipalities are compared to revenue sources of municipalities in some European countries, one easily comes to a conclusion that we are still much lagging behind them in this regard, especially in terms of revenue sustainability, in particular regarding such revenue amount and scope – and mostly in terms of such revenue quality.

For instance, in Germany, municipal share to personal income figures, representing joint revenue of the Federation and Districts, amounts to 15% (municipal shares to personal income in almost all countries of Europe are higher than in the Macedonian case). In addition to other common municipal revenues, present to a greater or a smaller extent in other European countries as well, the enterprise activity tax is a thing very specific to Germany.

Among other things, in Belgium, the municipality gets a portion of revenues collected from vehicle registration fees, a portion of revenues collected on insurance bases, a portion of revenues collected from issuing hunting and fishing licenses; a portion of incomes collected from energy fees, from manufacturing plant fees, from fees for mineral and natural resource exploitation etc.

In Portugal, a characteristic feature is the revenue collected from tourist fees, almost a 100-percent municipal revenue.

In Slovenia, one of the specific features is the municipal revenue representing a portion of the income tax, of which municipalities receive 35%; another one is a portion of revenues collected from games of chance, from fees for farming land or forest exploitation, etc.

In Croatia, municipalities receive 3% of the VAT revenue, and 32% of the income tax revenue – the City of Zagreb getting 45% of this particular tax. Municipalities receive 20% and 70% of the income tax and the games of chance and betting tax revenues respectively. In Croatia, in addition to mentioned taxes, certain portions are used by districts as well, being second-instance local self-government units. Other municipal revenues in Croatia are similar to municipal revenues recorded in other countries.

1.2. Territorial organisation in the Republic of Macedonia; history and solutions aligned with the Law on Territorial Organisation of the Local Self-Government

Small municipal competences in the period between 1991 and 1996 led to a new territorial organisation of municipalities in 1996. Instead of the 34 municipalities and Skopje-City having existed by that point, 123 municipalities and Skopje-City were launched. Territorial organisation was again modified in 2004 by the Law on Territorial Organisation of the Local Self-Government; since then, there have been 84 municipalities and Skopje-City, the latter being a separate local self-government unit.

According to Articles 17, 18 and 19 of the Law on Local Self-Government, the area within which a municipality is to be set up should represent a natural and geographical whole, an economically complete whole, with communication among settlements oriented towards a common centre, and it should also have developed infrastructure

facilities and social standard supporting structures. The municipal area should match the borders of cadastre municipalities, so that a municipality's borders do not cut the borders of cadastre municipalities.

The regulation of this issue varies from country to country so that no universal solution exists in this regard. Each country attempts to find the best possible solution for the political-territorial organization i.e. for its local unit organisation. This, of course, is not an easy task at all. In standard theory, but also in European practice, there are mainly two types of systems in terms of municipality size: the so-called Anglo-Saxon-Scandinavian model with relatively bigger municipalities, and the so-called French-Mediterranean model, where territorial organization is made into small components i.e. there are numerous small municipalities existing in a country, each having smaller territory and population. The most typical examples of this model may be found in France, Italy and Spain. As for transition countries, they have, within their overall reform processes, also conducted reforms regarding the territorial organisation of their local units. Some of them have embraced the first mentioned model of bigger units (Lithuania and Estonia) with the second mentioned model having been introduced by the Czech Republic, Hungary and Slovenia. Of course, one cannot find identical territorial organization models with two countries; each country has its own specific model of it. Nonetheless, in the context of this Project, it is worth mentioning that, in many European countries, the trend has been increasingly present in recent years of municipality clustering and municipality number decreasing. An average municipality in Denmark today has some 24.000 inhabitants, some 27.000 in the Netherlands, some 22.000 in Norway. This trend has mostly resulted from orientations towards having bigger and economically stronger municipalities. As opposed to these examples, municipalities in some other countries are considerably smaller; for instance, an average municipality in Portugal or in the Czech Republic has less than 2000 inhabitants and some 6000 in Romania.

In terms of history, the dilemma on whether to have small or bigger municipalities has been present in the Republic of Macedonia ever since 1945. Frequent modifications in territorial setup took place in this period.

The 1945 Macedonian Law on Territorial Organisation divided NRM into four districts, Skopje-City having been given special status in that regard. This Law envisaged that the Government of NRM was to issue decrees to determine district and local people's councils (27 district and 748 local people's councils were specified). In 1949, by the Law on Territory Organization of the Republic of Macedonia into Regions were established three regions, with Skopje-City being given the status of a separate unit, as well as 16 districts, with bigger towns separated from them. This Law was afterwards the subject of several amendments and modifications; in 1950, regions were cancelled, and 27 districts and 8 towns were specified, as well as Skopje-City having a special status, itself divided into four areas. In 1952, the Law on Territorial Organization into Districts, Towns, Urban Municipalities and Other Municipalities in Macedonia introduced 18 districts, 27 urban municipalities, and 205 other municipalities, as well as Skopje-City with a special status. Only three years later, the Law on District Areas and Municipalities set up 7 districts and 86 municipalities; its 1957 amendments reduced the number of municipalities to 73. In 1965, the Constitutional Law Amending the Constitution of the NRM cancelled the districts; ever since then, local self-government in Macedonia has been of one level only. The 1962 Law on Municipal Areas further reduced the number of municipalities to 32 municipalities and Skopje-City. In 1968, the number of municipalities was reduced to 29. In 1976, the Law on Establishing Municipalities within Skopje-City re-established municipalities in Skopje-City (5 in total), so that the total number of municipalities got to 34 plus Skopje-City. This territorial organization was functioning in the period between 1976 and 1996, that is, for 20 years. This was, actually, the longest period of existence of a municipal territorial organization.

In 1996, the Law on Territorial Organization and Determining the Areas of Local Self-Government Units increased the number of municipalities to 123, plus Skopje-City. The 2004 Law, as already mentioned, finally set the number of municipalities to 84, plus Skopje-City.

The above historical overview shows that dilemmas regarding municipality optimal size have historical roots in the Republic of Macedonia. This dilemma type is still present.

1.2. Law on Skopje-City

The Republic of Macedonia decided to allocate a special status to its capital of Skopje. This status was specified in the Constitution, in the Law on Local Self-Government as well as in the Law on Skopje-City; the last one defines relevant rights and duties i.e. competences as well as the manner in which joint revenues are to be distributed between Skopje-City and the ten municipalities in its composition.

This Law sets out the competence of the City in the secondary education field, with its municipalities being in charge of primary education. The City is in charge of the Urban General Plan, and municipalities are in charge of detailed urban development plans and of construction permit issuing. The City is in charge of main and service streets, with municipalities being in charge of collection streets. Water supply, heating energy supply and gas supply systems as well as the public transport system, being unique systems on the level of the City – all represent the competence of the City as such.

Frequent conflicts occur in terms of competences, mostly due to insufficiently clear definitions of these competences between the City and its municipalities, but also due to some illogical solutions disturbing the City structure as a whole. There have been frequent conflicts in competences and misunderstandings between City municipalities and Skopje-City with the maintenance and construction of some streets, with street lightening maintenance and paying bills for electricity used for street lightening. This also happens from time to time when detailed urban development plans are drafted and adopted being in charge of municipalities, with the drafting and adoption of the Urban General Plan being the competence of Skopje-City.

The practice of regulating the status of a country's capital by a special law is quite often in Europe, and this may be found in almost all European countries. In many countries, in addition to the capital, other major cities or towns are given special status. This is the case in the Czech Republic, Slovakia, Portugal, Poland, Denmark, etc. Various solutions exist in terms of whether there are separate municipalities within the capital with special elected bodies. Some capitals, such as Brussels, Amsterdam, Budapest, Bratislava, Bucharest, Istanbul, Lisbon and others, have separate municipalities within their status. Brussels has 19 municipalities, Bratislava has 17, Amsterdam has 16, Bucharest has 6, etc. Other capitals are united and no municipalities exist within their composition; this is the case with Paris, Ljubljana, Zagreb, Rome, Vienna, Helsinki and others. Some of them are composed of areas, districts etc., yet these are no separate legal entities and do not have their bodies so they practically represent dispersed "branches" of their City.

1.4. Conclusions insights and recommendations

1.4.1. In line with the Law on Local Self-Government and observing the period since the beginning of the first stage of the decentralisation process, it becomes obvious that municipalities in the Republic of Macedonia have competences that are compatible to the competences of municipalities in other European countries. Of course, another different issue is the issue of the volume and quality of municipal financing, as well as of municipalities' administrative and other capacities to maintain this funding, to be further discussed in detail in the present Report. At this point, certain weak sides could be mentioned of the Law on Local Self-Government although it may be perhaps too early to assess the Law as such, bearing in mind the fact that only two years have passed since the Law entered into force.

1.4.2. There have indeed been huge differences among municipalities in the Republic of Macedonia, in terms of their size, population numbers, surface area, rural/urban character, population density, economic features, mountain/valley nature etc. Hence, **the monotype character of municipalities should be abandoned and municipal polytypic character should be introduced according to which various municipalities would have various competences depending on their type.** The defining of competences into optional and obligatory, done in some separate laws, cannot compensate for the deficiency mentioned. In view of increased competences of municipalities in numerous spheres, accompanied by great difficulties to many of them (especially to smaller municipalities), efforts should be made on the part of both the central and local governments to foster inter-municipal cooperation. Rapid legal amendments are required in this context.

1.4.3. In terms of the Law on Financing of Local Self-Government Units, **needs have been evident of increasing municipal revenue sources, especially by means of budget fund re-distribution between the central government and municipalities (to the behalf of municipalities)** – rather than by introducing new public refunds – this being so primarily in view of the current economic situation and the possibility of handling citizen mistrust, and even reluctance to the decentralisation process when introducing new public refunds. However, more detailed comments on this aspect may be provided in the field of economy.

1.4.4. As for territorial organisation, we have obviously had frequent corrections to this concept. Problems and reluctance of various kinds occur whenever a new territorial organisation setup is about to be introduced. Some municipalities are most likely to, in a couple of years, turn out to be unable to carry out their decentralized competences in a high-quality manner; bearing in mind the polytypic character of municipalities and the one-stop-shop system, a need will arise of performing another correction to municipal borders, to further decrease the number of municipalities. Recent experience has shown that this “hot issue” (the correction of municipal borders) has been delayed for as long time as possible, mostly due to the fear of already mentioned problems and reluctance. Concerning the organisation of Skopje-City, it is to be expected that the view will prevail for a long time in the future that several municipalities should be existing within Skopje-City. Yet, in view of recent experiences with competence overlapping between the City and its municipalities, as well as weak sides detected in the carrying out of these competences, the Law should indeed be subject to certain modifications. In order to preserve the united nature of the City, for instance, the City itself (now being in charge of the Urban General Plan) should also be competent for drafting and maintaining detailed urban plans and for building permit issuing – matters currently being in the competence of municipalities within the City.

1.4.5. Furthermore, only the City should be in charge of street lightening maintenance and of services related with public hygiene. This would also clearly define responsibilities in these fields as numerous inconsistencies and disputes have so far taken place between the City and its municipalities having resulted in low quality in the delivery of these services.

1.4.6. An analysis of the legal framework mentioned above reveals the necessity of introducing modifications in the sense discussed to the following:

- The Law on Local Self-Government, in terms of introducing polytypic municipalities i.e. various competences for various municipalities;
- The Law on Skopje-City, in terms of precisely making distinctions in competences between Skopje-City and municipalities within its composition, as well as in terms of efforts towards increasing the City's competences, to the account of competences of the City's municipalities;
- Giving serious consideration to the need of decreasing the number of local self-government units i.e. municipalities, and introducing modifications in this regard to the Law on Territorial Organisation;
- The Law on Financing of Local Self-Government Units, in terms of increasing municipalities' financial capacities;
- Amendments to relevant legislation in terms of creating greater opportunities for delegating competences to municipalities by the central government, especially in view of the fact that both practice and research done within the present Project (on the basis of data from questionnaires filled-in) show that the State has so far not been delegating competences to municipalities.

1.5. Analysis of the municipalities covered by the survey in terms of decentralisation of competences

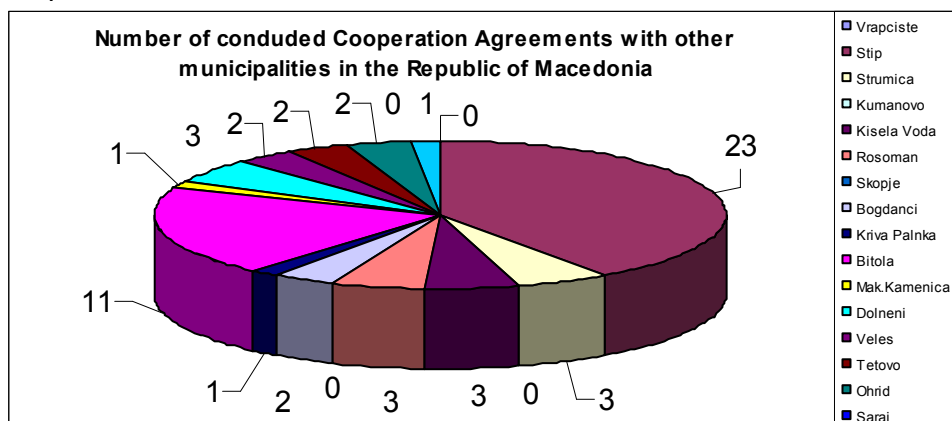
1.5.1. Human resources

The survey has shown that, in all municipalities covered, the number of employees is almost completely in line with relevant job systematization acts, with staffing almost completed. In some local self-government units, staff structures include employees with education levels completed higher than university education i.e. several MAs and a PhD. In smaller local self-government units, staffing structures are of much lower quality. In almost all local self-government units, employees have been engaged on temporal basis (the so-called temporal working contract etc.); their numbers vary between several in smaller LSGUs to over 100 in Skopje.

1.5.2. Inter-municipality cooperation among municipalities in the country and cooperation with the municipalities abroad

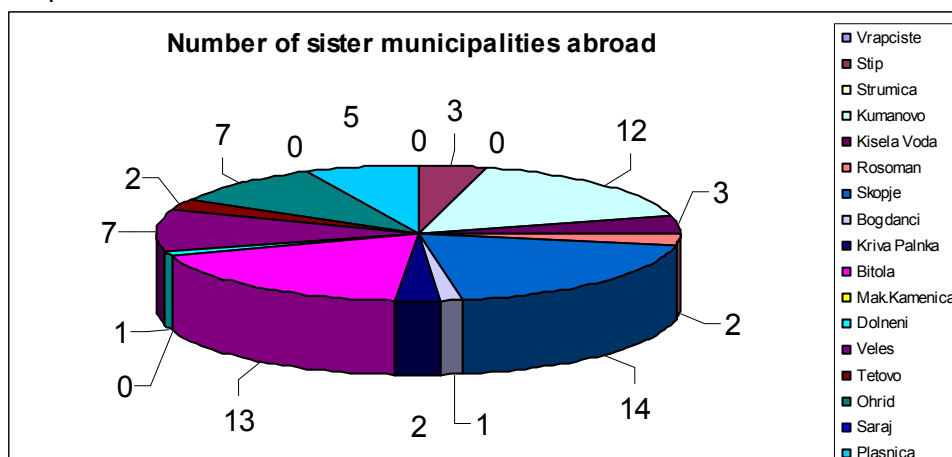
With the question: *“How many Cooperation Agreements has your municipality concluded with other municipalities in the Republic of Macedonia?”* we obtained the following results:

Graph 1:



We obtained the following results with the question: "What is the number of municipalities that your municipality has concluded Cooperation Agreements with?"

Graph 2:

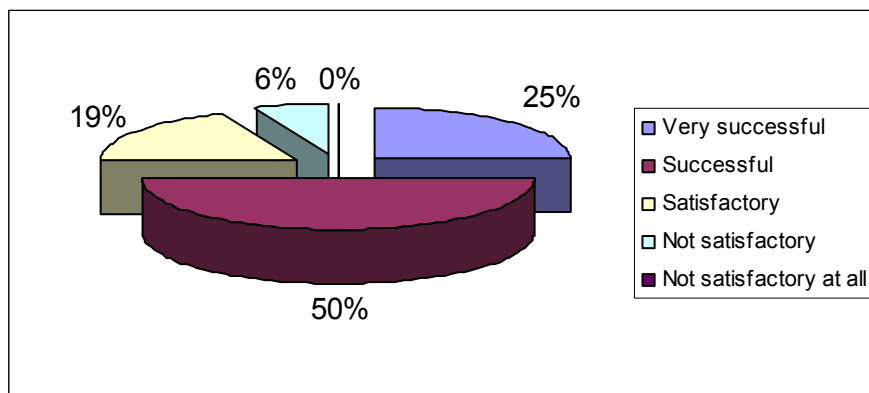


The survey having included the above mentioned local self-government units shows there has been intensive cooperation and concluding sister municipality agreements on the part of analyzed Macedonian municipalities with municipalities abroad – 72 in total. Skopje-City has concluded sister municipality agreements with 14 municipalities i.e. cities; Bitola has concluded such agreements with 13 municipalities. This kind of cooperation has been intensified by other municipalities as well, especially by Veles and Strumica. Time will show what the level is of specific benefit that may be expected from this cooperation. Furthermore, the analysis shows that cooperation among municipalities in the country has gradually been increasing; with analyzed municipalities, 57 inter-municipality cooperation agreements have been concluded, mostly in the fields of utilities, local economic development, as well as joint fiscal activity. This cooperation is now at its very beginning; any real increase in inter-municipality cooperation may be expected once a law has been adopted to regulate and stimulate cooperation among municipalities.

1.5.3. Implementation of the decentralisation normative framework

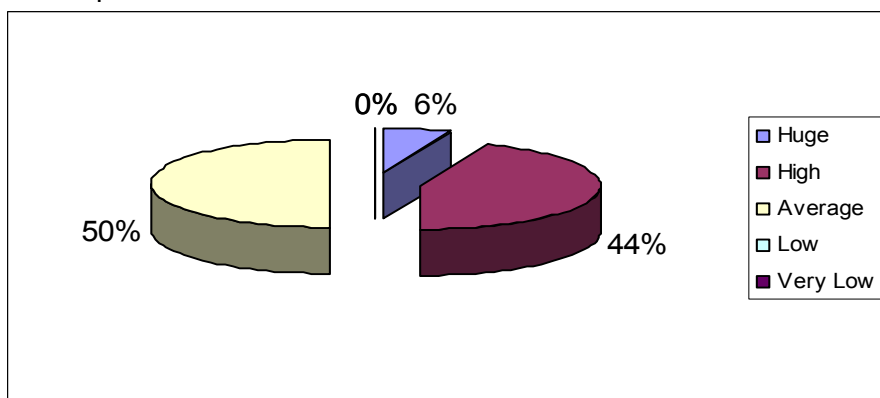
- The following answers were obtained with the question: *“How do you assess the implementation of the first stage of the decentralisation process?”*

Graph 3:



- The question: *“What are the expectations within your municipality regarding the second stage of the decentralisation process?”* revealed the following answers:

Graph 4:



Answers above show that the recent flow of the decentralisation process i.e. the implementation of its first stage has been assessed as successful by most of the municipalities covered by the survey. In spite of numerous problems (especially at the very beginning), the implementation of the decentralisation process has shown encouraging results and provided basis for hope that, bearing in mind decentralisation experiences in transition and post-transition countries, the further course of decentralisation will be more vigorous and faster.

Nonetheless, answers to the second mentioned question above show that there are still scepticism and fear with municipalities in terms of successful outcome of the second stage of the decentralisation process, mostly due to insufficient funding being currently available.

The definition of the success achieved with competence devolution is more strongly expressed by bigger municipalities. The most often problem quoted as hindering the successful transfer of competences is the lack of funding; human resources are mentioned much less. The highest degree of such competence transfer has been recorded in the fields of urban development planning and utilities. This is quite logical

as municipalities used to have rather large competences in these areas even before the first stage of decentralisation was initiated. Positive assessments of the degree of competence devolution in the field of local economic development result more from expectations in this regard than from progress achieved on the ground during the recent short time period. Nonetheless, success in the local economic development field may be attained relatively soon. The analysis of questionnaires filled-in by municipalities covered by the present Project shows that some of them have not at all taken over competences in some areas, primarily due to insufficient financial capacities or agreed giving out competences in question to other local self-government units⁸. This may be seen from filled-in questionnaires that have been enclosed to this Report.

It is interesting to note that, with the devolution of competences in the health care field, many municipalities stated they had completely taken over relevant responsibilities. An additional survey reveals that this answer represents a result of the fact that municipalities misunderstood the question as being related to the enactment of relevant legislation i.e. delegating members to the management board of the public health care institution in the territory of their local self-government unit.

Bearing in mind the above stated, we wish to issue the following recommendations:

- More comprehensive analyses should be carried out on the need of amending the relevant legal framework as stated in item 5 above i.e. the Law on Local Self-Government, the Law on Skopje-City and the Law on Financing of Local Self-Government Units. Further monitoring and analysis should be done of the implementation of the second stage of the decentralisation process and of the decentralisation course in further projects-surveys. As we are now at the very beginning of the decentralisation process' second stage, it has become obvious that real effects may be expected to be recorded following the end of the current year; this is why analyses carried out in the next year should be more comprehensive;
- Once relevant analyses have been conducted, the procedure should be initiated of amending the laws mentioned above: the Law on Local Self-Government, the Law on Skopje-City, and the Law on Financing of Local Self-Government Units;
- The decentralisation process implementation should intensively continue;
- Vigorous work is required towards the strengthening of local self-government unit financial capacities;
- Periodical analyses should be conducted of the way the second stage of decentralisation is implemented.

Author:

Mr. Zoran Sapuric, PhD

⁸ Source: findings of a survey conducted in 16 municipalities in the Republic of Macedonia, done by Urban Rural Consulting-URC.

2. TRANSFER OF COMPETENCES

2.1. Competences of the local self-government in the Republic of Macedonia

The process of decentralisation of powers (**the most important component / part of the local self-government reform**) in the Republic of Macedonia, which formally began with the adoption of the Law on Local Self-Government (“Official Gazette of the Republic of Macedonia” No. 5/02), actually as of 1 July, 2005 – marked a whole period of exceptionally significant and complex activities, especially in terms of transfer of competences from central to local levels, in areas such as the following:

1. Urban development (urban and rural) planning; issuing building permits for structures of local relevance; spatial and construction land arrangement.
2. Environment and nature protection – measures to protect and to prevent the pollution of water, air, soil; nature protection; noise protection; protection against non-ionizing emissions.
3. Local economic development: planning local economic development; identifying development and structural priorities; local economic policy maintaining; supporting the development of small and medium-sized enterprises and entrepreneurship on local level – and, in this context, participation in the establishing and development of a local network of institutions and agencies, as well as partnership promotion.
4. Utilities – potable water supply; technological water supply; waste water drainage and treatment; public area lightening; atmospheric water drainage and treatment; public hygiene maintaining; communal solid and technological waste collection, transportation and disposal; regulating and organizing local public transport of passengers; construction, maintenance, reconstruction and conservation of local roads and streets and of other infrastructure structures; regulating traffic regimes; construction and maintenance of street traffic signalling facilities; removing illegally parked vehicles; removing wasted vehicles from public areas; and other utilities specified by the Law on Utilities.
5. Culture – institutional and financial support to culture institutions and projects; cherishing folklore, customs, old crafts and similar cultural values; organizing culture events; encouraging various specific forms of artistic creation.
6. Sport and recreation – developing group sports and recreational activities; organizing sport events; construction and maintenance of sport structures and facilities; supporting sport associations.
7. Social protection and child protection – kindergartens and homes accommodating elderly persons; maintaining social care to persons with disabilities, parentless children etc.
8. Education – establishing, financing and administering primary and secondary schools, in cooperation with the central government, in line with law, organizing student transportation, nutrition and accommodation to boarding schools.
9. Health care – managing the network of public health care organisations and structures in the primary health care, etc.
10. Conducting preparatory activities and undertaking measures to protect and rescue citizens and material goods in situations of wartime destruction, natural and other disasters – and consequences thereof.
11. Fire protection.

Some of these competences, such as utilities and urban development planning, represented part of municipalities' competences even before the adoption of the Law on Local Self-Government. It is exactly due to this fact that municipalities are now expected to have sufficient capacities to completely cope/ with these competences.

2.2 Delegated competences

There are also so-called delegated competences that central government bodies may delegate to a certain municipality or to several municipalities to maintain. This possibility will most probably be made much use of in the future for the purpose of carrying out delegated competences in a more economic and more efficient manner. A central government body may delegate a competence to be carried out by the mayor of a municipality being then in charge of the carrying out of the competence delegated. The practice of delegating central government competences to local levels is much frequent in many European countries; most often examples include issuing driver licenses, traffic licenses and similar documents. No example has yet been recorded in the Republic of Macedonia of delegating a competence from central to local governments.

2.3. Transfer of competences in the educational system

A systematized overview of problems in the education before the beginning of the decentralisation process reveals the following:

- Centralized education with minimum competences for the local self-government, teaching staff and parents i.e. the community, often leading to politicizing of the situation on the ground;
- Extremely centralized – and hence politicized – education;
- Competence overlapping;
- Inadequate school network;
- Insufficient coverage of students of certain ethnic affiliations in primary and secondary education;
- Absence of a national strategy for education development;
- Domination of facts;
- Minimum computerization;
- Deteriorated structures;
- Chronic lack of information;
- Teaching staff lacking motivation and somewhere being inadequate;
- Unsatisfying managing capacities in administration and education institutions.

With the beginning of decentralisation, expectations are that responsibilities will increase on local and school levels, in particular by means of the following:

- Re-organisation of educational administration and management by introducing new laws on local self-government and financing local authorities;
- Improving management and administration in education, including strategic and conceptual documents on central level;
- Developing a more efficient system of financial planning, allocations and financial management (improved *per capita* formula);
- Improving management on local and school levels, as well as professionalism and effectiveness with school and local self-government unit staff;
- Precise definition and restructuring of the role and responsibilities of Administrative institutions on all three levels;
- Building the school self-government system and providing for school management and school principal training;

- Using capacities of administrative institutions to monitor and evaluate schools;
- Improving capital investments to the education system.

Re-distribution of power and responsibility from central to local government levels in the education field takes place in two stages.

In the first stage of fiscal decentralisation, local authorities are responsible for the operation and maintenance of schools and student transport, in particular for the following:

- Establishing primary and secondary schools in the territories of their municipalities, implying they will be owners of school property, will define schools' annual financial plans and will adopt schools' annual balance sheets; will influence the selection of school principals through their representatives in school boards, will appoint the selected candidate and, in time, will be responsible for the school network;
- Maintenance of educational institutions, meaning partly financing education out of local budgets;
- Permanent monitoring and internal control of the education process quality at the education institution through municipal education inspectors or departments – depending on relevant systematized needs of the local self-government unit;
- Organizing student transportation in the territory of the municipality and carrying out appropriate procedures in public procurement with goods and services (heating fuel, transportation);
- Creating conditions and possibilities for greater participation in local curriculum creation on the part of all interested schools, local entities and businesses.

When decentralisation begun on 1 July 2005, at the very start, municipalities faced the lack of funding necessary for material and technical operation; in comparison to historical costs incurred by the central government, this represented a decrease by 25-30%, which caused unplanned costs and re-allocations within local budgets, blocked accounts of schools and municipalities due to debts effectuated before 1 July, inadequate managing staff – both in terms of education completed and not having manager/principal certificates issued by verified institutions, etc.

The lack was identified in relation to historical costs; the “Official Gazette of the Republic of Macedonia” No. 25 dated 18 April 2005.

By the 2006 central budget rebalancing, debts were paid having been incurred by 1 July 2005; as for 2007 – necessary historical costs have been taken care of by means of special purpose grants for primary and secondary education and for student transportation.

Nonetheless, problems still persist related with transferred competences in the first stage, in particular:

- The ownership right of municipalities has not been regulated over school facilities – only the right of exploitation thereof has been regulated;
- In some municipalities, there are no employees dealing with this field; in others, there has been overlapping of competences in the field of monitoring, at the moment being the exclusive duty of the State Education Inspectorate;
- No priority plans and evaluations have been developed on investment outlays needed for the maintenance of infrastructure in central and local schools;
- The issue is still pending of school network rationalization in the eve of the second decentralisation stage.

Financing – state of affairs⁹:

- The 2003 education budget's share to GDP was 3.49 %
- In the period between 1996 and 2003, the GDP share of the education budget was decreased by 0.77 %
- Out of the total education budget, 59.15 % of funding were earmarked for primary education, 22.66 % for secondary education, 12.46 % for university education, 1.92 % for pupil standard, and 3.81 % for university student standard attaining
- Out of funds schools receive, nearly 80 % are allocated to salaries.

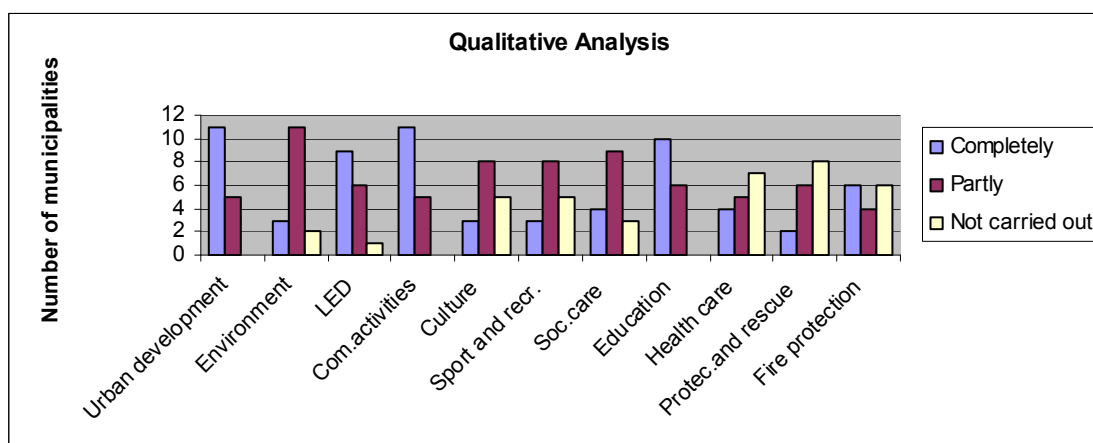
In the second stage of fiscal decentralisation, local authorities also take over the responsibility for paying salaries to the teaching staff, but also for school network rationalization, developing criteria for teaching staff evaluation, drafting programmes for teacher training in ICT and foreign languages, creating conditions and opportunities for private capital entry to education, giving greater freedom to education institutions when employing teaching, administrative, auxiliary and managerial staff - in which case participation of interested local entities, primarily parents, should be obligatory in this process.

Hence, with the second stage of decentralisation in education ahead, the evaluation of good governance capacities is more than required; it should first be free from any attributes of being a political decision or a daily advertising trick. It should represent a serious analysis of the situation, challenges, capacities, but also strict definition and delineation of roles of all actors on central, local and social levels. Before the second stage of decentralisation, meetings became more frequent among representatives of the Ministry of Education and Science and the Education, Science and Culture Trade Union.

2.4. Qualitative analysis of some municipalities and overall assessment

The following responses were recorded with questions related with the degree of competence decentralisation:

Graph 5:



⁹ Source: National Strategy for education 2005-2006

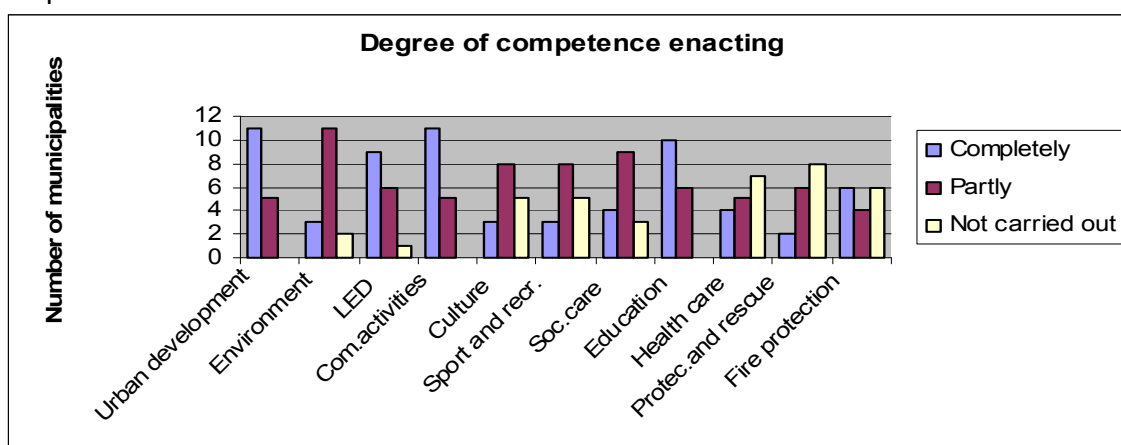
The above graph, developed on the basis of an analysis performed over responses provided in the questionnaire, shows various degrees of effectuating competences coming from the list of competences contained in the Law on Local Self-Government (Article 22). It demonstrates that full accomplishment of a competence has not been recorded in any area.

The situation is especially specific in the fields of urban planning, issuing building permits, and utilities. If the fact is considered that urban development planning (excluding building permit issuing used to be a municipal competence even before the adoption of the new Law on Local Self-Government), the following question needs to be posed: “Why are there still municipalities, including Skopje-City¹⁰, which partially accomplish this competence?” The case is even more evident with utilities, never within the competence of any central government body; out of 16 municipalities in total, as many as 5 have partially accomplished this particular competence.

Attention should be paid to responses regarding the accomplishment of competences in the health care field as 3 municipalities said they were completely accomplishing this competence. Apart from municipal participation in managing bodies and undertaking measures of protection against contagious diseases, there is no separate law transferring competences in this regard; this is why the question is posed of how this competence in particular may actually be completely accomplished¹¹. Interesting data was obtained with local economic development: even 9 municipalities stated they fully accomplished this competence, 6 said they accomplished it partially, and one municipality stated it did not accomplish this competence.

The graph below presents the extent to which each of the competences is accomplished within municipalities:

Graph 6:



There are various reasons for partial or complete non-accomplishing of competences. The most often mentioned one is the lack of funding, competences being not completely transferred, ownership over property and construction land, lack of fiscal capacity. Out of 16 surveyed municipalities, only three believe lack of administrative capacities may

¹⁰ Probably for the divided competences between the City of Skopje and municipalities in Skopje

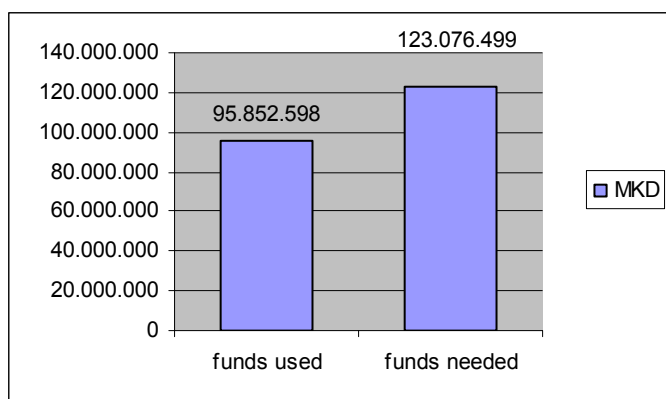
¹¹ Biggest part of the municipalities is considering that thought the assignment of own members in the Management Boards in the institutions from the area of healthcare are implementing their competences from the area of healthcare.

be the reason for competences not being carried out fully; only one municipality stated the reason might be found in the municipality's character (urban or rural).

The fact should particularly be noted that none of the municipalities perceive the number of inhabitants as reasons why some competences are not accomplished to partial or full extents.

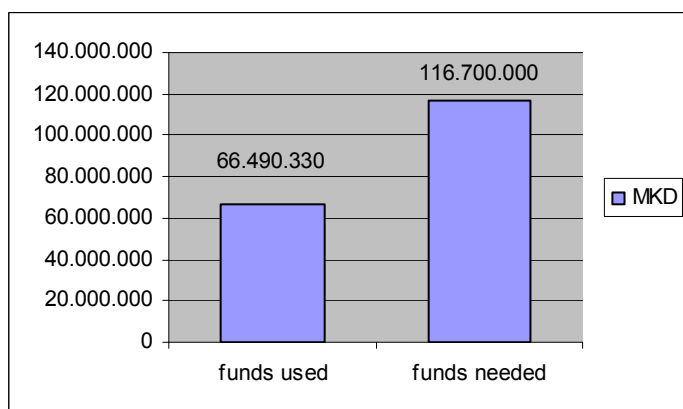
Planned and special funding for accomplishing competence. Funding represents the basic precondition for successful and complete accomplishing of municipal competences.

Graph 7: **The Municipality of Veles**

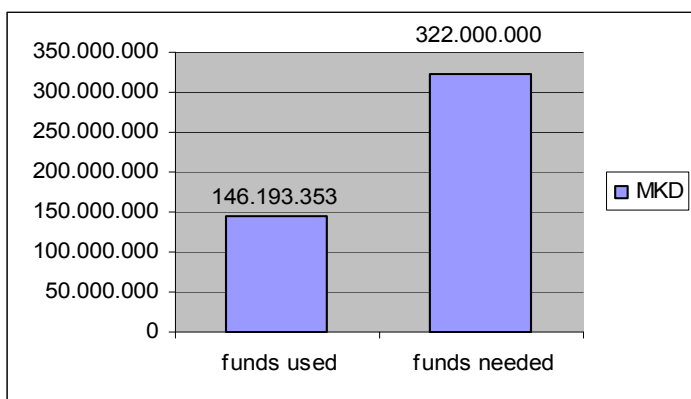


The above graph presents an overview of funds needed and required for the Municipality of Veles, one of the municipalities fully accomplishing all the competences mentioned in the list of competences (cf. Article 22). It may be noted that, in 2006, the Municipality had and effectuated funds to the amount of 95.852.598 MKD as opposed to the necessary 123.076.499 MKD, representing 77% of the necessary funding.

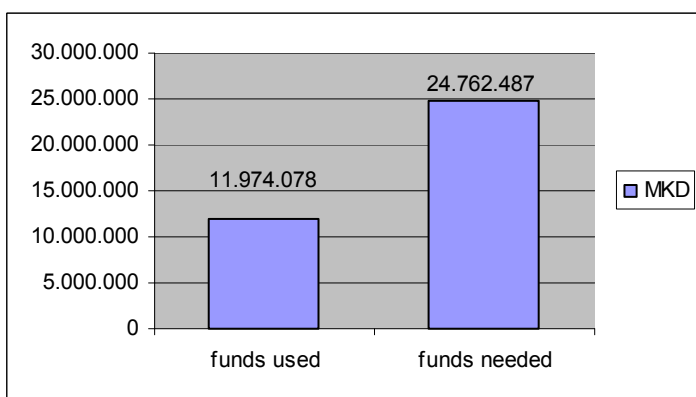
Graph 8: **The Municipality of Stip**



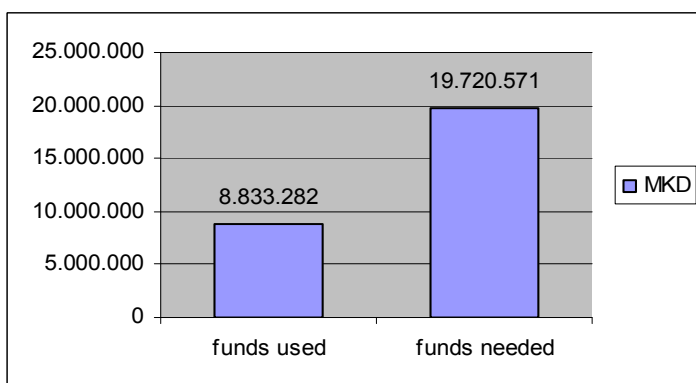
Graph 9: The Municipality of Strumica



Graph 10: The Municipality of Bogdanci



Graph 11: The Municipality of Makedonska Kamenica



Above graphs, showing the ratio between funds used and funds needed for competence accomplishing with two big and two small municipalities, show quite a big difference.

In the Municipality of Stip, 60% of funds needed were effectuated. This figure is 45% with the Municipality of Strumica, 48% with the Municipality of Bogdanci, and 45% with the Municipality of Makedonska Kamenica.

Responses vary to the question on which competences would be better accomplished on central than on local levels. Namely, most of the municipalities surveyed (7) said that the competence of protection and rescue would better be accomplished on central level; 6 of them said so about the health care, 3 about environment protection, and 3 municipalities responded in this manner in terms of fire protection.

In terms of which competences would better be accomplished on local than on central levels, municipalities surveyed responded in the following manner: 7 municipalities suggest the competence of managing construction land usage, 2 municipalities suggested local record services, 2 municipalities suggested social care, and 2 suggested police stations. In addition to these, the fields were also mentioned of riverbed regulation, farming land disposing, traffic police, emergency medical care. The fact should be noted that there has been no case so far of delegating a competence by state (central government) bodies to municipal mayors.

Authors:

Ms. Lefkija Gazovska and Mr. Kire Kitevski

3. OWN REVENUES

In addition to objectivity, transparency, stability and fairness, the newly-established system of local public finance introduced by reforms to the local self-government system should also provide for municipal autonomous nature and the right of municipalities to maintain their own policies within their competence fields. After all, the degree of development of a local self-government unit is assessed by the share of municipal expenditures to total public expenditures or by means of the percentage share of local public consumption to the Gross Domestic Product. It is particularly important to see how many percent of total municipal revenues come from own revenue sources the spending of which is the subject of discretionary powers of decision on the part of municipalities. The higher the share of own revenue sources, the more autonomous and independent a local government is because it does not depend to a high extent on transfers from the central government.

One of the basic provisions of Article 9 of the European Charter on Local Self-Government of the Council of Europe, states that funding sources should be appropriate to new duties; a portion of such revenues should originate from local fees and refunds - and that local governments should, in line with the law, make sure that the rates and sources of such funding be sufficiently numerous and flexible.

The decentralisation of power brought numerous new competences to local self-government units (LSGUs). They now have huge responsibility in terms of providing high-quality public services and improving the quality of life for their citizens. Hence, in addition to good will and commitment, sufficient funding needs to be provided. Unfortunately, increased duties and needs are usually not proportionate to funding provided.

3.1. Structure – types of revenues

In the Law on Financing of Local Self-Government Units, the “own revenue sources” term includes local taxes, local fees and local refunds, revenues from municipal ownership, local voluntary contribution revenues, revenues from penalties, revenues from grants, and other revenues determined by law.

Local taxes determined by law are: the property tax, the inheritance and gift tax determined by law, the immovable property turnover tax, and other local taxes determined by law.

Local fees determined by law are: communal fees, administrative fees, and other local fees determined by law.

Local refunds determined by law are: the construction land arrangement refund, utility refunds, refunds related with spatial and urban development plans, and other local refunds determined by law.

Ownership-related revenues include rent revenues, interest rate revenues, and property sale revenues (with the sale itself not disturbing a municipality’s public functions and competences).

The number of taxes belonging to the own revenue source group in the Republic of Macedonia is lower than the number of such taxes in other countries (Slovenia, Poland,

Bulgaria). Revenue types also differ. In Slovenia, also the following taxes have been introduced: the tax on games of chance, a special tax for using games of chance and slot machines beyond casinos - and there are also several taxes belonging to the groups of own or partially own revenues: the local tourism tax, the tax on maintenance of forest paths, the tax on changing purpose with farming land use, the tax on space degradation and usurping, other taxes related with sale, licenses and disposal; the fire tax, etc.

The following taxes have been introduced in Poland: the agriculture tax, the vehicle tax, the forest tax, the dog owner tax, the tax on activities in the civil law field, the tax on small enterprises, etc.

In Bulgaria, in addition to common local taxes, another characteristic tax is the tax on movable and immovable property turnover, the tax on vehicles, and the tax on roads. According to data from the Ministry of Local Self-Government, LSGU revenue sources had the following structure in 2006:

- 45% - revenues from local taxes and fees
- 16% - revenues not coming from taxes and fees
- 1% - capital revenues
- 20% - transfers and grants
- 18% - special-purpose grants

According to the same source, the share of local government total revenues to total central government revenues in 2006 amounted to 7%, or approximately 2.5% of the Gross Domestic Product. It is rather difficult to make objective comparisons due to differences in decentralized competences; yet, according to a 2002 OECD report on the measuring of the extent of fiscal decentralisation in some EU Member States and some countries being at that time EU membership candidate countries, differences in this regard are huge. The average share of local revenues to total revenues in EU Member States amounted to 26.4%, and to 19.5% with the ten candidate countries for EU membership. By countries, this ratio amounted to: 43.8% in Denmark; 33.2% in Belgium; 30.6% in Sweden; 28.8 in Poland; 26.7% in Hungary; and 26.0% in Latvia. The average share of local revenues to GDP in the eight EU Member States amounted to 16.1%, and to 7.6% in the ten candidate countries for EU membership.

These ratios will change following the start of the second stage of decentralisation and the transfer of block grants; yet, it is evident that, in spite of progress achieved in the Republic of Macedonia in this regard, considerable increase is required in local self-government units' own revenues.

Analyses of the structure of collected local taxes and the communal fee for company advertising board placing reveal the fact that insufficient use has been made of possibilities offered by the property tax. This leads to a conclusion that there has been no adequate approach in the Republic of Macedonia to the property tax; citizens are insufficiently informed about the significance of property taxation in the context of obtaining higher-quality services provided by the local government.

The property tax has been introduced in over 130 countries in the world. It is considered to be a very convenient revenue source; in most countries, it represents the main source of revenues to local governments. It has a broad basis and corresponds to the wealth status of the immovable property owner which is why it enables all immovable property owners to jointly share the costs of services they receive from local authorities.

Unfortunately, the 2006 percentage share of the property tax to total local taxes and the communal fee for company advertising board placing amounted to only 18%. Huge potentials exist of making full use of this revenue source. The share of the inheritance

tax is 3%; the real estate turnover tax has the highest share of 63%, with the communal fee for company advertising board placing having a share of 16%.

3.2. Sufficiency

Revenues from local taxes and fees do not meet LSGU needs at all because they are too low to cover LSGU liabilities and because collection rates are very low (especially with the property tax).

A study on measuring the level of property tax collection¹², done in August 2007 and relating to 2006 shows that the collection rate with the property tax amounted to 55.44%, the collection rate of the communal fee for company advertising board placing amounted to 33.59%, the collection rate of the inheritance tax amounted to 92.84%, and the collection rate for the real estate turnover tax amounted to 95.46%. In nominal amount terms, LSGUs collected the following during 2006: MKD 231.643.960 from the property tax; MKD 33.987.645 from the inheritance tax; MKD 125.047.399 from the communal fee for company advertising board placing; and MKD 1.052.836.563 from the immovable property turnover tax. The trend is obvious of increase with revenues collected from the property tax: MKD 40 million more than in 2005 were collected during 2006.

As opposed to the situation in many other countries, the perception of the property tax notion in the Republic of Macedonia has been wrong for years and decades. This type of tax has been prevalent with many illogical exemptions and intolerable low collection rates. Reasons for this trend may primarily be found in the fact that the property tax is a local one (and not a central one), yet by 1 July 2005, it was determined and collected by civil servants employed at the Public Revenue Office. The central government has for some time now been demonstrating an irresponsible approach in terms of granting exemptions preventing the collection of revenues belonging to municipalities and not to the central government itself. The property tax rate in our country has been inexplicably low: 0.1% to 0.2% of the value of a property. Property tax rates in some European countries, just for the purpose of comparison, amount to the following: 0.5% to 1% in Finland; 0.6% to 2.7% in Denmark (4% in Copenhagen); 0.3% to 0.8% in Greece; 1.0% in Latvia; 1.3% in Portugal; 1.5% in Bulgaria; 1.0% to 1.5% in Sweden; 2.0% in Poland – of the immovable property market value.

Wishing to avoid criticism from their citizens, LSGU Councils have been reluctant to introduce the maximum rate of 0.20% (introduced in two LSGUs only), so most of them (54 LSGUs) decided on a rate of 0.10%. Tax exemptions to the level of 50% are granted for structures in which tax payers live with their families, hence this rate has in most cases been reduced to 0.05% of the immovable property market value. Huge exemptions contrary to the European practice regarding commercial and manufacturing structures have been revoked under enormous pressure by the local self-government and ZELS, and considerable increase is expected in 2008 in terms of revenues from the property tax.

3.3. Transfer of own revenue administration

At the beginning of the first stage of decentralisation on 1 July 2005, the competence of determining the amounts and the collection of revenues from property taxes was

¹² A study on measuring the collection level with property taxes – ZELS.

transferred from central to local levels. This was the subject of consensus among all LSGUs, which was mostly due to dissatisfaction with the manner in which property taxes had been administered by PRO local offices. Being a non-core task to the PRO, this activity had been neglected (insufficient staff having inadequate training; low technical equipment levels, etc.); property tax administration had been neglected by the Office. Had the PRO determined and collected property taxes in an efficient and effective manner, the decentralisation of this competence would not have been necessary, especially with smaller LSGUs as this is a hard and expensive task to them and it does not pay off to establish own taxation services.

Central issues should also be highlighted in addition to the ones mentioned above:

- Low quality of the tax payer database;
- Irresponsible approach when voluntarily reporting the value of the property tax since 1994 (much lower property values were reported in order to pay lower property taxes, and some structures were not reported at all);
- Database updating not timely;
- Incomplete registry of property to be subject to taxation;
- Tax determination documents (i.e. “decisions”) not being timely mailed (mostly for political reasons);
- Unrealistic (from the office) assessment of immovable property values during transfers thereof (due to lack of a relevant methodology);
- Non-application of provisions on forced collection;
- Irresponsible approach, having led to claims on unpaid tax having become obsolete, something which caused huge material damage to LSGUs;
- Lack of motivation with PRO staff; etc.

In order to raise to a much higher level the specifying and collection of property taxes, being of enormous importance for the local self-government, most of the municipalities decided to take over some of the employees from PRO local offices and to create their own administrative capacities. Some smaller municipalities decided to cooperate on this matter with bigger municipalities. Bigger municipalities administer local taxes on the behalf and to the interest of smaller municipalities, and some established joint tax administration. Not all municipalities entered power decentralisation with equal level of preparedness. This is why some 36% of LSGUs developed the 2006 tax payer activation documents on their own; the Public Revenue Office developed such documents for some 40% of LSGUs.

An additional problem is posed by poor cooperation with the National Geodesy Administration, the Central Registry and the Ministry of Interior – it is hard and often simply impossible to get any taxpayer database from them, something which would make the whole job much easier (frequently as fees are charged for issuing databases though these are State Budget funded institutions). LSGUs are forced, for their own benefit, to establish completely new databases, building upon databases taken over from the PRO. This is the most important task; yet it’s a hard, difficult, time-consuming and expensive one. Registries need to be updated, structures need to be re-assessed and data needs to be processed; afterwards, timely delivery needs to be provided of “tax decisions” and consistent application of relevant legislation needs to be ensured, including the application of the least popular measure – forced collection. Communication with tax payers is another important aspect. They should be explained the basis, need, schemes and benefits related with existence and payment of taxes by various means (direct contacts, citizen gatherings, debate TV shows, TV spots, TV and radio messages, brochures, etc.). Another important thing is capacity strengthening with LSGU tax services (training, staffing, hardware and software procuring, etc.).

3.4. Qualitative analysis:

Table 1:

Own revenue sources 2006

| Item no. | Type of revenues | 2006 | | | | | | | | | | | |
|----------|--|-----------|-------------|---------|-------------|------------|-------------|------------|-------------|------------|-------------|-----------|-------------|
| | | Plasnica | | Saraj | | Ohrid | | Tetovo | | Veles | | Dolneni | |
| | | Planned | Effectuated | Planned | Effectuated | Planned | Effectuated | Planned | Effectuated | Planned | Effectuated | Planned | Effectuated |
| | Total revenues | 1.940.000 | 873.913 | | | | | | 86.484.703 | 61.030.781 | 50.840.317 | 7.920.000 | 2.805.020 |
| 1. | Local tax revenues | 1.050.000 | 260.009 | | | 68.350.000 | 73.189.014 | | 57.401.503 | 20.238.806 | 18.679.836 | / | / |
| 1.1 | Property tax revenues | 500.000 | 96.893 | | | 12.000.000 | 13.943.523 | 8.650.000 | 6.927.885 | 4.668.806 | 3.818.212 | 1.050.000 | 186.860 |
| 1.2 | Inheritance and gift tax revenues | 50.000 | / | | | 3.350.000 | 3.396.653 | 1.082.000 | 1.347.867 | 550.000 | 450.764 | 300.000 | 208.016 |
| 1.3 | Immovable property and related right turnover tax revenues | 500.000 | 163.116 | | | 53.000.000 | 55.848.837 | 51.233.000 | 49.053.730 | 15.020.000 | 14.410.860 | 1.100.000 | 876.387 |
| 1.4 | Revenues from other property taxes | / | / | | | / | / | | | / | / | 30.000 | / |
| 1.5 | Interest rate revenues | / | / | | | / | / | 41.000 | 72.021 | / | / | / | / |
| 2. | Local fee revenues | 860.000 | 591.816 | | | 41.275.000 | 51.833.874 | | 28.822.500 | 24.469.619 | 21.328.532 | / | / |
| 2.1 | Communal fee revenues | 730.000 | 516.166 | | | 33.675.000 | 44.757.886 | 21.570.000 | 19.994.488 | 21.927.200 | 19.410.832 | 5.260.000 | 1.243.899 |

| | | | | | | | | | | | | | |
|-----|--|---------|--------|--|--|-------------|-------------|------------|-----------|------------|-----------|---------|---------|
| 2.2 | Revenues from exploitation fees or fees for issuing activity performing licenses | / | / | | | 1.000.000 | 489.313 | | | 1.600.000 | 1.461.705 | / | 64.800 |
| 2.3 | Administrative fee revenues | 130.000 | 75.650 | | | 6.600.000 | 6.586.675 | 4.599.000 | 4.537.701 | 942.419 | 455.995 | 140.000 | 144.760 |
| 3. | Local refund revenues | 30.000 | 22.088 | | | 200.000.026 | 172.181.128 | | | 11.083.759 | 8.453.520 | / | 5.965 |
| 3.1 | Revenues from construction land arrangement fees | 30.000 | 22.088 | | | 200.000.026 | 172.181.128 | 30.000.000 | 4.253.311 | 11.083.759 | 8.453.520 | 40.000 | 74.333 |
| 4. | Ownership-related revenues | / | / | | | / | / | | 259.700 | 2.701.115 | 1.129.607 | / | / |
| 4.1 | Rent revenues | / | / | | | / | / | 259.700 | 259.700 | 1.730.000 | 334.742 | / | / |
| 4.2 | Property sale revenues | / | / | | | / | / | | | 900.000 | 723.750 | / | / |
| 5. | Revenues from grants | / | / | | | / | / | | | 71.115 | 71.115 | / | / |
| 6. | Local voluntary contribution revenues | / | / | | | / | / | | | 2.466.367 | 1.177.707 | / | / |

Table 2:

Own revenue sources 2006

| Item no. | Type of revenues | 2006 | | | | | | | | | | | |
|----------|--|---------------|-------------|------------|-------------|-----------|-------------|---------------|-------------|-------------------------|-------------------------|------------|-------------|
| | | Kriva Palanka | | Bitola | | Bogdanci | | Skopje | | Kisela Voda | | Vrapciste | |
| | | Planned | Effectuated | Planned | Effectuated | Planned | Effectuated | Planned | Effectuated | Planned | Effectuated | Planned | Effectuated |
| | Total revenues | 10.475.000 | 9.567.462 | | | 8.350.000 | 2.592.550 | 1.516.200.000 | 848.470.842 | | | 67.157.488 | 24.726.253 |
| 1. | Local tax revenues | 5.960.000 | 5.371.494 | | | 1.100.000 | 803.588 | 375.000.000 | 329.139.129 | 3.775.100 | 36.707.607 | 12.380.000 | 6.545.439 |
| 1.1 | Property tax revenues | 2.000.000 | 1.926.030 | 23.000.000 | 19.237.398 | 250.000 | 278.933 | 90.000.000 | 34.638.336 | 8.000.000 | 104.957 4.824.579 | 5.800.000 | |
| 1.2 | Inheritance and gift tax revenues | 460.000 | 464.358 | 3.271.000 | 1.633.062 | 100.000 | 55.697 | 12.000.000 | 7.912.135 | 3.000.000 | 2.055.836 | 560.000 | |
| 1.3 | Immovable property and related right turnover tax revenues | 3.500.000 | 2.981.106 | 36.213.578 | 38.535.740 | 700.000 | 428.723 | 270.000.000 | 285.815.862 | 18.000.000 8.600.000 | 19.692.484 9.915.346 | 6.020.000 | |
| 1.4 | Revenues from other property taxes | / | / | | | | | 0 | 0 | | | 0 | 0 |
| 1.5 | Interest rate revenues | / | / | 150.000 | 229.813 | 50.000 | 40.235 | 3.000.000 | 772.793 | 151.000 | 114.405 | 0 | 0 |
| 2. | Local fee revenues | 2.692.000 | 2.351.065 | | | 2.750.000 | 1.650.462 | 157.700.000 | 68.179.671 | 14.710.000 | 16.930.402 | | |
| 2.1 | Communal fee | 1.980.000 | 1.537.307 | 38.933.000 | 27.514.655 | 2.600.000 | 1.442.834 | 155.700.000 | 62.408.403 | 3.000.000 | 2.321.967 | 39.785.000 | 939.753 |

| | | | | | | | | | | | | | |
|-----|--|-----------|-----------|------------|------------|-----------|---------|-------------|-------------|------------------------------------|----------------------------------|---------|--------|
| | revenues | | | | | | | | | 1.600.000 10.000.000 110.000 | 1.536.950 11.564.327 5.100 | | |
| 2.2 | Revenues from exploitation fees or fees for issuing activity performing licenses | 92.000 | 91.773 | 800.000 | 994.705 | 0 | 76.688 | 0 | 2.913.391 | | | 0 | 0 |
| 2.3 | Administrative fee revenues | 620.000 | 721.985 | 1.540.904 | 1.584.406 | 150.000 | 130.940 | 2.000.000 | 2.857.877 | 1.100.000 | 1.502.058 | 50.000 | 76.000 |
| 3. | Local refund revenues | 1.723.000 | 1.597.867 | | | 1.500.000 | 138.500 | 958.500.000 | 438.423.147 | 90.000.000 | 82.611.562 | 250.000 | |
| 3.1 | Revenues from construction land arrangement fees | 1.723.000 | 1.597.867 | 38.000.000 | 22.877.761 | 1.500.000 | 138.500 | 958.500.000 | 438.423.147 | 90.000.000 | 82.611.562 | 250.000 | |
| 4. | Ownership-related revenues | 100.000 | 247.036 | | | | | 25.000.000 | 12.728.898 | 12.000 | 12.000 | | |
| 4.1 | Rent revenues | 100.000 | 247.036 | 800.000 | 393.641 | | | 25.000.000 | 12.714.950 | 12.000 | 12.000 | 0 | 0 |
| 4.2 | Property sale revenues | / | / | | | | | | 13.948 | | | 0 | 0 |
| 5. | Revenues from grants | / | / | | | 3.000.000 | 0 | 0 | 0 | 400.000 | 250.000 | 0 | 0 |
| 6. | Local voluntary contribution revenues | / | / | | | | | 0 | 0 | | | 0 | 0 |

Table 3:

Own revenue sources 2006

| Item no. | Type of revenues | 2006 | | | | | | | | | |
|----------|--|---------------------|-------------|------------|-------------|------------|-------------|-----------|-------------|-------------|-------------|
| | | Makedonska Kamenica | | Stip | | Strumica | | Rosoman | | Kumanovo | |
| | | Planned | Effectuated | Planned | Effectuated | Planned | Effectuated | Planned | Effectuated | Planned | Effectuated |
| | Total revenues | 9.603.000 | 6.508.241 | 44.365.000 | 410.947.365 | 97.152.872 | 100.703.048 | | | 129.400.000 | 110.540.000 |
| 1. | Local tax revenues | 4.580.000 | 3.575.225 | 24.100.000 | 24.496.074 | 22.554.000 | 21.038.766 | | | 45.000.000 | 42.171.845 |
| 1.1 | Property tax revenues | 700.000 | 197.553 | 7.200.000 | 4.840.272 | 6.500.000 | 4.375.138 | 1.600.000 | 400.000 | 9.000.000 | 7.233.260 |
| 1.2 | Inheritance and gift tax revenues | 100.000 | 26.367 | 300.000 | 224.916 | 1.000.000 | 351.254 | 50.000 | | 1.500.000 | 1.407.283 |
| 1.3 | Immovable property and related right turnover tax revenues | 3.730.000 | 3.351.305 | 16.500.000 | 19.363.312 | 15.000.000 | 16.295.180 | 1.800.000 | | 34.000.000 | 33.541.302 |
| 1.4 | Revenues from other property taxes | | | | | | | 1.000 | | / | / |
| 1.5 | Interest rate revenues | 50.000 | | 100.000 | 67.574 | 54.000 | 17.195 | 10.000 | | 500.000 | 25.464 |
| 2. | Local fee revenues | 2.823.000 | 1.141.655 | 19.765.000 | 16.048.154 | 25.967.000 | 16.628.285 | | | 40.800.000 | 26.600.899 |
| 2.1 | Communal fee revenues | 2.023.000 | 824.055 | 18.565.000 | 15.046.9140 | 21.667.000 | 14.195.850 | 1.500.000 | | 36.600.000 | 23.358.331 |

| | | | | | | | | | | | |
|-----|--|-----------|-----------|---------|---------|------------|------------|-----------|--|------------|------------|
| 2.2 | Revenues from exploitation fees or fees for issuing activity performing licenses | | | 400.000 | 242.660 | 1.000.000 | 344.035 | 100.000 | | 1.000.000 | / |
| 2.3 | Administrative fee revenues | 800.000 | 317.600 | 800.000 | 758.584 | 3.300.000 | 2.088.400 | 10.000 | | 3.200.000 | 3.241.568 |
| 3. | Local refund revenues | 2.200.000 | 1.791.361 | | | 45.591.772 | 54.267.351 | | | 41.000.000 | 39.714.605 |
| 3.1 | Revenues from construction land arrangement fees | 2.200.000 | 1.791.361 | | | 45.591.772 | 54.267.351 | 3.000.000 | | 41.000.000 | 39.714. |
| 4. | Ownership-related revenues | | | 500.000 | 403.137 | 1.700.000 | 8.768.646 | | | 2.000.000 | 2.052.846 |
| 4.1 | Rent revenues | | | 500.000 | 403.137 | 1.500.000 | 2.044.021 | 10.000 | | 2.600.000 | 2.052.846 |
| 4.2 | Property sale revenues | | | | | 200.000 | 6.724.625 | | | / | / |
| 5. | Revenues from grants | | | | | 10.32.100 | 1.964.024 | | | / | / |
| 6. | Local voluntary contribution revenues | | | | | 308.000 | 4.573.504 | | | / | / |

Table 4:

Property taxes and communal fees by municipalities 2006

| Item no. | Type of decisions | 2006 | | | | | | | | | | | | | | | | | |
|----------|--|---------|---------|--------|---------|--------|---------|--------|---------|--------|---------|----------|---------|---------|---------|----------|---------|--------|---------|
| | | Dolneni | | Saraj | | Tetovo | | Veles | | Ohrid | | Kumanovo | | Rosoman | | Strumica | | Stip | |
| | | Deliv. | Receiv. | Deliv. | Receiv. | Deliv. | Receiv. | Deliv. | Receiv. | Deliv. | Receiv. | Deliv. | Receiv. | Deliv. | Receiv. | Deliv. | Receiv. | Deliv. | Receiv. |
| 1. | Total number of property tax decisions delivered | 2.908 | 2.466 | 4.300 | 3.900 | 16.678 | 11.640 | 14.790 | 14.790 | 18.527 | 14.800 | 25.055 | | 1.280 | 1.280 | 11.598 | 11.018 | 12.852 | 12.852 |
| 2. | Total number of decisions delivered on communal fees for company advertising board placing | 173 | 159 | | | 3.169 | 2.890 | 1.408 | 1.408 | 3.266 | 1.887 | 4.253 | | 78 | 70 | 2.461 | 1.861 | 2.807 | 2.075 |
| 3. | Total number of issued decisions on immovable property turnover tax | 165 | 147 | | | 1.350 | 1.296 | 471 | 471 | 991 | 991 | 2.950 | 2.950 | 68 | 68 | 510 | 510 | 539 | 539 |
| 4. | Total number of delivered decisions with updated property tax data | 2.908 | 2.466 | | | | | | | | | | | | | | | 12.852 | 12.852 |

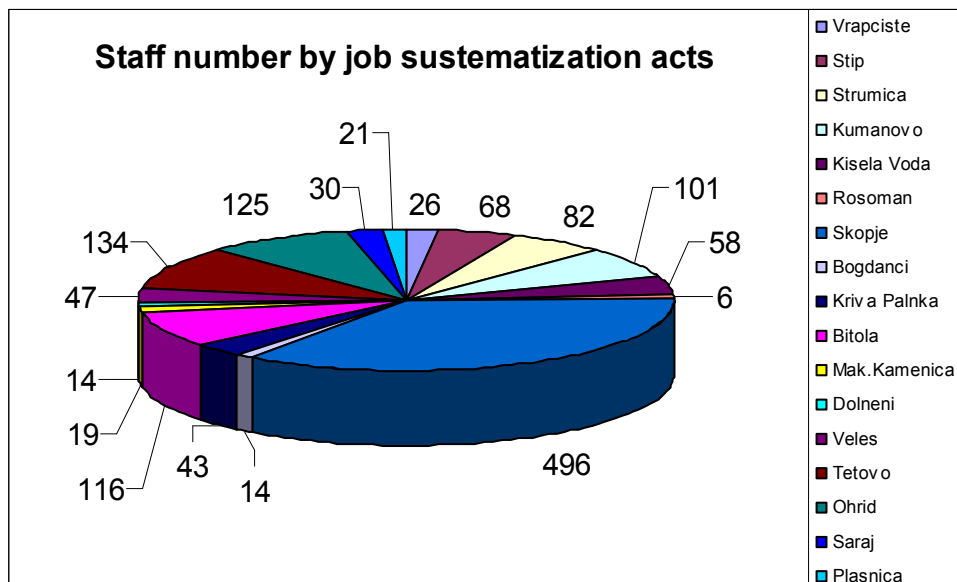
Table 5:

Property taxes and communal fees by municipalities 2006

| Item no. | Type of decisions | 2006 | | | | | | | | | | | | | | | | |
|----------|--|----------|---------|-------------|---------|--------|---------|------------|---------|----------|---------|---------|---------|---------|---------|-----------|---------|-------|
| | | Plasnica | | M. Kamenica | | Bitola | | K. Palanka | | Bogdanci | | Skopje | | K. Voda | | Vrapciste | | |
| | | Deliv. | Receiv. | Delive. | Receiv. | Deliv. | Receiv. | Deliv. | Receiv. | Deliv. | Receiv. | Deliv. | Receiv. | Deliv. | Receiv. | Deliv. | Receiv. | |
| 1. | Total number of property tax decisions delivered | 824 | 800 | 661 | 521 | | | 4.201 | 4.201 | 3.800 | 3.500 | 126.079 | | | | | 4.652 | 4.474 |
| 2. | Total number of decisions delivered on communal fees for company advertising board placing | 30 | 25 | 175 | 93 | | | 432 | 432 | 350 | 300 | 28.697 | | | | | 591 | 585 |
| 3. | Total number of issued decisions on immovable property turnover tax | 28 | 28 | | 69 | | | 335 | 335 | 92 | 92 | 14.723 | 13.200 | | | | 200 | 200 |
| 4. | Total number of delivered decisions with updated property tax data | | | | 521 | | | 200 | 200 | | | | | | | | 60 | 60 |

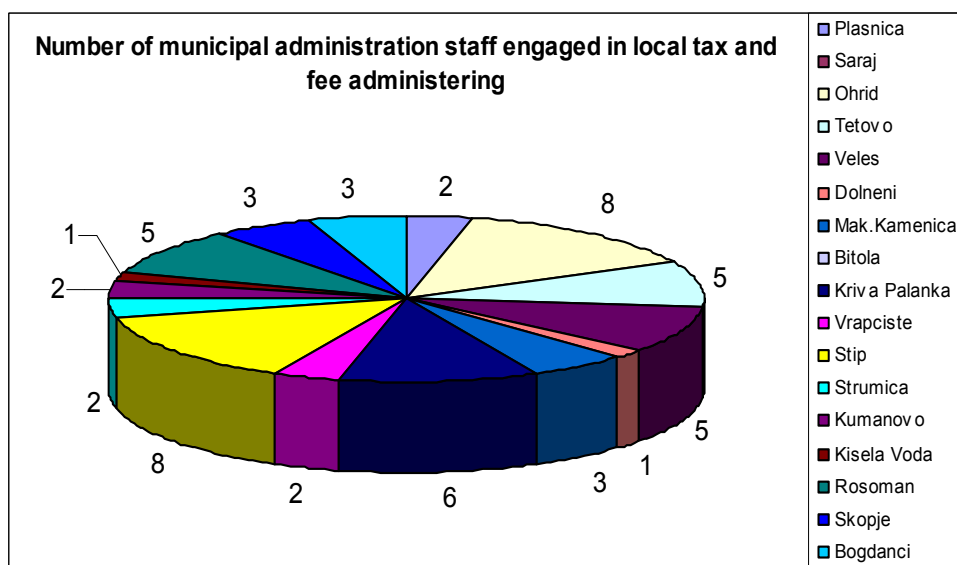
1. The question: "How many employees does your municipality have according to municipal administration job systematization acts?" revealed the following responses:

Graph 12:



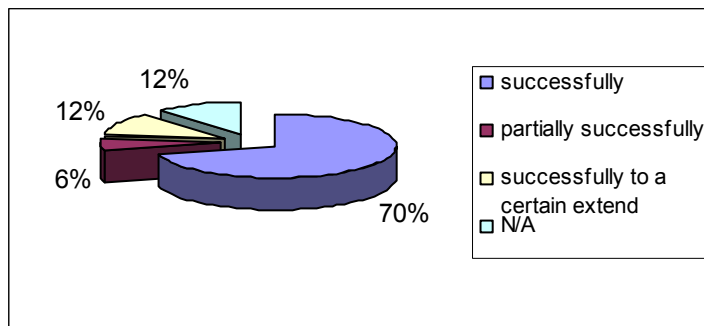
2. With the question: "How many municipal administration employees work on local tax and fee administration?" the following situation was determined:

Graph 13:



3. The following responses were provided to the question: “Does your municipality manage to successfully administer property taxes and communal fees with the above stated staff numbers?”

Graph 14:



4. According to the survey, *cooperation agreements on tax and fee administration with other LSGUs or with the PRO* have been concluded only by the following municipalities:

- The Municipality of Veles with the Municipality of Caska, on property tax and communal fee administration;
- The Municipality of Kriva Palanka with the Municipality of Rankovce, on tax administration; and
- The Municipality of Ohrid with the Municipality of Debarca, on local tax administration and on market value assessment by a competent Commission.

5. The question “Does your municipality re-assess value of property subject to property tax?” was answered positively by all municipalities. Such re-assessments are done by a Commission established by the municipal council, operating according to the Government Methodology on Assessing the Value of Property Subject to Property Taxation. The only exception is the Municipality of Kisela Voda; it does not do any re-assessment; this is done on its behalf by the administration of Skopje-City serving the needs of municipalities within Skopje-City.

3.5. Overall assessment and recommendations

Fiscal decentralisation represents one of the biggest challenges within local self-government reform processes. Republic of Macedonia is still one of the mostly centralized countries in Europe. The transfer of numerous and complex competences covering many important fields needs to be accompanied by an adequate funding transfer procedure. Should this not happen, once again the old tacit rule is going to be confirmed that getting more rights without having sufficient funding available is more of a burden than a right.

In order for the Republic of Macedonia to build local government that will be genuinely (and not declaratively) strong, autonomous and independent, as much as possible of total municipal revenues need to be provided from so-called own sources of revenues on the spending of which the local government will be deciding autonomously and

independently from the central government. Another important thing is the correlation between citizens – tax payers on one side, and high-quality utilities on the other side. Citizens – tax payers need to know that, if they want to be able to demand and expect good, efficient and effective services, they need to pay and, in doing so, have the right of holding their elected local representatives, administrative bodies and utilities accountable. Thus, local governments will become much more responsible and accountable.

The local public consumption share to total public consumption and the GDP is still very low, especially when compared with relevant figures in “old”, but also in “new” EU Member States. Especially unsatisfactory is the share of property taxes to local governments’ total revenues. There is huge potential resting with property taxes. By means of expert and scientific debates, the issue should be discussed in the forthcoming period of the advantages and disadvantages of the local public finance concept and of introducing a concept based upon strong own revenues and a huge percent rate of the personal income tax instead of the VAT; funding should be allocated from the central budget for reconciliation of differences existing among LSGUs in this regard.

Consideration should also be given to extending the list of property taxes by following relevant examples in countries where such practice has yielded good results.

Property tax rates are considerably lower when compared to such rates in most of the European countries. In spite of the fact that it may be a rather “unpopular” measure, especially in the eve of elections, these rates must be increased, step by step, in stages. At the beginning, LSGUs need to be encouraged to adopt the highest rates enabled to them by the law, rather than introducing the lowest rates for political reasons.

Numerous exemptions from the property tax need to be reviewed; they should be revoked, both in terms of the property tax (structures, land) and in terms of the inheritance and gift tax (now applicable equally to both the richest and the poorest citizens).

In terms of tax specifying and collection, LSGUs need to be stimulated to create the best possible conditions (expert administrative bodies undergoing continuous training, ICT usage). Smaller LSGUs should be encouraged to create joint administrations with their neighbouring LSGUs or to purchase services from bigger LSGUs or from the PRO.

All LSGUs not having started or completed the re-assessment of immovable property market value should be encouraged to do so as soon as possible in order to create their own databases. This may increase their revenues by several times, especially if they manage to introduce to their records numerous immovable property pieces that have not been registered so far.

LSGUs should be persistent in their demands to receive, free of charge, taxpayer databases from the National Geodetic Administration, the Central Register and the Ministry of Internal Affairs.

In order to enable better understanding of the public nature of local taxes, LSGUs should develop campaigns to better introduce to tax payers the needs, duties and effects related to taxes and fees, and to inform taxpayers on the amount, purpose, and manner of their spending the money coming from tax payers to LSGU budgets.

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12. “An Analysis of the Decentralisation Process Implementation”; July, 2006 – OSCE/CPJA

Author:

M.A. Ace Kocovski

4. INTERGOVERNMENTAL TRANSFERS

4.1. Introduction

Intergovernmental transfers signify subsidy/grants meaning transfer of financial assets from the Budget of the RM and from the fund budgets to the LSGU budgets. Subsidy in the theory of public finances is usually found as a synonym for intergovernmental transfers. It is a synthetic instrument for regulating intergovernmental fiscal relations. The subsidy scope, type, structure and quality are subsidiary to the goals of the fiscal system established by each country, and as a result, this area differs against different countries. In some countries intergovernmental transfers constitute important source for sustainability of local public finances, whereas in others they even constitute dominant part. Central governments regularly increase the level of their financial involvement in sub-national and local governments. In the course of 1960's and 1970's this was initiated, first, as reliability for the intensified needs for public and governmental services on local and regional levels, and then in their efforts to combat the problem of increased disparities between regional and urban centres in the countries. During 1980's and in particular in 1990's also in developed countries occurred big differences in their regional development, and as a result urban metropolises emerged from one side and rural communities on other side having significant difference in the level of their development. With the time this difference constantly increases due to the occurrence of the need to find out adequate instruments for balanced regional development in the countries. Consequently, the countries created strategy for *fiscal equalization* (Caulfield, 1997) known as horizontal equalization.

4.2. Normative system capacity and its implementation

It is known that subsidies granted by the central authority are simpler political form to increase local revenues and many local communities depend on their equalization and redistributive effects. Moreover, those revenues are mostly desirable for local "governments" due to the political opportunity. However, this has explicit implication on the local autonomy, which will depend on at least three factors:

- the proportion, covering subsidies in total revenues of the local government budgets;
- the form and manner of subsidies granted to local governments - as specific allocation or general grant; and
- the formula used in distribution of the subsidy.

A survey carried out in the OECD member states in 1983 supports the argument in the account of *fiscal autonomy* proving that in the countries where local governments were not responsible to decide on taxes, local expenditures rapidly increased (Caulfield, 2000). This survey leads to the conclusion that local governments should assume additional responsibility concerning fiscal capacity on local level, i.e. when creating fiscal system local authorities to be granted sufficient fiscal sovereignty so they feel more responsible against taxpayers. Subsidies, if dominantly expressed in local government revenues, may transform the latter in "fiscal parasites" that will be proactive in consumption, and more passive in creating revenues.

In 2004, Republic of Macedonia adopted the Law on Financing of Local Self-Government Units, as a normative system to regulate public finances of local authorities

and determined to gradually implement efficient and functional fiscal decentralisation in two phases:

1. **The first phase of fiscal decentralisation**, commenced as of 1 July 2005 and covers transfer of municipality own tax incomes (share of personal tax incomes) and drafting methodology for both capital and earmarked grants, activities in charge of the Government as well as implementation of the plan for consolidation of accumulated municipality debt to 31 January 2001, activities in charge of the local self-government units. In this phase municipalities were conditioned with technical parameters such as “quantitative” criteria, by providing at least two financial officers and three tax experts.

This phase, among other, confirmed long ago indicated failures of this system such as:

- R. Macedonia has not installed system for functional fiscal decentralisation, so it may be called fiscal de-concentration, since the major part of the source competences of municipalities are financed through the financial transfers by the central government (see Table 5.2-1), and not through municipality own local fiscal sources, and accordingly, transferred subsidies are synonym for horizontal equalization (de-concentration) and not for functional fiscal decentralisation. Namely, in the political theory of different-level authority relations it is usual that competences and responsibilities are delegated from higher to lower government levels, certain financial assets are also transferred for their accomplishment as earmarked or block grants – whose source scope and structure remain in the competence of central governments (this is financial de-concentration), whereas discretion fiscal rights are determined for certain source competences of local governments which constitute fiscal decentralisation. (Kenneth D. “Fiscal Autonomy and efficiency, as well as Bexheti A. “Macedonia after the Ohrid Framework Agreement” – FIIOM, Skopje 2006).
- the structure of municipality own revenues provides, nether in its scope nor in its structure (type and amount of taxes as well as tax base) sustainable fiscal system for the local self-government, in accordance with the competences laid down in the system law on local self-government, i.e. there is a “*extended list*” of types of taxes, taxes with tight fiscal capacity emerging on the surface incompatibility between “*granted*” competences and the “*provided*” financial sources;
- almost all “*poor pay taxes*” have been left to the local self-government (for ex. personal tax to craftsmen estimating 100% - personal incomes to shoemakers, saddle makers, and etc.) against “fine taxes” kept for itself by the central authority (for ex. 97% of VAT and personal tax);
- local self-government, lacking opportunity to make disposal of construction land, suppresses and discourages the local initiative for local economic and social development;
- departing from “*conventional and outdated*” human resources, technical, spacious and other capacities in balance of partition with the local units of the central government cause local authorities to feel inferior and powerless in the competition against central authorities;
- criteria defined for horizontal equalization do not generate equitable and efficient horizontal distribution since they contain relatively high rate of variation among LSGU (besides the number of inhabitants, other parameters are included such as area, and etc.);
- lack of revival of the local public debt as financial institution still restrains the municipalities in their action from developing local capital projects and investments, and etc.

The second phase of fiscal decentralisation, which "*normatively*" began as of 1 January 2007 only in those municipalities that have successfully "*passed*" the "*transitional exam*"! Conditions defined in the "*exam*" were primarily of staffing and financial-fiscal nature, both as municipality staffing financial capacity (specified in the first phase) and good financial and fiscal results (financial solvency, regular financial reports, and etc.) for the first two years of the fiscal decentralisation.

Successfully passed transitional exam will facilitate the municipalities to transfer the competences, thus permitting block transfers for:

- culture,
- social welfare and child protection,
- primary and secondary education, and
- healthcare (public healthcare organizations and primary medical care).

According to Article 8 of the Law on Financing of Local Self-Government Units of the Republic of Macedonia envisages subsidies from the Budget of RM and from the fund budgets to provide additional revenues in the municipality budget for funding its competences provided for in legislation. Paragraph 2 referred to in the said Article provides for the following types of subsidies:

- **Incomes from the Value Added Tax** – 3% of the collected Value Added Tax realized in the previous fiscal year;
- **Earmarked grant** – used for funding actual activity, and supplied by the competent ministries and funds for appropriate project or programme;
- **Capital grant** – provided on the basis of programme established by the Government of R. Macedonia, and used for funding investment projects;
- **Block grant** – used for funding actual competences laid down in the Law (Article 22 points 5, 7, 8 and 9 of the Law on Local Self-Government); and
- **Delegated competence grant** – supplied by certain state administrative body used for funding delegated competence.

Table 6 below shows the structure of municipality revenues relating to the fiscal capacity of local communities in R. Macedonia: -in 000 MKD

| | 2004 | % | 2005 | % | 2006 | % |
|---------------------------------------|------------------|------------|------------------|------------|------------------|------------|
| Capital incomes | 83.079 | 1,68 | 4.263 | 0,08 | 84.964 | 1,06 |
| Domestic debt | 44.792 | 0,90 | 13.550 | 0,25 | / | / |
| Non-tax incomes | 310.333 | 6,27 | 188.251 | 3,48 | 1.116.457 | 13,89 |
| Tax incomes | 3.196.801 | 64,55 | 3.169.564 | 59,10 | 3.462.686 | 43,09 |
| Transfers and subsidies/grants | 1.292.033 | 26,09 | 2.038.173 | 37,16 | 3.380.718 | 42,07 |
| TOTAL | 4.952.320 | 100 | 5.573.119 | 100 | 8.035.195 | 100 |

Source: Research on Decentralisation 2007, OSCE, September 2007, Skopje

Half a year prior to the expiry of the time limit for completion of the first phase of the fiscal decentralisation (31.12.2006) tax incomes still share approximately 43% of the

total municipal revenues, 14% share of tax-free incomes, 1% capital incomes and about 42% share of revenues transferred by the central government.

However, the above data may not contribute to drafting quality dynamic analysis since the fiscal decentralisation commenced as of 1 July 2005 so that time distance is not equal compared to the whole 2006, but it is obvious that there is permanent increase in the amount of the financial transfers from the central to the local authority levels.

4.3. Some comparative insights in intergovernmental transfers and their trends

The scope, type, structure and quality of the intergovernmental transfers (subsidies/grants) depend on the goals of the fiscal system established by each country, and as a result this area differs against different countries. In some countries intergovernmental transfers constitute important source for sustainability of local public finances, whereas in others they even constitute dominant part.

Local governments in most OECD member states are supported by significant percentage of their revenues in intergovernmental transfers. Some member states (such as Germany) provide those transfers through sharing stable subsidies, whereas the others allocate subsidies on the basis of discretion alternative made by the central government (Smith, 1996).

Intergovernmental transfers share **at least 30%** of the total local revenues of many OECD member states, whereas in some countries (G. Britain, Kingdom of Norway, Ireland, Spain and Italy) and share **over 70%** (OECD, 1997) as follows: Countries such as Spain and Italy, organized as regional, are “special” in this sense.

Local authorities in Belgium, Canada and Luxemburg are almost subordinate to **50%** of the intergovernmental transfers, whereas Norway, Luxemburg and USA have **30%** share of those transfers, and Australia, Austria, New Zealand and Island less than **20%**. Those percentages of “share” of the central government “owned” revenues in the structure of total local revenues also show the local authorities’ high level of financial dependence on the central government. However, we must take into consideration the level of political democracy and culture in those countries eventually compared to us!

*The following review shows the **structure of total revenues** (in %) by types of local authorities in some developed countries for 2002:*

Table 7:

| Country | Own revenues % | Financial transfers % | Other Own revenues % | Loa % | Total % |
|----------------|-----------------------|------------------------------|-----------------------------|--------------|----------------|
| 1. Denmark | 45 | 19 | 34 | 2 | 100 |
| 2. Finland | 42 | 22 | 33 | 3 | 100 |
| 3. France | 52 | 29 | 12 | 7 | 100 |
| 4. Italy | 28 | 40 | 20 | 12 | 100 |
| 5. Holland | 7 | 57 | 28 | 8 | 100 |

| | | | | | |
|--------------|----|----|----|---|-----|
| 6. Spain | 32 | 36 | 23 | 9 | 100 |
| 7. Sweden | 54 | 15 | 28 | 3 | 100 |
| 8.G. Britain | 13 | 64 | 22 | 1 | 100 |
| 9. USA | 55 | 36 | 9 | - | 100 |

Source: For the countries under item 1 to 8 overtaken from: "Option for Reforming Local Government Founding to Increase Local Streams of Founding: International Comparison" John Loughlin and Steve Martin with Suzannah Lux, Cardiff University, 2002. For item 9, same source - own calculation - no loan data.

What is the situation with governmental transfers in the region?

In **Croatia**, the share of subsidies in the regional revenues (zupanii) is 25%, 3% in cities and 19% in municipalities. Subsidies only are used for fiscal equalization so that only local communities under the average development in the country or those that cannot cover budget expenditures with own revenues have "access" thereto (Loughlin and others, 2002). Amount of the subsidy to a local community depends on the difference between the amount of the budgetary expenditures required and the capacity size of the local community. Two types of subsidy exist in Croatia – general and specific for certain purpose.

In **Bulgaria**, the share of governmental transfers in total local revenues in 1998 estimated to 37.2%, whereas in 2005 it estimated to 34.3%, i.e. about one third; however the distribution of personal income tax among authorities is not calculated (CEA, Skopje November 2006).

In **Slovenia**, the share of governmental transfers in total local revenues in 1998 estimated to 18.4% (Setnikar and others, 2002), which is almost the lowest percentage of local community fiscal dependence on governmental transfers.

For unitary states such as France, Turkey or Greece is characteristic that the share of governmental transfers in total local community revenues is more explicit and so is the local community dependence on the central government.

4.4. Qualitative analysis of certain municipalities

A suitable instrument – Questionnaire, filled in by authorized persons in the relevant communities was designed according to the methodology of qualitative positive analysis within the municipalities of R. Macedonia, through prior determined representative sample covering 17 municipalities from all statistical - mountainous regions in R. Macedonia.

What do the results indicate?

1) The scope, trend and structure by types of transfers from the central budget and from the fund budgets to the municipal budget against municipalities and years are as follows:

Table 8 (2004)

| Year - 2004 | Transfers from the RM Budget (741112) | | Transfers from the fund budgets (741113) | | VAT incomes (741115) | | Earmarked grants (741116; 741117; 741118; 741119) | | Capital grants (7412) | | Block grants (7412) | | Subsidies for delegated competences | | TOTAL | |
|---------------|---------------------------------------|-------|--|-------|----------------------|---|---|---|-----------------------|------|---------------------|---|-------------------------------------|---|------------|-------|
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Skopje City | 17.500.000 | 18,5 | 32.265.791 | 34,1 | / | / | / | / | 44.765.500 | 47,4 | / | / | / | / | 94.531.291 | 100 |
| Saraj | 1.500.000 | / | 1.800.000 | / | / | / | / | / | / | / | / | / | / | / | 3.300.000 | / |
| Tetovo | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / |
| Vrapciste | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / |
| Kumanovo | 10.970.280 | / | 499.959 | / | / | / | / | / | / | / | / | / | / | / | 11.470.239 | / |
| Stip | 2.000.000 | 5,4 | 310.431 | 0,80 | / | / | / | / | 1.395.329 | 3,8 | / | / | / | / | 3.705.760 | 10,0 |
| Strumica | 9.655.418 | 11,28 | 13.442.634 | 15,70 | / | / | / | / | / | / | / | / | / | / | 23.098.052 | 26,98 |
| Bogdanci | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / |
| Plasnica | 800.000 | / | 800.000 | / | / | / | / | / | / | / | / | / | / | / | 1.600.000 | / |
| Kriva Palanka | 3.910.512 | 18,32 | 7.260.000 | 34,00 | / | / | / | / | / | / | / | / | / | / | 11.170.512 | 52,32 |

| | | | | | | | | | | | | | | | | |
|---------------|-----------|-------|------------|-------|---|---|---|-----------|---|---|---|---|---|---|------------|-------|
| Veles | 9.537.786 | 13,19 | 14.000.000 | 19,36 | / | / | / | / | / | / | / | / | / | / | 23.537.786 | 32,55 |
| Bitola | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / |
| Ohrid | / | / | 18.174.930 | / | / | / | / | / | / | / | / | / | / | / | 18.174.930 | / |
| Kisela Voda | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / |
| Rosoman | 1.300.000 | / | / | / | / | / | / | 5.000.000 | / | / | / | / | / | / | 6.300.000 | / |
| Mak. Kamenica | 2.698.784 | | 3.500.000 | | / | | / | | / | | / | | / | | 6.198.784 | |
| Dolneni | 937.400 | | 4.633.900 | | / | | / | | / | | | | / | | 5.571.300 | |

Table 9 (2005)

| Year - 2005 | Transfers from the RM Budget (741112) | | Transfers from the fund budgets (741113) | | VAT incomes (741115) | | Earmarked grants (741116; 741117; 741118; 741119) | | Capital grants (7412) | | Block grants (7412) | | Subsidies for delegated competences | | TOTAL | |
|-------------|---------------------------------------|------|--|------|----------------------|------|---|------|-----------------------|---|---------------------|---|-------------------------------------|---|-------------|-----|
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Skopje City | 21.599.444 | 18,9 | 42.000.000 | 36,7 | 15.160.000 | 13,2 | 35.713.208 | 31,2 | / | / | / | / | / | / | 114.472.652 | 100 |

| | | | | | | | | | | | | | | | | |
|---------------|-------------|------|------------|------|------------|------|------------|------|------------|------|-----------|---|---|---|-------------|-------|
| Saraj | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / |
| Tetovo | 144.527.197 | 61 | 7.324.785 | 3 | 13.200.678 | 5,5 | 13.981.185 | 6 | / | / | / | / | / | / | 179.033.845 | 75,5 |
| Vrapciste | 11.023.516 | / | 4.416.169 | / | / | / | 2.035.000 | / | / | / | / | / | / | / | 17.474.685 | / |
| Kumanovo | 18.004.716 | / | 499.959 | / | 17.415.476 | / | 20.566.000 | / | 20.672.726 | / | / | / | / | / | 77.158.877 | / |
| Stip | 5.092.933 | 6,5 | 11.735.298 | 15 | 9.801.711 | 12,5 | 12.305.235 | 16 | 6.078.086 | 8,5 | / | / | / | / | 45.013.263 | 58,5 |
| Strumica | 11.098.707 | 8,15 | 11.274.406 | 8,33 | 9.247.674 | 6,83 | 15.195.447 | 11,2 | / | / | / | / | / | / | 46.756.234 | 34,55 |
| Bogdanci | / | / | 5.976 | 0,1 | 1.713.170 | 20 | 1.770.959 | 3 | / | / | / | / | / | / | 3.490.105 | 23,1 |
| Plasnica | 3.914.646 | / | 677.471 | / | 923.433 | / | 743.289 | / | 2.999.539 | / | / | / | / | / | 9.258.380 | / |
| Kriva Palanka | 3.000.000 | 13 | 2.450.000 | 10,5 | 5.512.360 | 23,6 | 4.054.824 | 17,4 | 4.582.502 | 19,5 | / | / | / | / | 19.499.686 | 83,87 |
| Veles | 13.818.563 | 15,2 | 10.872.427 | 11,9 | 9.810.929 | 10,8 | 15.248.757 | 16,8 | / | / | / | / | / | / | 49.750.676 | 54,67 |
| Bitola | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / |
| Ohrid | / | / | 1.469.748 | / | 9.755.317 | / | / | / | / | / | / | / | / | / | 11.225.065 | / |
| Kisela Voda | / | / | 23.536.792 | / | 2.022.093 | / | 11.705.809 | / | / | / | 3.660.000 | / | / | / | 40.924.694 | / |

| | | | | | | | | | | | | | | | | |
|---------------|-----------|---|-----------|---|-----------|---|-----------|---|-----------|---|---|---|---|---|------------|---|
| Rosoman | 1.100.000 | / | / | / | 1.321.310 | / | 1.378.126 | / | 7.450.881 | / | / | / | / | / | 11.250.317 | / |
| Mak. Kamenica | 2.717.426 | | / | | / | | 1.583.610 | | 3.151.706 | | / | | / | | 7.452.742 | |
| Dolneni | 2.687.708 | | 4.333.687 | | 4.351.562 | | 3.735.009 | | / | | / | | / | | 15.101.968 | |

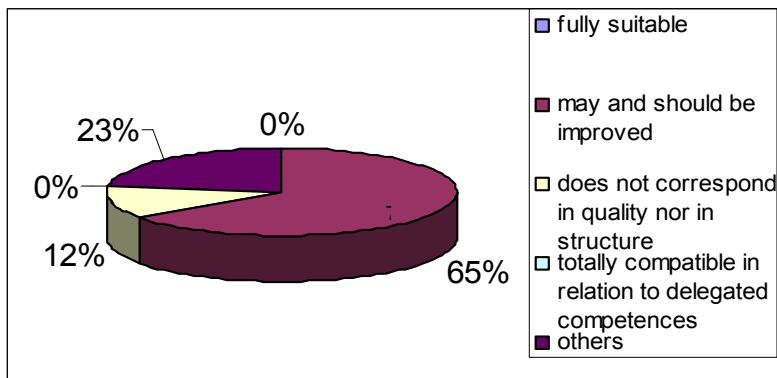
Table 10 (2006)

| Year - 2006 | Transfers from the RM Budget (741112) | | Transfers from the fund budgets (741113) | | VAT incomes (741115) | | Earmarked grants (741116; 741117; 741118; 741119) | | Capital grants (7412) | | Block grants (7412) | | Subsidies for delegated competences | | TOTAL | |
|-------------|---------------------------------------|----|--|------|----------------------|------|---|------|-----------------------|-----|---------------------|---|-------------------------------------|---|-------------|------|
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Skopje City | / | / | 25.441.249 | 11,3 | 31.869.611 | 14,1 | 168.114.182 | 74,6 | / | / | / | / | / | / | 225.425.042 | 100 |
| Saraj | / | / | 2.500.000 | / | 9.806.306 | / | 10.145.216 | / | / | / | / | / | / | / | 22.451.522 | / |
| Tetovo | 32.133.068 | 11 | 13.847.808 | 4 | 26.961.000 | 8,5 | 49.713.879 | 15,5 | / | / | / | / | / | / | 126.655.755 | 39 |
| Vrapciste | 14.343.330 | / | / | / | / | / | 5.895.716 | / | / | / | / | / | / | / | 20.239.046 | / |
| Kumanovo | 4.195.600 | / | / | / | 36.611.115 | / | 62.280.683 | / | 16.728.697 | / | / | / | / | / | 119.816.095 | / |
| Stip | / | / | 10.377.271 | 7,5 | 20.605.326 | 15 | 29.507.549 | 21,5 | 3.500.000 | 2,5 | / | / | / | / | 63.990.146 | 46,5 |

| | | | | | | | | | | | | | | | | |
|---------------|-----------|------|------------|------|------------|------|------------|------|------------|---|---|---|---|---|------------|-------|
| Strumica | 4.161.284 | 1,96 | 9.713.201 | 4,6 | 19.440.620 | 9,19 | 36.411.320 | 17,2 | / | / | / | / | / | / | 69.726.425 | 33 |
| Bogdanci | / | / | 3.596.270 | 15 | 3.987.732 | 16 | 4.074.321 | 17 | / | / | / | / | / | / | 11.657.911 | 48 |
| Plasnica | 5.062.614 | / | 1.899.745 | / | 2.618.749 | / | 1.817.112 | / | / | / | / | / | / | / | 11.398.420 | / |
| Kriva Palanka | / | / | / | / | 11.245.000 | 26,5 | 13.692.879 | 32,3 | / | / | / | / | / | / | 24.937.879 | 58,8 |
| Veles | 3.430.000 | 2,49 | 9.627.032 | 6,99 | 20.624.703 | 14,9 | 36.172.740 | 26,3 | / | / | / | / | / | / | 69.854.475 | 50,71 |
| Bitola | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / | / |
| Ohrid | / | / | 22.152.033 | / | 20.507.792 | / | / | / | / | / | / | / | / | / | 42.659.825 | / |
| Kisela Voda | / | / | / | / | 4.250.877 | / | 28.518.958 | / | 13.306.039 | / | / | / | / | / | 46.075.847 | / |
| Rosoman | 1.000.000 | / | / | / | 2.900.000 | / | / | / | 9.000.000 | / | / | / | / | / | 12.900.000 | / |
| Mak. Kamenica | 500.000 | | 8.938.000 | | 4.307.884 | | 4.867.570 | | / | | / | | / | | 18.613.460 | |
| Dolneni | / | | 4.232.719 | | 9.147.923 | | 10.536.276 | | / | | / | | / | | 23.916.918 | |

2) To the question “*Are municipalities satisfied by the Governmental Transfers*” the municipalities responded as follows:

Graph 15:



The data show that the trend of governmental transfers permanently increases and in most municipalities structural share of governmental transfers in total local revenues is from 40% to even 60% (Skopje City has misstated the structure as 100%). The lowest share of 33% is shown in Strumica followed by Tetovo with 39%. This is possible consequence of better fiscal capacity of these municipalities.

The structure of governmental transfers itself shows that the share of real budget and off-budget fund transfers (approximately 10-15%) is lower than the transfers based on distribution of VAT (approximately 10% or 15%) and earmarked grants (from 20% to 30%).

If we consider that the share of the governmental transfers in urban municipalities such as Skopje City, Kumanovo, Veles, Stip, Strumica and etc., is higher than that in rural municipalities, it can be established that this instrument in R. Macedonia is not in a function of horizontal balance („*fiscal equalization*“) of balanced regional development in the country.

3). To the question “*Do you consider that the transfer structure and quality is adequate to the structure of municipal competences*” the authorized officers in the municipalities responded as follows:

Out of 17 municipalities, 14 consider that the transfer structure and quality is not adequate in quality to the structure of municipal competences and that the system requires improvement, 2 municipalities (Stip and Rosoman) consider that the system is totally inadequate.

4) To the question “*Which fiscal sources (out of central taxes) and to what extent they would be more appropriate for quality accomplishment of the granted competences*”, the following responses were given:

Table 11:

| Municipality | VAT incomes, to % | Personal tax incomes, to % | Property and concession incomes, to % | Other revenues, to % |
|---------------------|-------------------|----------------------------|---------------------------------------|----------------------|
| Skopje City | 5 | 50 | 30 | |
| Saraj | 30 | 20 | 10 | |
| Tetovo | 16 | 20 | 10 | |
| Vrapciste | | | | |
| Kumanovo | 10 | 10 | | |
| Stip | 5,5 | 5,5 | 60 | |
| Strumica | 5 | 100 | 100 | 100 |
| Bogdanci | 30 | 25 | | |
| Plasnica | | | | |
| Kriva Palanka | 6 | 6 | 100 | 100 |
| Veles | 5 | 100 | 100 | 50 |
| Bitola | | | | |
| Ohrid | | | | |
| Kisela Voda | 5 | 25 | 100 | |
| Rosoman | 7 | 70 | 70 | |
| Dolneni | 5 | | 10 | from block grants |
| Makedonska Kamenica | 5 | 30 | 40 | |

Of a total of 17 municipalities, 13 municipalities consider that the VAT share in local revenues is to be significantly increased (most municipalities are very impartial and take consideration only to VAT duplication, and some even consider that it should increase ten times at least). It is reasonable that they highlight the need to significantly increase personal tax incomes – and concession-based incomes

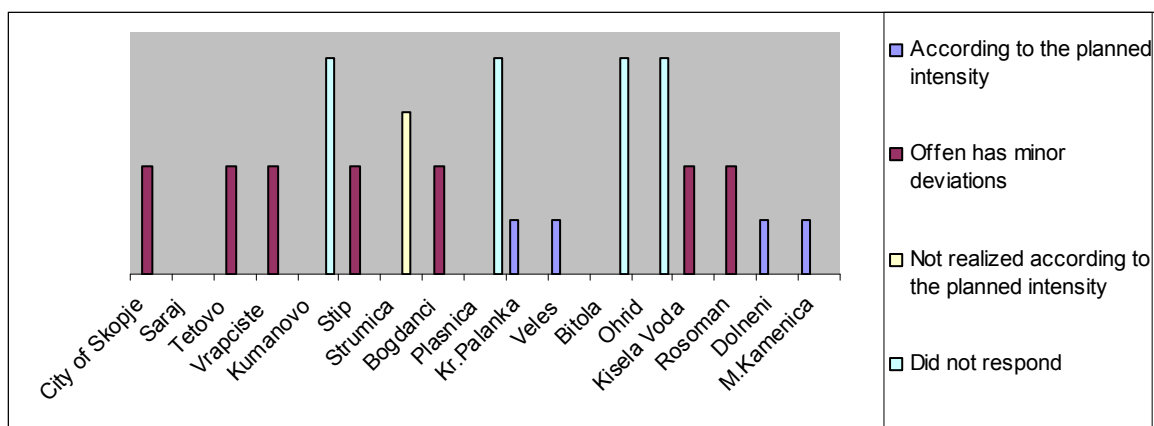
- 5) To the question "Which criteria and to what specific extent (sum of 100) do you consider adequate for horizontal equalization and equality among municipalities" the following results were provided:

Table 12:

| Municipality | Number of inhabitants, in % | Area of municipal territory, in % | Level of development of different progress by inhabited sites, in % | Infrastructure development, in % | Other, in % |
|---------------|-----------------------------|-----------------------------------|---|----------------------------------|-------------|
| Skopje City | 90 | 10 | | | |
| Saraj | | | | | |
| Tetovo | 70 | 20 | 10 | | |
| Vrapciste | | | | | |
| Kumanovo | | | | | |
| Stip | 60 | 10 | 20 | 20 | |
| Strumica | 50 | 10 | 10 | 30 | 20 |
| Bogdanci | 20 | 25 | 15 | 30 | 10 |
| Plasnica | | | | | |
| Kriva Palanka | | | | | |
| Veles | 35 | 15 | 20 | 20 | 10 |
| Bitola | | | | | |
| Ohrid | | | | | |
| Kisela Voda | | | | | |
| Rosoman | 10 | 10 | 30 | 20 | 30 |
| Dolneni | 28 | 25 | 32 | 15 | / |
| Mak. Kamenica | 20 | 20 | 25 | 30 | 5 |

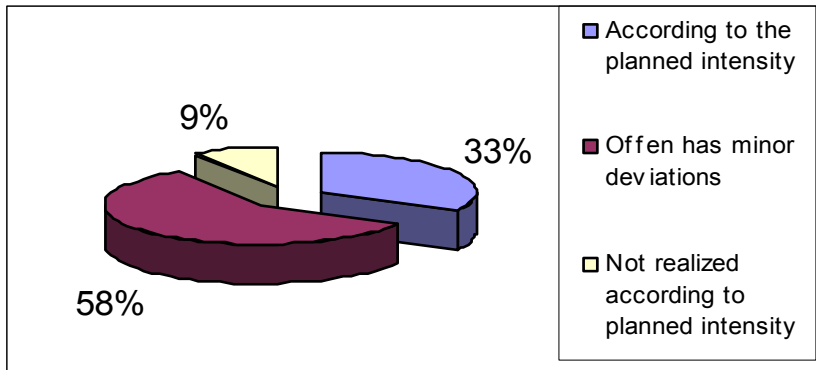
The responses to this question are indicative. If “common multiple” is found to this responses it may be “one grist to one’s mill” Urban and densely populated municipalities “force” the criteria to “bring” them most revenue, i.e. the number of inhabitants, whereas rural municipalities “support” criteria – municipal territory or level of the municipal development.

Graph 16:



6) To the question "How are transfers realized", the following responses were provided:

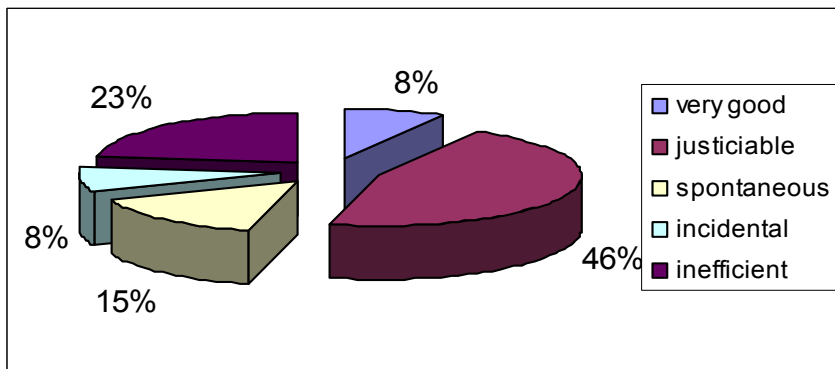
Graph 17:



Most of the municipalities are almost satisfied with the intensity of realization of the governmental transfers (other than Strumica) in spite of slight deviations from the planned dynamic. This shows that the central government has better fiscal solvency than fiscal structure of the transferred financial sources to the local authorities.

7) To the question "How do you evaluate the efficiency of allocation of the financial transfers from the central government", municipalities provided the following responses:

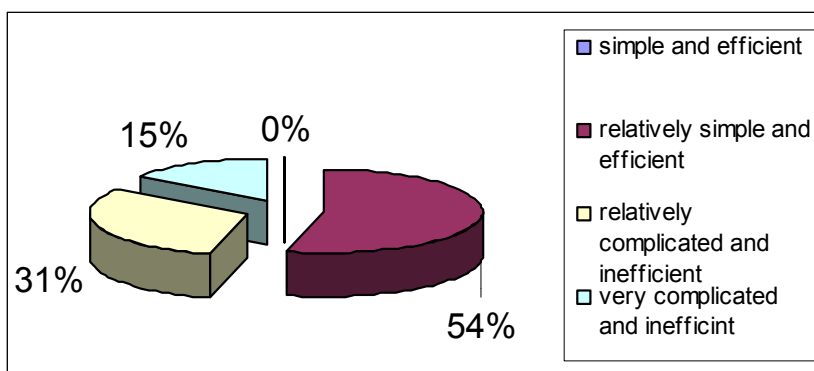
Graph 18:



Results show that 46% of the municipalities are satisfied with the allocation efficiency of financial transfers from the central government, whereas 23% consider that the allocation system is inefficient. Part of the municipalities did not respond to that question (20%).

8) The results to the question "Are the procedures for valid transfers simple and efficient" are as follows:

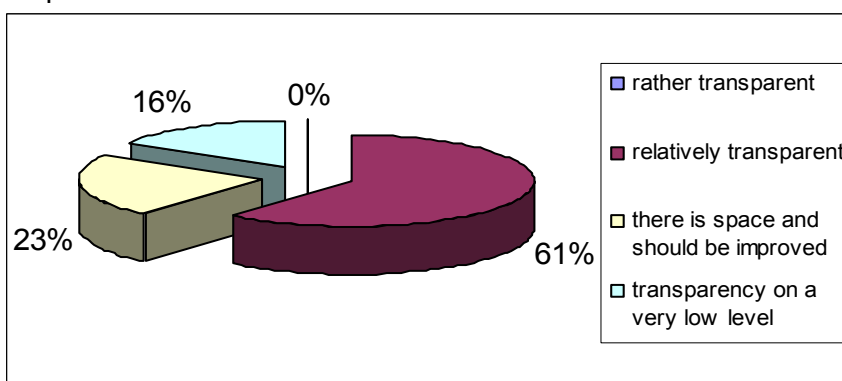
Graph 19:



Half of the municipalities are of opinion that the procedures for governmental transfers are relatively simple and efficient, and the other half considers that they are complicated and inefficient.

9) To the question "Are the procedures for governmental transfers transparent", the responses are as follows:

Graph 20:



The situation concerning transparency of the governmental procedures is a little better with regard to realization of the governmental transfers, 61% are of opinion that the procedures are relatively transparent, whereas 39% are not satisfied with their transparency.

4.5. Conclusive insights and recommendations

From the aforementioned, the following conclusions with regard to the area of fiscal decentralisation may be drawn and on that basis the following appropriate recommendations are provided:

1) It is possible that governmental transfers as fiscal instrument for horizontal equalization in R. Macedonia are suitable in scope, however they are not suitable in structure. The scope is usually applied for "satisfying" political reasons other than economic reasons for fiscal decentralisation - related to the efficiency and effectiveness of this system. Transfers based on system division of stable taxes such as VAT, and in particular personal income

tax are to be improved; thus “transforming” the existing system of fiscal de-concentration in functional fiscal decentralisation.

2) Like in comparative insights within the developed countries (OECD member states) it may be perceived that in the countries of the close region, subsidies and grants as inter-governmental transfers serve more as instruments for horizontal balance (“*fiscal equalization*”), whereas this fiscal instrument in R. Macedonia is not in the function of qualitative horizontal balance of the sporadic regional development in the country. This is also confirmed by the qualitative analysis of 17 municipalities, 14 out of which consider that the transfer structure and quality do not correspond in quality to the municipality competence structure and that it is necessary to improve the system.

3) Even though in June 2007, the Government adopted Amendments to the Methodology for distribution of VAT incomes for 2008, they are only “make-up” and are not qualitative changes to the criteria for sharing “joint taxes”, in particular concerning VAT and personal income tax. Only objective criteria and parameters are to be installed in the formula and paradigm for share of subsidies throughout the local municipalities completely eliminating political and subjective parameters that prevail much more now. For that purpose it is necessary to interfere in the existing Law on Financing of Local Self-Government Units.

4) Having had sufficient information on the fiscal capacity of municipalities, in which the second phase of the fiscal decentralisation is being implemented, we can objectively determine the existing discrepancy between the source competences of local self-government and fiscal capacity both to source municipal revenues and to transfer taxes from the central budget and fund budgets to the local community. A wide gap really exists between those two dimensions.

5) This project has emerged on the surface the extensive failure not only of the financial capacities of municipalities but, above all, in addition to technical capacities (IT, premises), the human capacity.

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Authors: Ph.D. Abdulmenaf Bexheti and Ph.D. Murtezan Ismail

5. INDEBTEDNESS

5.1. Legal regulation

Article 9 of the European Charter of Local Self-Government regulates the LSGU right to access national capital market for the purpose of capital investments.

The adoption of the Law on Local Self-Government in 2002 was intended for facilitating the final result in terms of establishing municipality capable of and accountable for accomplishing local public works in prompt and quality manner and for resolving day to day problems of citizens that occur, in the interest of the citizens from the territory of the municipality and the place they live in and work.

The Law on Financing of Local Self-Government Units regulates the issue relating to the local self-government indebtedness, on which basis municipality may incur debts (as of 1 July 2007) on short- and long-term basis in the country and abroad, and all due obligations to the suppliers exceeding ninety calendar days are treated as indebtedness.

With regard to short-term indebtedness of a municipality, the loan is to be returned by the end of the calendar year, and the total amount of the short-term indebtedness may not exceed 20% of the realized total revenues of the municipality current operative budget in the previous fiscal year. Total revenues of current operative budget means all revenues to the budget, other than subsidies/grants from the Budget of the Republic of Macedonia and fund budgets intended for financing capital investments, voluntary revenues and funds obtained through loans. Long-term indebtedness of a municipality is conditional to the total amount of the municipality undue long-term debt, including all issued guarantees for the purpose of not exceeding the amount of the total revenues of the municipality current operative budget in the previous year.

Another condition to be fulfilled by a municipality concerning long-term indebtedness is that the total amount of the annual repayment of the debt of the long-term indebtedness may not exceed 15% of the total revenues of the municipality current operative budget in the previous fiscal year. Long-term debt is paid off in equal or declining annuities.

The municipality council by adopting its act is to approve long-term indebtedness following public debate in which the project is described and conditions on its funding explained. The decision on long-term indebtedness adopted by the council shall be valid provided that the indebtedness contract is concluded in the fiscal year in which the decision has been adopted. In case where the indebtedness contract is not concluded in the fiscal year in which the decision on indebtedness has been adopted by the council, it is necessary to readopt decision on indebtedness.

Public enterprises owned by the municipality operate in its territory. They may incur debts for the purpose of maintaining current solvency or other purposes. Public enterprises established by the municipality may only incur debts with prior decision on guarantee adopted and issued by the municipality council.

Mayor of the municipality shall be obliged to inform the Ministry of Finance on all guarantees issued. Furthermore, the municipality may, upon decision adopted by the council, guarantee and undertake obligations deriving from long-term loans incurred by public enterprises which are established by the municipality.

Municipality may incur long-term debts when the Ministry of Finance determines that all conditions have been fulfilled as follows:

- To continuously submit positively evaluated financial reports in a period of at least two fiscal years as of the date of the application of the Law on Financing of Local Self-Government Units (the Law has been applied as of 1 July 2005), and
- Not to have outstanding obligations to creditors within 90 days as of the due date continuously for a period of at least two fiscal years as of the date of the application of the Law on Financing of Local Self-Government Units.

Even though those two criteria are not met, the Government may, in exceptional cases, grant approval for indebtedness for financing municipality capital investments upon prior positive opinion provided by the Ministry of Finance.

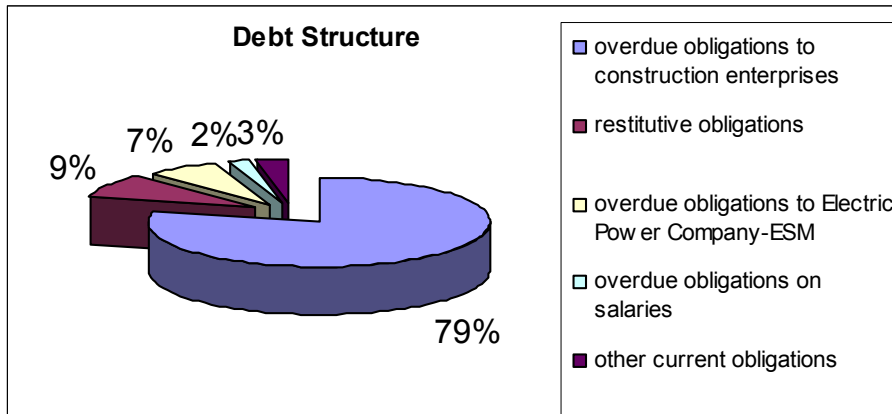
According to the provisions referred to in the Law on Securities, besides other entities as provided for in the provisions referred to in Article 3 of the Law on Securities, securities may be also issued by the municipalities in the Republic of Macedonia and Skopje City as a separate unit of local self-government. The total nominal value of one issue of bonds guaranteed by a municipality or Skopje City may not exceed the value of the principal capital. Securities on the primary market, including own shares are issued upon prior approval supplied by the Securities and Exchange Commission.

According to the Law on Public Debt, the Sector for Public Debt Management within the Ministry of Finance is to grant approval on all initiatives for indebtedness of all public institutions (including municipalities), having into consideration the Strategy for Managing of Debts, annual restrictions on indebtedness and the debt sustainability. With regard to indebtedness by municipalities it is necessary to coordinate with the Sector for Budget.

5.2. Situation in Macedonia

As of May 2004, the total outstanding debt of the LSGUs in Macedonia has been estimated to about 47 million EUR or 1,4% of Macedonian GDP compared to the average of the 15 EU Member States (for additional details see Schlumberger Scheme, 2004). The structure of the local debt in Macedonia is shown in the Table below. It is worth mentioning that those figures in nature are overdue outstanding obligations, not traditional debt. Experience indicates that, if LSGUs save 15% of the current operative expenditures for paying off their debts, 24 LSGUs (out of total of 84) it will require more than 7 years to pay off their debt, and 10 municipalities will require more than 10 years (yet it should be mentioned that in the recent period, part of this debt is outstanding, however, due to lack of data we are not in position to notify the recent situation).

Graph 21:



Source: Schlumberger Scheme (2004)

According to this Study, major portion of the total debt amounts (overdue) in Macedonia is only concentrated in 10 LSGUs (72% of the total debt). As shown in the graph, overdue obligations to creditors dominate in the local debt. Overdue obligations are significant problem, and Article 45 of the Law on Financing of Local Self-Government Units – LFLSGU require that, by the end of 2004, each of the LSGUs prepare plan for resolving overdue debt accumulated before 31 December 2001. However, it seems as no entire efficient solution exists, even though the debt/overdue obligations to 2005 are halved.

Overdue obligations will influence credit standing of Macedonian LSGUs and their capacity to make use of the credit instruments in their capital programmes, since this is a form of hidden operative deficit.

According to the Ministry of Finance, since the beginning of the decentralisation, LSGUs have gradually decreased the amount of those overdue debts (24 million EUR by the end of 2005). According to the latest information available, 29 out of a total of 84 LSGUs have decreased their overdue debts, one LSGU has increased its debt, and the remaining 55 have not registered progress in resolving this problem.

In most EU Member States local debt in relation to GDP is averaged to 5%, which is relatively low percentage, and in 11 out of 15 EU Member States, local debt in relation to GDP declined between 1995 and 2000 (for more details see Swianiewicz, 2004).

5.3. Demand from LSGUs for indebtedness in R. Macedonia

Challenge for Macedonia is to increase private and public investments for the purpose of supporting economic development and modernization of LSGU infrastructure, accompanied by maintaining stable macroeconomic environment. LSGUs and municipal enterprises will have important role in this context, since they are responsible for undertaking significant portion of the investments required in infrastructure on local level.

Investments in LSGUs are under the necessary level to fulfil the EU infrastructure standards in the course of the pre-accession period. Currently, a large part of the local infrastructure is outdated and great effort is required to replace and modernize it. Utilities such as water supply, sewerage and hard waste systems require high

costs. Consequently, huge investments are necessary to increase the level of such services. It is evident that great part of the development, replacement and renewal of local assets is to be funded out of the LSGU revenues.

As approximate calculation of the scope of the demand for LSGU indebtedness in Macedonia (similar calculations are provided for in Romania and Bulgaria) may be used the calculations of the EAR Project for Strengthening the Capacity of the Ministry of Environment and Physical Planning relating to assessments of meeting capital and operative costs of investments required for compliance with European Union directives and policies in the area of “big investments” when managing the environment. Within the framework of this Project, indicative assessments of the cost to access the area of big investments are given in the Table below.

Table 13. Assessment of total investments in million EUR/per capita in EUR for approximation of Macedonian, Romanian and Bulgarian legislations with the EU legislation on environment.

| | Macedonia | Romania | Bulgaria |
|--|------------------|-------------------|------------------|
| Treatment of urban waste waters, sewerage | 229/113 | 1,385/63 | 2,056/267 |
| Large incineration plants | 274/136 | 402/18 | 1,627/211 |
| Management of municipal waste, landfill sites | 80/40 | NA | NA |
| Management of municipal waste, other installations | 120/59 | NA | NA |
| ISKZ licences | 381/187 | 806/36 | 3,261/424 |
| TOTAL: | 1,084/537 | 10.593/475 | 6,944/902 |

Source: Future of local public finances: Case studies in Romania, Bulgaria and Macedonia, editor, Marjan Nikolov 2006

Presentation 1. Discussion on capital demand by LSGU according to data provided in the Questionnaire

According to the Questionnaire carried out within the framework of this Project, only 5 municipalities responded that they have plans for capital investment. They count to 9 million EUR, or 94% of their total revenues.

These municipalities cover almost 10% of the total number of inhabitants in Macedonia. According to the plans of these municipalities each of the inhabitants should provide about 50 EUR for the purpose of realizing their plans for capital investment (not all of the municipalities have indicated time scale for their plans).

It is impossible to make additional analyses such as analysis on the legal annuity limit and comparison of the number of inhabitants and other indicators due to the weak response of the municipalities with regard to filling in the Questionnaire.

5.4. Offer to LSGUs for indebtedness in R. Macedonia

Macedonian economy in the past was cash-based with low- or high- centralized banking sector without functional capital markets. Main capital costs on LSGU level were funded by grants or soft loans focused to central authorities, or in case of small routine projects, financed on the basis of pass-as-you-go by areas. Donor aid was unsystematic, and upon their selection.

Financial institutions in the Republic of Macedonia are banks (20), insurance companies (10), leasing companies (8) and brokerage houses (11).

Table 14: Financial institutions in the Republic of Macedonia (end of 2005)

| | Banks | Insurance companies | Brokerage houses | Leasing companies |
|---|--------------|----------------------------|-------------------------|--------------------------|
| Funds (in million MKD) | 14,0345 | 13,618 | 447 | 2275 |
| Share of financial institutions in total funds | 89.6 | 8.7 | 0.3 | 1.5 |
| Share in GDP (%) | 50.6 | 4.9 | 0.2 | 0.8 |
| Concentration in % (biggest two//three) of the total industry funds | 66.0 | 81.4 | 58.8 | 61.0 |
| Capital (in million MKD) | 21,670 | 2,894 | 348 | 121 |
| Foreign capital % | 53 | 63 | 100 | 100 |

Source: Future of local public finances: Case studies in Romania, Bulgaria and Macedonia, editor, Marjan Nikolov 2006

So far only the Government is issuer of bonds (except in 2004 when one private company issued bonds to known buyer). The Ministry of Finance commenced issuing government securities even in 2000 when large structural problems (frozen foreign currency deposits from Yugoslavia, denationalisation, financial rehabilitation and privatization of the banking sector) in Macedonia were resolved through issue of long-term securities to the legal and natural persons concerned. However, typical securities (3 and 6 months) were issued for the first time in 2004. Since then the Ministry of Finances has carried out regular auctions for short- and long- term governmental securities (primary market) ensuring that those securities are further traded in the Macedonian stock exchange and market through desk (secondary market).

Municipalities may be interesting entities for the banks, but with a high dose of reserve, since the quality of financial reports and management within each of the municipalities should be thoroughly checked (which in the beginning will make municipalities less attractive for the banks). In that sense main obstacles for bidders/investors will be as follows:

- Untrustworthy municipality financial reports,
- Lack of transparency and responsibility in the local ruling,
- Lack of professional staff in the municipalities for long-term financial planning,
- Lack of good ideas / projects for funding,
- Problems in collection, i.e. limited possibilities for incomes from the investment.

5.5. Factors for LSGU credit rating in R. Macedonia

R. Macedonia still lacks experience in this area and municipalities have not made initial steps in this area yet. However, we will present what reputed agencies¹³ specialized in drafting credit rating take into consideration for assessment of the credit rating factors when evaluating the LSGU credit standing. They are summarized in the table below:

Table15. Factors taken into consideration in assessment of LSGU credit standing

| Factor | Comment |
|---|---|
| National rating (prepared by reputed agencies specialized in drafting credit rating) | The national authority rating is usually the highest possibly possessed rating by LSGU Exclusions from this rule may be found in case where the debt is provided by foreign funds. |
| Economy | Fiscal security is often closely related to the security of local economy and diversity in the portfolio of the economic activity (usually is followed by the size). Demography has important role. High-dependent population (very young and very old have negative influence) as does very increased growth of population. Higher revenue and much more educated population are positive. Creditors are also interesting in the analysis of the local economy structure. Particularly, what is the size of the part in private ownership and how much LSGU economy is dependent on one industry or small number of large size employers. As a result, local authorities should be able to provide accurate data to creditors on the employment distribution in many types of firms and industries, as well as information on the general economic situation of the large-size employers. Of particular importance in this context is the information on the number of enterprises (in fact persons) who have significant overdue tax obligations, since they are good sign for economic crisis and their monitoring is often used by local authorities and creditors to envisage potential economic problems. Yet, credit standing agencies usually require that local authorities provide lists of largest employers as well as lists of firms having largest overdue obligations. For Macedonian LSGU it is worth to assess whether they are more dependent on property tax incomes than on personal tax incomes in the context of economic activity, since personal tax incomes are more adaptable to economic fluctuations. Reasonable long-term solution for Macedonian LSGU is to improve their own tax administration, implementation, collection. |
| Structure and management | Intergovernmental transfers are taken into account for their size and predictability. National authorities' preparedness and capability to detect and resolve financial instability is a positive step. Strictness and timeliness of budgetary and financial procedures are checked and may present either positive or negative aspect, depending on the flexibility they provide. Timeliness and comprehensiveness of financial reporting and adherence to consistent standards is a positive step. |
| Fiscal output | Possible indicators: % of GDP incomes and % of LSGUs that have revenues lower than the national average. Crucial weakness of the current intergovernmental financial system is that Macedonian LSGUs have limited competences to increase their revenues, and as a result major portion of their revenues derives from shared taxes and fees or transfers. This creates problems to the creditors due to two reasons. On the one hand, it means that local authorities have minor capacity to adjust their revenue policies to fulfil their requirements relating to servicing the debt. On the other hand, it means that their revenues fundamentally depend on the tax policy of the central |

¹³

For instance: Standard & Poor, Fitch, Moody's

| | |
|---|--|
| | <p>government. Other problems may arise from the poor collection of their own property incomes. If some tax payers do not pay their tax obligations, whereas other do, the system becomes less equitable. The case where the richer and more powerful segments of the field do not pay is a particular problem. This may lead to a situation that those who pay tax conclude that tax is unfair and decide not to pay further. Another problem is lack of predicting capacity and possible overestimating of revenues. Capital budgeting is to replace drafting list of wishes with establishing clear priorities.</p> |
| Structure and trends of expenditures | <p>Capital consumption and maintenance costs are positive aspect; high salary rate is negative since expenditures are more rigid and provide little possibility to generate operative surplus. Moreover, this creates hidden risk concerning unfavourable outcome in critical periods for economy. In that situation LSGU reserved funds become increasingly important. Budgeting capability and precise budget realization are positive aspects. Capital budget planning and payment of high amounts with current revenues is positive aspect. Possible indicators: % of GDP incomes and % of LSGUs that have revenues lower than the national average. Budget predicting and planning as well as realization are important indicators of the LSGU financial management. If the trend leads to lower extent of timely collection, this is a clear signal that the budget planning is poor, and professional capacity to predict is weak, thus being a risk to build up a short-term debt.</p> |
| Financial position | <p>Liquid assets and market real assets are favourable factors as are health reserves related to yearly expenditures. Outstanding debt is taken into account. Short-term debt should be taken into account if not serviced periodically. A short-term debt with bullet maturity is negative factor due to the continuous refinancing pressure and potential burden to the current expenditure. Possible indicators: % of total expenditure investments and % of LSGUs that have revenues lower than the national average.</p> |
| Legal framework | <p>Lack of clear laws, precedent in law or efficient judicial system is big obstacles, in particular where there is restrictive income or enterprise-based pledge. The history of lack of fulfilment or insolvencies is high level of negative aspect. Granting loans by the central authority and other restrictions on local indebtedness may be positive aspects if efficient and not politized, but it may be negative if complex, hard and politized. LSGU in Macedonia are forbidden to use property as pledge if used for provision of public services.</p> |
| Accounting and financial reporting | <p>The base and quality of financial reports are examined, and accurate and consistent reports are positive aspects. Timely and independent audits are also positively evaluated. Information on cash or cash-based accounting that provides authentic information on the money that may be used for debt servicing is positive aspect. Clear financial relation between LSGUs and enterprises (such as utilities) that may create debt is of particular importance. Clear relations between them and the possible increasing accounting, perceiving all growths, raises the LSGU rating.</p> |

Source: Future of local public finances: Case studies in Romania, Bulgaria and Macedonia, editor, Marjan Nikolov 2006

Presentation 2. Discussion on credit standing of LSGU according to the data provided in the Questionnaire

According to the Questionnaire carried out within the framework of this Project, from the aspect of local economy of those municipalities that supplied data, most part of the employed are concentrated in the non-financial and state sector (added value measured by method of institutional sector). Non-financial sector covers corporative sector. Minor number covers households (sole proprietor, craftsmen and farmers). Employees are mainly concentrated in services, followed by industry and agriculture. However, it should be mentioned that those data are provided by 10 LSGUs out of all that were interviewed.

Consequently it may be considered that economy as a factor in those LSGUs is not concentrated and dependent on only one sector, which is favourable.

Increase of population in those municipalities is on a relatively low level, which is considered unfavourable even though in some municipalities concentration is focused to younger population, and in some to older population. The number of graduated students as potential for economy of knowledge of the number of inhabitants from 18 to 65 years of age differs from LSGU to LSGU and extends from 1 to 7 students per number of inhabitants from 18 to 65 years of age.

Tax incomes of those municipalities are higher than the transfers that may be considered favourable for LSGUs. But with certain reserve since utility taxes in accounting are kept as tax income, even though essentially they are capital income for LSGUs (account 7171).

However, it should be taken into consideration that potential for generating own revenues by LSGU is not still exploited taking into account that only two years have passed from the commencement of the decentralisation in Macedonia.

5.6. Conclusions

Municipalities themselves are facing fast changes to the fiscal decentralisation system by which besides the current problems they have inherited system difficulties concerning poor infrastructure in almost all activities related to their competences. LSGU administration is not prepared and has poor capacity of technical knowledge, and they also face general lack of data. Poor statistical information system in Macedonia is basic obstacle for any serious analytical operation in this field. In addition, the impression is that central governmental institutions do not perceive local government as authority and do not allow official access to data. In this direction, complete review of legal solutions has been proposed, according to which data delivery should be officialised even for LSGU. It is evident that there is a lack of initiative on LSGU level, perceived by the response to the survey. This completely new LSGU right to indebtedness cannot be analyzed through the survey within the envisaged scope due to the poor response and due to objective obstacles.

Other alternative to be reviewed is LSGU restriction in Macedonia to keep their deposits in treasury. This can hinder municipality development as a client as well as restrain banking sector from introducing municipality financial operations and needs. As a result, banks do not perceive municipalities as "potential clients", since they are legally limited in investing their assets in bank. This situation results in lack of development of the relation bank-client, where bankers are generally introduced with financial operations and needs of their clients from LSGUs.

With regard to loans a legitimate question may be asked. Is banking system in Macedonia sufficiently stable to invest in LSGUs? This question should be subject to discussions between central and local authorities. It seems that in Macedonia banks do not understand the structure of municipal financing or the types of information to be used for evaluation of the LSGU credit standing. Due to such insecurity, it is usual that banks provide loans to municipalities through governmental guarantees or through seeking sizeable liquid pledge, or payment of high premium through high interest rates.

The following areas may be of interest for the banks:

- Clarification of legal rules related to municipal indebtedness, use of pledge, legal instrument in case of payment impossibility, and etc.
- Analysis of the municipality capacity to pay off loans.
- Reducing the risk through use of pledge and other forms of provision of local loans.
- Real evaluation of the community capital needs and process of investment priority through drafting plan for local capital investment and local capital budget.

To that end, it may be concluded that legal regulation was adopted; however certain areas are not sufficiently regulated (for ex. what in case of LSGU impossibility to pay off the debt). Furthermore, LSGUs in Macedonia do not have sufficiently firm financial management and experience in the management of public debt even though basic elements for development of capital market in Macedonia exist for LSGUs.

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Author:

M.A. Marjan Nikolov

6. FINANCIAL MANAGEMENT

Importance of developing sustainable system for financial management, situation of municipalities in Macedonia, awkward areas, requirements to promote capacities.

6.1. Laws and by-laws

The budgeting process in LSGU is regulated by the below laws and by-laws and internal acts adopted by the LSGU council or management (mayor, secretary or relevant sector and unit managers in LSGUs) as follows:

- **Law on Budgets** (Official Gazette of RM No 64/2005);
- **Law on Financing of Local Self-Government Units** (Official Gazette of RM No 61/04, 96/04, 22/07 and the provisions referred to in the Law Amending the Law on Internal Audit in the Public Sector, 61/07);
- Notification / instructions on preparing municipality budgets for 2008 / budget circular;
- LSGU Statute;
- Budget calendar, and etc;

Accounting policies, accounting evidence, inventory of material assets, revenue classification and interpretation of capital transfers by the central authority are regulated by the laws and by-laws below:

- **Law on Accounting of the Budget and Budget Beneficiaries** (Official Gazette of RM No 61/2002, 98/2002 and 81/2005);
- **Law on Financing of Local Self-Government Units** (Official Gazette of RM No 61/04, 96/04, 22/07 and Amendments to the Law on Internal Audit in the Public Sector, 67/07);
- **Rulebook on accounting of budget and budget beneficiaries** (Official Gazette of RM No 28/2003, 62/06 and);
- **Rulebook on application of International Accounting Standards on the Cash Basis for the Public Sector** (Official Gazette of RM No 116/2005);
- **Rulebook on revenue classification** (Official Gazette of RM No 100/01, 138/06);

Treasury operations in LSGUs are primarily regulated by the Law on Budgets already indicated above, and relevant for regular treasury operations is as follows:

- **Guidelines on the manner of treasury operations** (Official Gazette of RM No 85/2006) (in which the manner of operation of LSGUs and their budget beneficiaries);

Appointment of responsible accountant, access to information and their publication / transparent operation, monthly, quarterly and annual reports, final statements, data on outstanding obligations and inclusion of the public in the process of adopting financial reports, besides the aforementioned law and by-laws are regulated by the following laws and by-laws:

- **Guidelines on the form and content of periodical financial reports of the local self-government units** (Official Gazette of RM No 97/2005);

Internal control and internal audit are some of the most significant segments in the LSGU work. Segments that have not developed according to the predicted intensity in the recent period for which competent institutions as well as the LSGU management, above all, LSGU mayors need to ensure support, or their implementation in the day to day LSGU functioning (defining and introducing internal controls and employment of internal auditors) and appropriate independence for objective and impartial action of the internal auditors.

The internal and internal audit control systems are stipulated by the following legal regulations:

- **Law on Public Internal Financial Control** (Official Gazette of RM No 22/07);
- **Law on Internal Audit in the Public Sector** (Official Gazette of RM No 69/04 and 22/07);

6.2. Requirements / necessary conditions in accounting and financial reporting

Time limits for planning of the municipal budget are regulated by the budget calendar adopted by the municipality council, (Article 27 point 4 of the Law on Financing of Local Self-Government Units);

The municipality council adopts the budget for the following year before 31 December in the current year, upon accounts, programmes and items (Article 28 point 1 of the Law on Financing of Local Self-Government Units);

If during the fiscal year, revenues and expenditures have not been realised according to the plan of the municipality budget, the mayor proposes to the council amendments to the budget (budget readjustment) in the year, in accordance with the Law (Article 29 point 1 of the Law on Financing of Local Self-Government Units);

Recording (registering, amending and annulling) of the obligations taken by the budget beneficiaries, is carried out in treasury offices by submitting two copies of the undertaken obligation form – Form O1 (part IX – Keeping records on the obligations taken by the budget beneficiaries points 77-96);

Acceptance of revenues and other inflows, expenditures and other outflows included in the main book on budgets and budget beneficiaries is carried out according to the accounting principle on cash flow statement (*“Article 18(1) of the “Law on Accounting of the Budget and Budget Beneficiaries”*);

Main financial statements, accompanied by the explanation thereto comprise the annual account. (*“Article 23 of the Law on Accounting of the Budget and Budget Beneficiaries”*);

Accounting policies and explanatory notes are determined in point 1.3.30 of the Rulebook on application of International Accounting Standards on the Cash Basis for the Public Sector;

Assessment of balance positions and inventory of assets is regulated by Articles 19-21 of the Law on Accounting and International Accounting Standards on the Cash Basis for the Public Sector.

Budgets and budget beneficiaries are obliged to draw basic financial statements as follows: balance sheet, revenue and expenditure balance and consolidated balance. Consolidated balance as financial statement is not prepared in the Accounting of the Budget of RM and in the accounting of the budget of LSGUs; (Article 22(1) of the Law on Accounting and points 2.1.37-2.1.44 of IPSCBPS);

The municipality mayor appoints accountant in charge, who has graduated from the Faculty of Economy having at least five-year experience in the area of finances; (Article 36 of the Law on Financing of LSGUs);

Periodical financial statements, adoption of annual account and statement are defined in Articles 32-34 of the Law on Financing of LSGUs and the Guideline on the form and content of the periodical financial statements of LSGUs; (following the adoption of quarterly report, and the mayor informs the public on the content of the reports. Provided that the reports are not adopted, the council president makes public the reasons thereto, Article 32(4) of the Law on Financing of LSGUs); Periodical financial reports are as follows:

- Monthly report of the municipality budget beneficiary on realization of revenues and expenditures.
- Monthly report of the municipality budget beneficiary on the reporting period (cumulative) to the month the report refers to;
- Monthly report of the municipality budget beneficiary on the due outstanding obligations;
- Quarterly report on the realization of the municipality budget;
- Quarterly report on due outstanding obligations of the municipality; and
- Quarterly report on municipality indebtedness (point 2 of the Guidelines on the form and content on periodical financial reports of the local self-government units).

The entity manager is obliged to establish organizational structure and processes to enable functioning, monitoring and development of efficient system of secure financial management and control, taking into consideration the specifications of the entity and activities that are funded, work risks, applying standards for internal control, basic elements of financial management and control and technical guidelines and instructions on financial management (Article 5 point 1 of the Law on Public Internal Financial Control).

The entity manager is obliged to establish a unit for internal audit and to provide resources for its functioning (Article 12 point 1 of the Law on Internal Audit in the Public Sector).

FINANCIAL REPORTS

- Periodical: Monthly and Quarterly;
- Annual: Balance Sheet, Revenue and Expenditure Balance and Consolidated Balance;

Annual/Final Account and Annual Report.

6.3. Qualitative analysis of the survey - Questionnaire

6.3.1. Budgeting process

Budgeting process is one of the essential segments in the work of the LSGUs. This process is in continuous transition, i.e. over bridging the adoption of decisions in closed or semi-closed offices of the municipal administration against public forums/gatherings/debates with high level of public participation (citizens, NGOs and business sector), in one word, practicing participation access in the budgeting process.

Certainly that participation by itself does not mean that it will be practiced by the municipal administration and provide the desired results, if the suitable approach, real information, appropriate setting assessment and sufficient flexibility of the entire process are lacking.

However, in order to sense the condition of the budgeting process appropriate questions are designed in this area, and the following states were established:

Most part of the surveyed local self-government units, or 10 (62,5%) declared that have adopted budget calendar, whereas 4 responded that have not and 2 LSGUs have not responded at all. Such situation indicates that even though the second phase of the fiscal decentralisation is ongoing and three years of the adoption of the Law on Financing of LSGUs passed, there are still LSGUs that have not adopted budget calendar in spite of their legal obligation. Such situation is justified by some LSGUs with the fact that "they consider that it is not necessary to adopt budget calendar", being a paradox if we take into account that among LSGUs which have not adopted budget calendar are municipalities with a high number of inhabitants.

Local self-government units that have confirmed the question regarding the budget calendar, gave positive response to the question related to its monitoring.

With regard to the data supplied by the central government, 13 LSGUs provided positive response, whereas only three LSGUs have remarks on the timely data delivery by the central government. The lack of remarks on the timely data delivery by the central authority is grounded on the fact that LSGUs have undertaken the required activities on time resulting in adoption of the municipal budget of the following year up to 31.12 in the current year.

One LSGU only does not practice participation principle in the budgeting process, which is unfavourable for the functioning of that LSGU. Participation practice is mainly carried out through involving local/urban communities. In spite of the positive response with regard to practicing the said procedure/approach, it is unavoidable that in the further period appropriate significance and suitable and qualitative participation practice is given to the budgeting process, and in particular by involving citizens, NGO and business sectors.

One local self-government unit only has not presented the municipal budget to the general public.

The possibility of citizen participation in the council session is announced well in advance and interim the adopted budget and annual report are adequately presented before the citizens. The manner of presentation of the said documents differs from LSGU to LSGU, as follows: through citizen information centres, local media, citizen gatherings, and five LSGUs only through the municipality web-site.

The percentage of realized revenues and expenditures to 30.06.2007 compared to the planned ones in all LSGU (17 surveyed LSGUs: Kumanovo, Bogdanci, Ohrid, Saraj, Veles, Bitola, Kriva Palanka, Stip, Tetovo, Vrapciste, Dolneni, Strumica, Kisela Voda, Plasnica, Rosoman, Makedonska Kamenica and Skopje City) is not satisfactory and extends from 15% to 48% relating to revenues and from 15% to 41% and in one LSGU only 55%, relating to expenditures, which indicates to the following possible situations:

- It is possible that appropriate regular planning of real revenues and expenditures of the municipal budget has not been carried out;
- Timely activities for preparation and distribution of solutions for local taxes and fees have not been taken;
- Appropriate measures and activities for collection of local taxes and fees have not been taken; and
- Inappropriate information of the citizens on the abandonment of the traditional approach of non-payment of the obligation by the end of the year¹⁴;

Almost all surveyed LSGUs have amended the municipality budget, whereupon the minimum number is one and the maximum number is six, which yet indicates to the need to increase the professional capacities of the municipal administration concerning the budgeting process.

Most number of surveyed LSGUs are facing the problem with overdue debts, i.e. 13 LSGUs, or 81,25% of the surveyed, whereas three LSGUs only (Veles, Strumica and Stip) do not have problems with overdue debts. Out of the total of registered overdue debts (for nine LSGUs) the total obligation counts to MKD 394,425,430, whereupon the lowest amount counts to MKD 1,462,587, and the highest debt counts to MKD 221,747,049 or an average of MKD 43,825,047 to each of the nine LSGUs. For the lowest percentage being serviced, the overdue debt is 13%, and the highest 100%, whereas the overdue debt compared to the total budget is only 2% or 12%.

So far, the treasury accounts were blocked in seven LSGUs due to outstanding debts accounting to 43.75% of the surveyed, which at the same time indicates to the fact that certain LSGUs still have problems with regular payment of due obligations numbering different reasons.

Most of the surveyed LSGUs had negative response, i.e. 8 LSGUs gave negative response, 5 LSGUs did not give a response, and three responded that they are in disposal of fiscal strategy. Such situation implies to conclusion that education of the municipal administration on preparing and proposing appropriate fiscal strategy to the competent authorities is unavoidable.

At the end of the reporting period, i.e. the state on 31.12.2006, 11 LSGUs represented state of unused assets (balances) of accounts of earmarked grants counting to 68,75%, whereupon all of them took activities for the municipality budget readjustment so as they could be used by budget beneficiaries.

¹⁴ Indicated conclusions are brought on the basis of the experts' long-term experience, carrying out research in LSGU, possible problems perceived and researches accomplished.

6.3.2. Accounting

Accounting and accounting evidence in LSGUs, or acknowledgement of revenues and expenditures and assessment of balance positions are carried out according to the accounting principle on “cash statement”, i.e. cash-based, which principle is consistently applied by all surveyed LSGUs.

Quality financial statements and the quality of information provided by the financial reports are grounded on many requirements, including existence of accounting policies, explanations and interpretations accompanying financial reports, i.e. requirement for consistent observance of IPSCBPS. The data collected indicate that most surveyed LSGUs elaborate the required policies and interpretations of financial reports, and 2 LSGUs only provided negative response. In spite of such responses we may certainly point out that a low number of LSGUs have stipulated accounting policies, quality of the drafted explanations of the financial reports do not meet the requirements, and none of the LSGUs has drafted the said interpretations which is not in compliance with the IPSCBPS.

With regard to the consistent application of IPSCBPS, Skopje City only provided negative response, and all others provided positive response, which is opposite to the practice, i.e. the responses provided, other than that of Skopje City, do not reflect the real situation, i.e. they do not apply IPSCBPS¹⁵.

Each of the LSGUs indicated that they are in disposal of policies for interpretation of the asset state (property), LSGU accounts receivable and accounts payable; however knowing the practice in the Republic of Macedonia, unresolved system issues relating to municipality ownership (property in public enterprises, public institutions, primary and secondary schools, and etc.), drafting unconsolidated financial reports and existence of two different accounting principles (cash- and accounting- based), cause that LSGUs do not have appropriate policies for interpretation of the municipal property. Such situation is supported by the fact that all LSGUs, except for LSGU Rosoman, responded that have problems in the inventory of tangible assets, i.e. the municipal property and their interpretation in the financial reports.

Municipalities / local self-government units have problems in the interpretation of capital transfers from the central government or donations from the country and abroad, i.e. 6 LSGUs responded positively and 6 responded negatively, and 4 LSGUs did not provide a response, indicating that the lack of timely information and full and credible documents are biggest problems. The problems often refer to cash-based no statement of the transfers or donations received on the budget bank account if they are paid by way of cession or directly to the contractor who realizes the object received by transfer or donation. In that case, the transfer or donation cannot be stated in the revenue balance. Further problem is that the employees in the accounting are not provided with credible and well-ordered documentation, as base for recording tangible assets in the accounting evidence and in the relevant registers within the competent authorities (State Authority for Geodetic Works).

Even though seven local self-government units responded that have approached drafting consolidated financial reports, in practice almost no LSGUs have approached drafting consolidated financial reports, and the essential reason is that

¹⁵ Indicated conclusions derive from the research accomplished, perceiving the actual situation in LSGU, insight into LSGU financial reports and insight into the audit report to the financial reports of certain LSGUs.

they are released from keeping consolidated financial reports on the LSGU budgets¹⁶ according to the Law on Accounting of the Budget and Budget Beneficiaries.

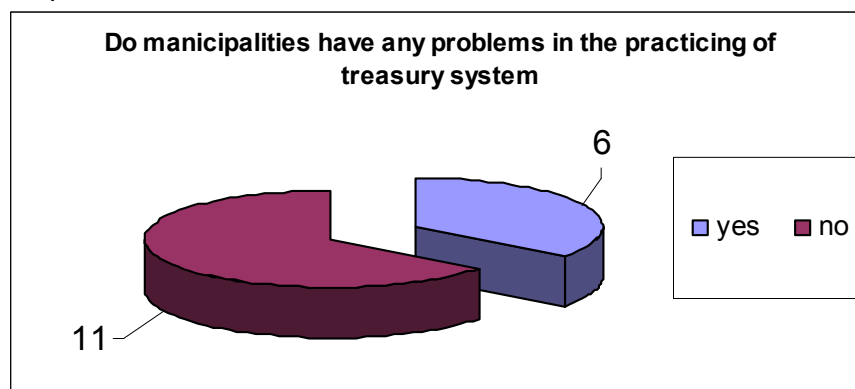
Surveyed LSGUs are satisfied of the last format of the final account, or 9 LSGUs, 4 LSGUs consider that it does not provide the necessary information, and three LSGUs did not provide any responses; however perceived from an expert aspect final account in the format presented before the LSGU council, lacking detailed explanations and additional interpretations is significantly limited and does not provide appropriate and quality information.

None of the local self-government units provides additional information or supplements to the area concerned, which indicates that the Questionnaire is well structured and covers all subjects in the accounting field.

6.3.3. Treasury management

To the question “Have you had any problems in the practicing of the treasury system of R.M.” municipalities have given the following responses:

Graph 22:



Each of the LSGUs provided positive response that the manual supplied for treasury operation is adequate and provides the necessary information, except for LSGU Veles, which responded negatively indicating to the need for detailed explanation on the types of obligations that may be paid from relevant item and programme.

It is known that there are no treasury offices in all LSGUs in RM, and as a result, financial transactions of those LSGUs that are remote from the seat of the treasury office are occurring with difficulty. The need for increasing the number of the treasury offices is unavoidable which is confirmed by the fact that 12 LSGUs have provided positive response, and four LSGUs only provided negative response. Increase in the number of treasury offices or finding out appropriate electronic connection of LSGUs not covered by a suitable treasury office will reduce wasting unnecessary time and assets for journeys from the LSGU seat to the treasury office seat, i.e. it will increase economic, efficient and effective use of the municipal administration assets and labour. With regard to the increase of the number of treasury offices we indicate to

¹⁶Described in details in Article 22(1) of the Law on Accounting of Budget and Budget Beneficiaries.

the need to increase their number through territory dissemination as an instrument for moving close to the budget beneficiaries.

High number, or 75% of the surveyed LSGUs have reported outstanding obligations, i.e. only Veles, Strumica, Rosoman and Saraj have not reported outstanding obligations, pointing out to the fact that LSGUs do not generate sufficient financial assets to appropriately cover expenditures, i.e. realization of obligations is not within the framework of generating revenues in LSGUs. The term plan reported in the Form 01 is observed when paying outstanding obligations, except for in LSGU Tetovo.

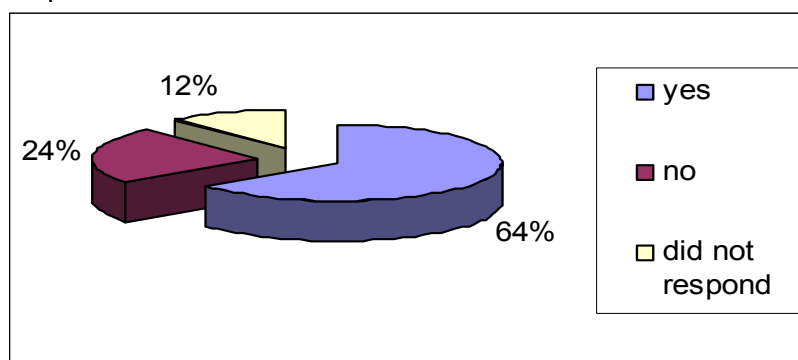
Only ten local self-government units make use of electronic access to the treasury, whereas six LSGUs do not practice electronic access, and to the question “*Do you consider necessary to develop the system of electronic signature and electronic payment*”, each of the LSGUs provided positive response, which clearly points out to the need for taking activities to develop and implement the said payment system.

Eleven LSGUs responded that they have not opened deposit account, whereas 5 did not respond, and LSGU Tetovo only responded that they required opening that account, however no conditions were provided. Such situation indicates to the LSGU inferiority, i.e. they are not interested, and in the case where some of the tax-payers require deferred payment of tax obligation, whereupon, if a need for payment of guarantee appears they will be forced to wait for opening the necessary deposit account. The need for the said account is unavoidable and real, and the manner of its opening and functioning is detailed in the Guideline on the manner of treasury operations¹⁷.

6.3.4. Reporting

To the question “*Have LSGUs created and adopted certain policies on the access to information in the area of realization of the LSGU budget and financial reports*”, the municipalities provided the following responses:

Graph 23:



It can be concluded from the graph that there is a need for elaborating certain policies concerning availability of information on budget realization, publication and distribution. Such conclusion is confirmed by the fact that most LSGUs are regularly

¹⁷ Guidelines on the manner of treasury operations (Official Gazette of RM No 85/06)

provided with monthly financial reports by budget beneficiaries accompanied by interpretations on the realization of revenues and expenditures and the outstanding obligation state; however occurrence in certain LSGUs not to apply the said practice points out to the need to take specific steps to resolve that situation.

Budget beneficiaries have not established suitable practice to accompany financial reports by interpretations. Such practice is based on the fact that out of all surveyed LSGUs, seven LSGUs only provided positive response to the question mentioned, or 43,75%. Lack of the required interpretations decreases the credibility, relevance and usefulness of the information provided by the reports, and at the same time influence their quality.

Quarterly reports are regularly submitted to the competent ministry and to the municipality council, and the system for public information on the content of quarterly reports includes their publishing through public media, official gazettes and LSGU web-site.

Surveyed LSGUs, other than LSGU Saraj, responded positively that they have established policies and practices to timely deliver data to the competent ministry and to the public on outstanding obligations, or municipality indebtedness. However the practice indicates that certain inconsistencies exist in public information concerning outstanding obligations¹⁸. The prescribed Form K2 – outstanding obligations that is communicated to the Ministry of Finance and to the LSGU council provides for only the total amount with regard from thirty to sixty days and over sixty days; however it is not shown where they derive from.

The same situation occurs with drafting Annual Reports on the LSGU operation; however the practice shows that certain difficulties arise in drafting the annual report, its completion and time scale of its adoption.

There are no clear and precise policies to include the public in the adoption of LSGU financial reports, so that they are introduced thereto through the municipality official gazettes, web-site and through live broadcast of the municipality council session they are discussed in.

None of the local self-government units provided additional information or supplements to the said area, which points out that the Questionnaire is well structured and covers all subjects in the field of financial reporting.

6.3.5. Internal control and audit

Seven LSGUs only, or 43,75% responded positively that have taken activities relating to the assessment of the risks the LSGUs are facing to, and all of the others provided negative response or did not provide any, which indicates that LSGU management has not developed appropriate policies to take activities concerning risk assessment and development of suitable activities to decrease the risk level, or bring it to adequate acceptable level. This is a relatively new activity in the work of LSGUs that deserves much more serious approach and appropriate implementation or practice in the work of LSGUs.

¹⁸ Indicated conclusions derive from the research accomplished, state of outstanding debts established in the Ministry of Finance, the report on evaluation of the accomplishment of the conditions in the second phase of fiscal decentralisation, and etc.

The situation is almost identical, i.e. 9 LSGUs only responded positively on established efficient internal controls throughout their working processes. Consideration of the fact that the Law on Public Internal Financial Control was adopted during 2007 indicates that it is unavoidable to develop suitable control activities in the LSGU operation. Such condition is also confirmed by the existence of ex-ante and ex-post financial control. Same responses follow as to the appointment of responsible accountant. 7 LSGUs or 43,75% of the surveyed LSGUs have not appointed responsible accountant, which negatively affects the level of control and monitoring of the realization of the municipality budget and the application of the provisions referred to in the Law on Accounting of the Budget and Budget Beneficiaries.

Ten LSGUs have appointed internal auditors, and six or 37,5% have not appointed internal auditors, which affect the LSGU transparency, reporting and good operation. Internal audit system in the municipalities of the Republic of Macedonia is in its initial phase and it is necessary to take certain activities focused to indicating the need for the existence and functioning of internal audit on the one hand and creating conditions for its independent and objective operation on the other. This certainly cannot be created overnight, this is a long lasting process; however it must be continuously supplemented by new value in order to give the expected results soon.

The number of audits carried out is neglected, above all due to the fact that those internal auditors appointed in some LSGUs lack or have very modest experience in this field. LSGUs themselves indicate that internal audit to provide the expected results it is required to carry out suitable training, which in the moment is provided by OSCE - Spillover Monitor Mission to Skopje donation, and implemented by the Association of Financial Workers of Local Self-Government and Public Enterprises from Veles.

It must be pointed out to the management that internal audit is not focused against the LSGU management work, internal audit is independent, objective activity to control information in order to confirm its accuracy and provide advice for the purpose of improving the LSGU operation.

Having into consideration that the Sector for Internal Financial Control within the Ministry of Finance is occupied with the implementing activities / setting up units for internal audit within budget beneficiaries of the Budget of Republic of Macedonia and their suitable education, the existence of comprehensive plan and programme for education of internal auditors¹⁹ is unavoidable / necessary, and very important and useful. It is necessary that the Ministry of Finance cooperates with international institutions (engagement of NGOs and other legal entities relating to implementation of the said education), drafts plan and programme on education of all LSGU internal auditors, which will significantly contribute to unify audit reports of all LSGUs in RM.

6.4. Overall evaluation

Fiscal decentralisation is a process that is implemented now and in the future, and it is certainly burdened by particular problems that in their essence may be divided in three basic categories: legal framework, model of local self-government and administrative and human resources in municipalities. To surpass part of the said or

¹⁹ Article 8 of the Law on Internal Audit in the Public Sector "Ministry of Finance shall be competent for regulation, development and compliance of the system for internal audit in the public sector and shall cooperate with the relevant international institutions in the area of internal audit".

indicated problems / inconsistencies in the field of financial management we recommend as follows:

- To carry out education and point out to the role and importance of the budget calendar in the budgeting process;
- To provide for in the Law on Financing of LSGUs a fine for those LSGUs which will not adopt and adhere to the budget calendar;
- To provide appropriate measures for continuous and quality practice of suitable techniques concerning participation approach in the budgeting process;

To find out adequate way to place / present information concerning municipality budget and annual operation report to the citizens, business and NGO sectors and to interim enhance the possibility to use municipality web-sites;

- To point out to the need and carry out suitable education on proper planning of the municipality budget revenues and expenditures;
- To point out to taking timely activities concerning administration of local taxes and fees;
- To carry out education on the manner of determining the LSGU fiscal capacity;
- To carry out education on proper application of the following expressions / terms: budget reallocation, budget expansion and amendments / budget readjustment;
- To find out appropriate solution on settling LSGU outstanding debts for the purpose of their smooth functioning;
- To examine the conditions and responsibilities concerning inherited overdue obligations;
- Education of the municipal administration on drafting municipality fiscal strategy;
- To take suitable activities concerning proper and timely information on the available assets deriving from earmarked / block grants and their utilization by the reporting period;
- To provide professional expertise and to facilitate the process of preparing and drafting of:
 - accounting policies, and
 - interpretations of LSGU financial reports;
- To provide education in the field of practical application of IASCBPS and to select pilot LSGUs to carry out implementation of the said standard;
- To take activities concerning education of LSGU employees engaged in drafting consolidated financial reports, to establish record of the ownership of the LSGU property;
- Domestic and foreign capital transfers and donations to be transferred on the LSGU bank accounts, not on the account of the final contractor, to abandon transfer by way of cession or assignation or use of instruments according to the Law on Obligations, to provide and forward complete and credible accounting documents and to deliver timely information;
- To take activities on amending the Law on Accounting of the Budget and Budget Beneficiaries and consistent observance of IASCBPS;
- To acquire knowledge of the international practice and propose modification of the final report form of the municipality budget, and in particular to enhance the suitability and quality of information it offers;
- To carry out continuous education of the municipal administration in the area of treasury operations;
- To take activities to appropriately cover the premises for treasury offices in the municipalities or to establish electronic connection in those LSGUs that do not have treasury offices in their seat;
- LSGUs to adopt suitable policies under which the budget (creation of expenditures / revenues) will be realized within the generated revenues;

- To take activities for promoting and introducing the municipal administration with the possibilities and advantages provided by the electronic access to the Treasury of RM;
- Treasury of RM of the Ministry of Finance of Republic of Macedonia to commence drafting comprehensive plan for implementation of electronic signature and payment of budget beneficiaries and to carry out their appropriate education;
- To point out and introduce the LSGUs with the need for opening deposit account, and in particular as of 01.01.2008 when properties of legal entities will be subject to property tax;
- Elaboration of certain policies concerning availability of information on budget realization, publication and distribution;
- To provide suitable staff engaged in regular drafting monthly reports accompanied by relevant explanations. (such practice is alert within primary and secondary education due to lack of financial officers);
- To present and point out to the LSGU management to the role and significance of the transparency and openness of the local self-government, to stipulate suitable policies to make public the content of quarterly financial reports and to stipulate misdemeanour sanctions in the Law on Financing of LSGUs, for LSGUs that do not make public the content of the quarterly reports;
- To stipulate misdemeanour sanctions for the failure to draft annual reports, to establish the time scale / time limit for drafting annual report, to carry out education on the role and significance and drafting annual reports;
- To propose amendments to laws and by-laws prescribing compulsory obligation:
 - to publish financial reports on the web-site of appropriate budget entities and to remote the transparency of the entire process;
 - to envisage and increase the penalties / fines for not-observing the said obligations;
- To establish policies directed to inclusion of the public in the process of adopting financial reports, printing brochures to introduce citizens with the content of the financial reports;
- To expand the policies on introducing the public with the content of the audit reports;
- To develop suitable programme on the role and knowledge concerning provision of complete information on the past, present and projections of the future fiscal activities of the local authorities, and in particular observing good practices for fiscal transparency;
- To carry out education of the LSGU management and administration in the field of risk assessment and developing suitable activities to minimize it;
- To carry out education of the LSGU management and administration in the field of internal control system, and in particular financial control in the LSGU operations;
- To point out and insist on appointment of responsible accountant in LSGUs and stipulate provision relating to misdemeanour sanction in the Law on Financing of LSGUs;
- To amend the Law on Internal Audit in the Public Sector stipulating fine for those entities / LSGU which will not establish unit for internal audit;
- To take activities pointing out to the need for establishing record of internal audit or determining internal auditors in LSGUs;
- To draft suitable plan and programme for continuous education of internal auditors in LSGUs.

Authors: Mrs. Evgenija Gramatikova and Mr. Maksim Acevski

7. MONITORING AND COORDINATION

To provide accurate evaluation whether the purpose of the fiscal decentralisation is accomplished, continuous monitoring is required. The objectives have to be precisely defined in advance in order to be compared with the results achieved. As a result, conditions are created in the course of the process of implementation to take specific activities for the purpose of improving of the situation. Accurate, fact-based information should be provided in the process appropriate for making analyses, identifying weak sides and hazards as well as clear segments and possibilities to take specific measures and activities.

The fiscal decentralisation process is complex and complicated. Coordination of the following interested key factors is necessary for its successful management: Government, ministries, other governmental organizations and LSGUs represented by the Association of the Units of the Local Self-Government of the Republic of Macedonia (ZELS).

The Ministry of Local Self-Government is competent authority to regularly monitor the decentralisation process, and the Ministry of Finance is in charge of the fiscal decentralisation process. Monitoring is focused to following the realization of the transferred competences, implementation of legislation, the capacity built in LSGUs, effects of the concept of the municipal public finances.

The working group for decentralisation coordinates the work of ministries having representatives in ZELS. Ten subject sub-groups have been established in the following areas: local economic development, urban planning, culture, education, citizen protection and rescue, environment protection, sport and recreation, health, utilities, social and child protection. Monthly reports, key risk registration, LSGU surveys for the purpose of collecting information on their needs and problems, indicators for monitoring of the implementation of transferred competences are main monitoring and evaluation instruments.

Twenty-seven-month process of decentralisation emerged on the surface a number of weaknesses:

- serious extent of distrust of the central authorities in local authorities (sometimes manifested by erroneous treatment);
- big difference between declared commitments and actual policies and procedures;
- failure to meet legal and undertaken obligations;
- need to enhance the capacities of the Ministry of Local Self-Government and Ministry of Finance;
- insufficient cooperation of LSGUs and ZELS with the competent state bodies.

It is necessary to highlight the fruitless work of the LSGU Commission for resolving the problem with inherited debts as a most serious LSGU problem that hinders them to face the challenges and to fulfil the conditions to access the second phase of the fiscal decentralisation.

Operation of the governmental Commission for Monitoring the Development of the System of LSGU Funding is on unsatisfactory level. It is limited to commission for amending the decrees concerning distribution of VAT assets and earmarked and block grants. In spite of its important tasks to monitor the effects from the application of the law, due to its staffing failure on the one hand and failure to provide funds for engagement of experts on the other hand, effects failed due to the Commission incompetence with regard to the tasks subject to its operation, which may have negative effects.

It is frequent practice that LSGUs are not consulted on the legal projects regulating the relations in the local self-government, even though it is central authority constitutional and legal obligation. The cooperation between ZELS and Ministry of Local Self-Government is on an exceptionally good level, whereas the cooperation of the former with other ministries (Ministry of Transport and Communications) is not on a quality level. It is necessary to raise the coordination between the Government and ZELS on highest level by participation of the President of Government, key ministers for decentralisation and ZELS managers through maintaining bilateral meetings on a three-month basis. This may have very important role in this phase of the decentralisation when many problems have emerged, in particular in the financial sphere.

Introducing indicators for monitoring of the accomplishment through adequate systems for monitoring and evaluation of the transfer of competences and resources in the transferred competences will assist in the accomplishment of the objectives and what is most important it will improve the LSGU operations and generate better quality services to the citizens. This process commenced in 17 selected municipalities supported by foreign donors, and standards for enhanced municipal management were brought by other projects and the project for meeting the objectives for LSGU certification is currently ongoing.

Distribution of funds, in particular capital investments have always been burning subject prompting vigorous and contradictory reactions. Opposite to the fundamental principles for objective, impartial and transparent distribution of LSGU funds, up to now all of the ruling groups, more or less distribute the funds by party, native or other reasons, and not by real problems and needs and quality of the LSGU projects. As a result, LSGUs are brought to unequal position, since there are no grounds for competition of ideas and quality, progress due to labour and mind, in fact this is another distortion of the merit system. This approach is not sustainable; it is detrimental and simply must change. ZELS efforts, up to now, to change the situation are partially successful.

So far, monitoring and coordination have been realized also in the field of carrying out training through the so called trilateral committee constituting of representative from the Ministry of Local Self-Government, ZELS and Civil Servants Agency. Special commission comprising representatives from the central and local authorities carried out monitoring and evaluation on the observance of legal conditions concerning transition of LSGUs into the second phase. Unfortunately, this process emerged on surface the weaknesses of an important part of LSGUs: failure to build capacities, poor management of financial debts and etc.

Monitoring and coordination are to be carried out in continuation. It is time at the close of 2007 as a first complete fiscal year of the commencement of the decentralisation process to make analyses to determine whether the local public financial system has accomplished the anticipated objectives, to detect the weaknesses, and on the grounds of assuming good European practices and their adjustment to our specific needs to build-up the system. Therefore, cooperation between the central and local government and timely preparation of public opinion for support of the changes are necessary.

Author: Mr. Ace Kocovski

8. PARAMETRES (INDICATORS)

Revenues and expenditures represent the two basic indicators in all local self-government units in the Republic of Macedonia. These two basic indicators are further subdivided into numerous sub-indicators in line with the official classification of revenue and expenditure items within the country's local self-government units.

Database transfer from the Arc View to the Excel programme enables fast, available and simplified usage of all data; creating various tables; developing analyses to serve the needs of various beneficiaries – all in order to provide information and data whereby the current situation and tendencies may be identified, both in the process of fund raising within the municipality and in the process of spending finances by specific sectors and undertaken activities within the field of municipalities' competencies.

The survey yielded parameters on the total revenues and expenditures of all municipalities that may be compared to the Gross Domestic Product and the national-level Public Consumption.

Each municipality's annual financial statement (its revenue or expenditure sides) may be compared to the total of all municipalities' revenue/expenditure items. Local self-government units' revenues and expenditures may be compared on the level of the eight statistical regions in the country.

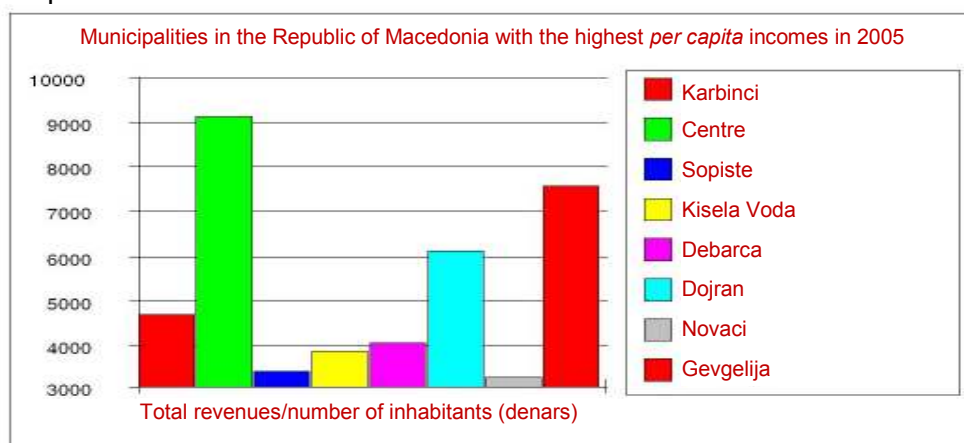
8.1. Local self-government unit revenues

8.1.1. LSGU revenues in 2005

In terms of **the 2005 budget year**, 23.15% of all revenues of municipalities in the country correspond with the revenue side of Skopje-City; 7.47% belong to the Municipality of Centre, and 4.18% belong to the Municipality of Tetovo. There are municipalities the shares of which are minimal, such as the shares of the Municipalities of Vranesnica (0.06%), Vevcani (0.08%), Zrnovci (0.08%) and Lozovo (0.10%).

It is interesting to note that the national level *per capita* income amounts to 2.755 MKD. Some municipalities have considerably higher than this *per capita* income, such as the Municipalities of Centre (9.162 MKD), Gevgelija (7.560 MKD), Dojran (6.131 MKD), and Karbinici (4.649 MKD).

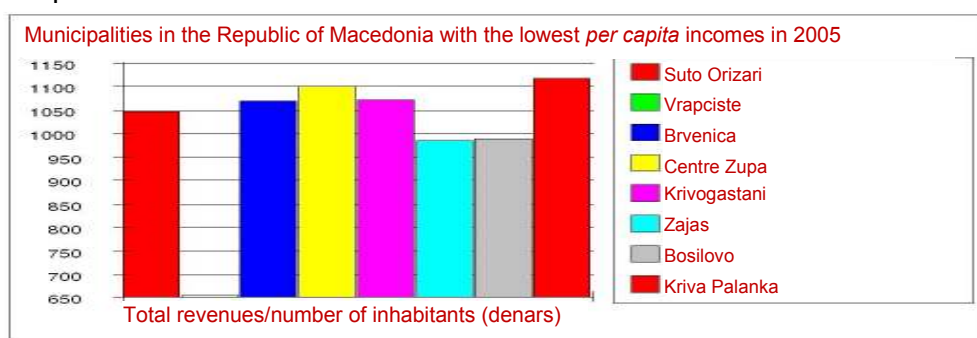
Graph 24



Note: The order of records in the graph and the legend come from the left to the right, and from the top downwards (appropriately).

Very low per capita incomes were recorded with the municipalities of Vrapciste (658 MKD), Zajas (985 MKD), Bosilovo (989 MKD), and Suto Orizari (1.048 MKD).

Graph 25

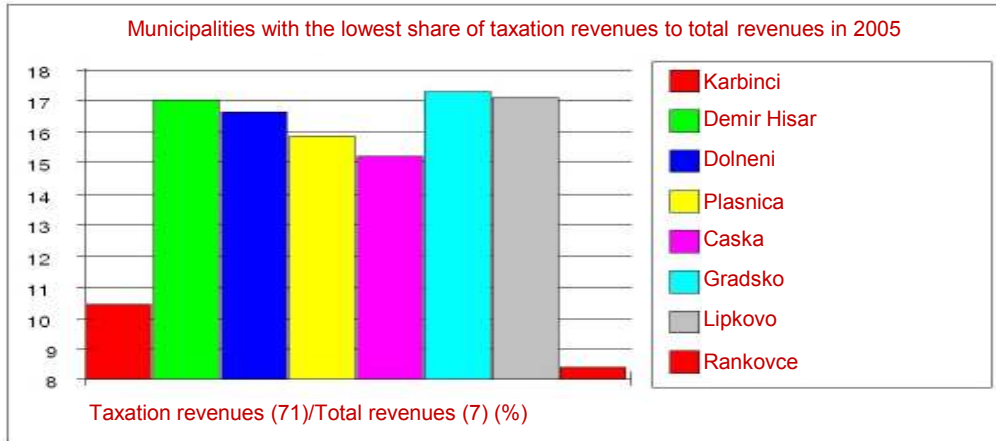


Note: The order of records in the graph and the legend come from the left to the right, and from the top downwards (appropriately).

The revenue structure is also very significant; this especially goes to genuine revenues i.e. taxation revenues amounting on average to 59.10% in the total revenues of all municipalities in the country. The fact is to be noted that there is a low extent revenues collected on the basis of tax revenues (71), as may be noted with the municipalities of Rankovce (8.47%), Karbinci (10.43%), Caska (15.21%), and Plasnica (15.88%). In addition, there are municipalities with a high percentage of revenues on the basis of local taxes, like the municipalities of Centre (89.45%), Skopje-City (84.51%), Ohrid (78.88%), and Karpos (77.77%).

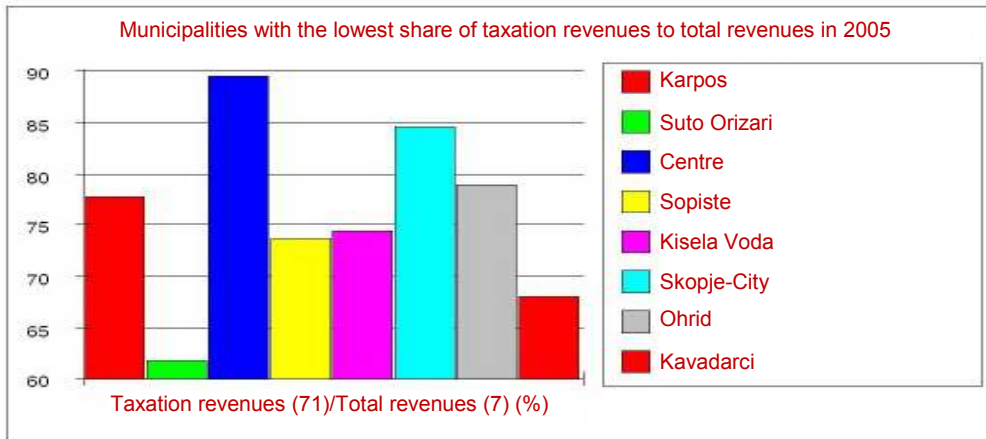
The graphs bellow show local self-government units having the lowest and the highest shares of their taxation revenues to their total revenues in the course of 2005.

Graph 26



Note: The order of records in the graph and the legend come from the left to the right, and from the top downwards (appropriately).

Graph 27



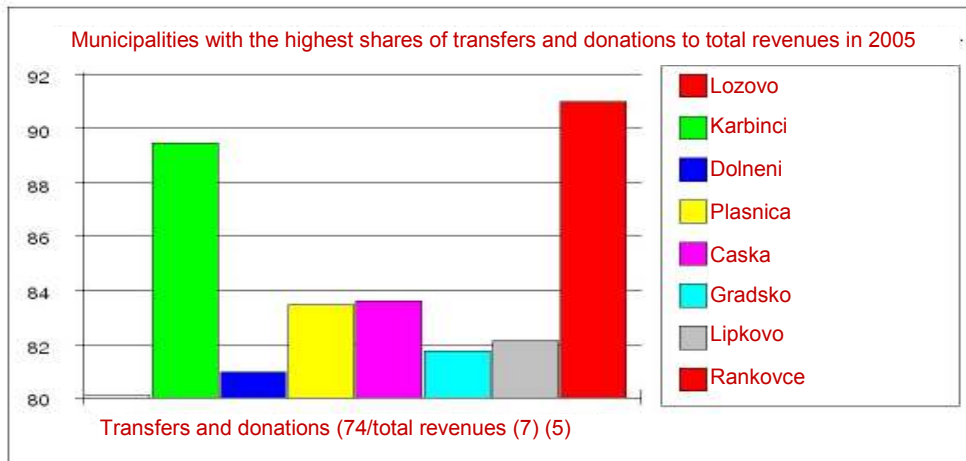
Note: The order of records in the graph and the legend is from the left to the right, and from the top downwards (appropriately).

Transfers and donations (74) municipalities receive from the central government and from various national and international donors constitute the second in size revenues source in LSGUs. The average of revenue items with municipalities, received on the basis of transfers and donations, amounts to 37.16 %. The highest percent share of transfers and donations is recorded with the following municipalities: Rankovce (91%), Karbinici (89.48%), Caska (83.66%), and Plasnica (83.45%). The lowest percent share on the same basis is recorded with the following municipalities: Skopje-City (9.58%), Centre (9.7%), and Karpos (20.59%).²⁰

The graphs below present local self-government units who have the highest shares of transfers and donations to total revenues, as well as revenues in which such shares are the lowest.

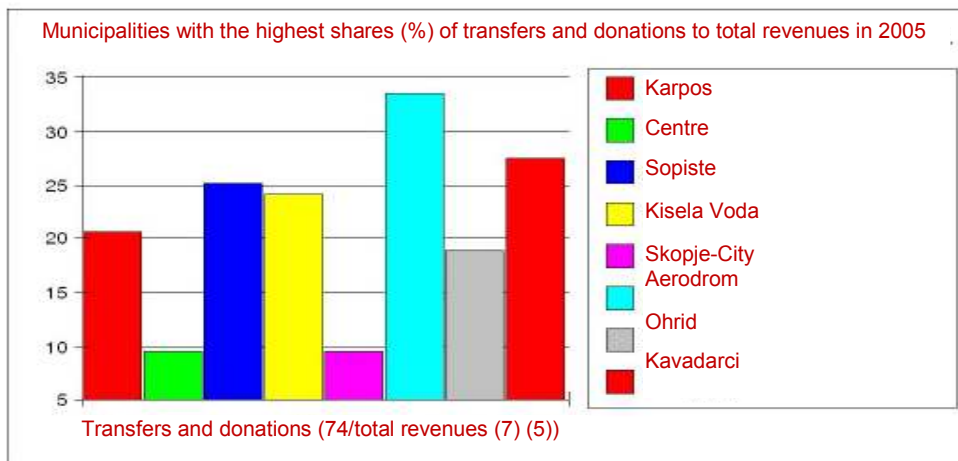
²⁰ There is available data also for 2003 and 2004

Graph 28



Note: The order of records in the graph and the legend is from the left to the right, and from the top downwards (appropriately).

Graph 29



Note: The order of records in the graph and the legend is from the left to the right, and from the top downwards (appropriately).

8.1.2. LSGU revenues in 2006

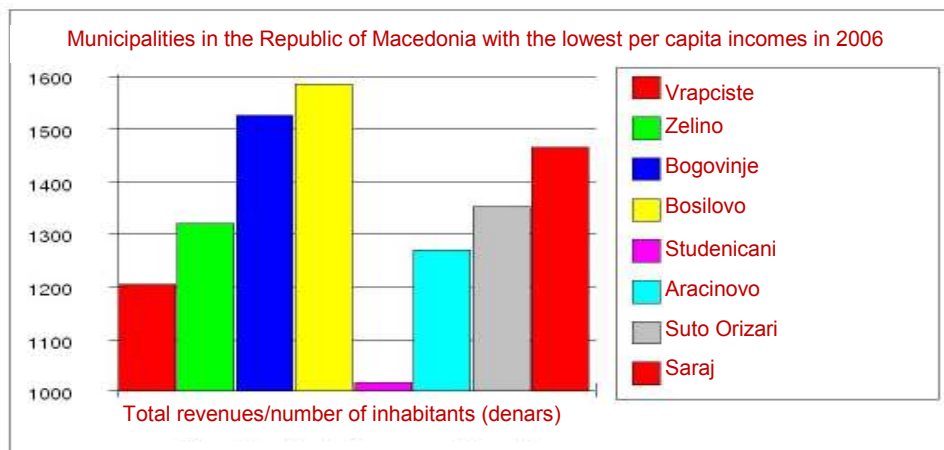
The 2006 budget year may be classified as the first year of real fiscal decentralisation. Local self-government units had the legal opportunity – but also realistic preconditions²¹ to accomplish this particular competence. Parameters (results) obtained from the survey on the revenue and expenditure structure by means of LSGU annual financial statement represent a good starting basis to carry out various comparative surveys as 2006 is the first fiscal year in which local self-government units started to independently accomplish competencies in this specific field.

²¹ Sufficient time to issue taxation decisions; establishing departments and sectors for municipality financing and budgeting; taxpayer database.

An increase may be noted with total revenues of all LSGUs meaning also an increase in the *per capita* income on national level. Graphs below process local self-government units having the highest and those having the lowest *per capita* incomes. The 2006 national average of *per capita* income amounted to 3.973 MKD, as opposed to the 2005 figure of 2.755 MKD.

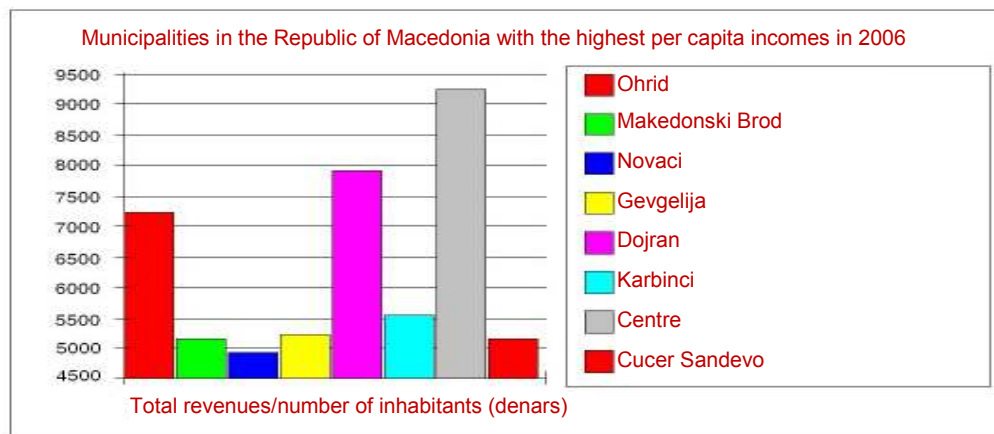
Graphs below show local self-government units having the lowest and those having the highest *per capita* incomes.

Graph 30



Note: The order of records in the graph and the legend is from the left to the right, and from the top downwards (appropriately).

Graph 31



Note: The order of records in the graph and the legend is from the left to the right, and from the top downwards (appropriately).

In the revenue structure of all LSGUs, taxation revenues have the highest percent share (71). In 2006, on national level, all LSGUs recorded a mean value of 43.09% share of taxation revenues (71) to the structure of LSFU revenues. On the basis of obtained comparative parameters on the share of taxation revenues (71) to total revenues of LSGUs in the country, a conclusion may be drawn that this share decreased in the revenue structure in the period between 2003 and 2006. In absolute values, an increase was recorded in this period in the total amount of collected tax revenues.

The table below presents the share of taxation revenues to total revenues of local self-government units on national level. In addition, absolute revenues have been presented (expressed in MKD), collected within all local self-government units in the country.

Table 16

| Year | 2003 | 2004 | 2005 | 2006 |
|--|---------------|---------------|---------------|---------------|
| Tax revenue percent share to total shares of all LSGUs | 65.06% | 64.55% | 59.10% | 43,09% |
| Tax-related revenues in all LSGUs, in MKD | 2.888.377.267 | 3.196.800.525 | 3.169.564.320 | 3.462.685.606 |

Transfers and donations (74) are second in size revenue of LSGUs in the country; its share in the national-level budget amounted to 42.07 % in 2006. If a comparison is done of the recent 4 (four) fiscal years, a conclusion will be drawn that the share of transfers and donations (74) to the revenues of local self-government units has been increasing each year. This increase is mostly due to special-purpose grants transferred by central government institutions within the accomplishment of competencies foreseen in the 2002 Law on the Local Self-Government and actually transferred following the start of the decentralisation process on July 1, 2005.

Table 17

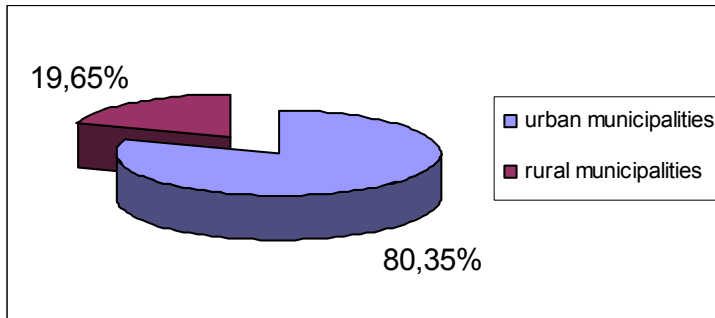
| Year | 2003 | 2004 | 2005 | 2006 |
|--|---------------|---------------|---------------|---------------|
| Percent share of transfers and donations to total revenues of all LSGUs (74) | 29.15% | 26.09% | 37.16% | 42,07% |
| Transfers and donations, in MKD | 1.294.113.813 | 1.292.032.832 | 2.038.173.242 | 3.380.718.104 |

8.1.3 Analysis of revenues in urban and rural LSGUs

An analysis can also be made of revenues whose centres are located in towns (urban) or in villages (rural). The comparison includes the 2005 and 2006 fiscal years.

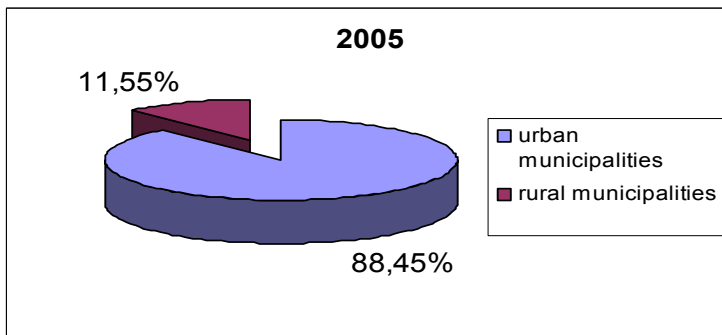
Out of total population, following is the population in urban and rural municipalities:

Graph 32



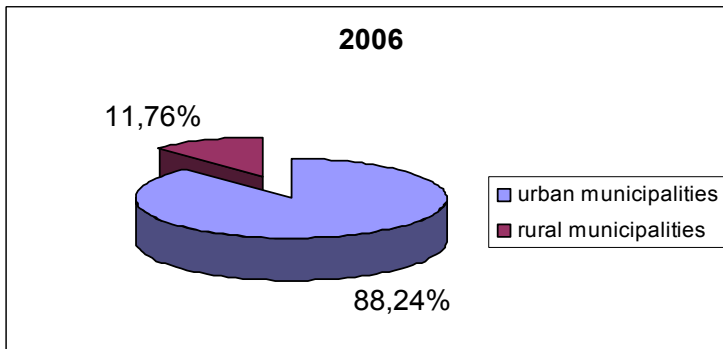
The 2005 shares of urban and rural municipalities' revenues to total national revenues amounted to the following:

Graph 33



The 2006 shares of urban and rural municipalities' revenues to total national revenues amounted to the following:

Graph 34



A comparison of the revenue structure of urban and rural local self-government units reveals indicators showing taxation revenues represent the highest revenue item with urban municipalities (71), such item being transfers and donations with rural municipalities (74).

In the course of 2005, urban municipalities' taxation revenue share to total revenues amounted to 62.70%, with this figure being 30.65% with rural municipalities. In 2005, the national-level average (urban and rural units) of taxation revenue share to total revenues in all LSGUs amounted to 59.10%.

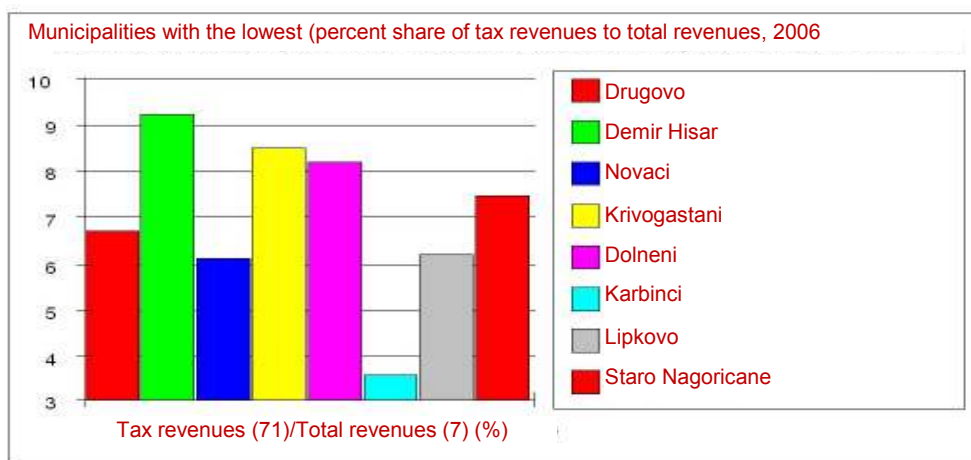
In 2006, tax revenue share to the revenue side structure amounted to 45.80% in urban LSGUs, 23.01%, in rural LSGUs, and 43.09% on national level.

Table 18

| Tax revenue share (71) to total LSGU revenues | All LSGUs | Urban LSGUs | Rural LSGUs |
|---|-----------|-------------|-------------|
| 2005 | 59.10% | 62.70% | 45.80% |
| 2006 | 43.09% | 30.65% | 23.01% |

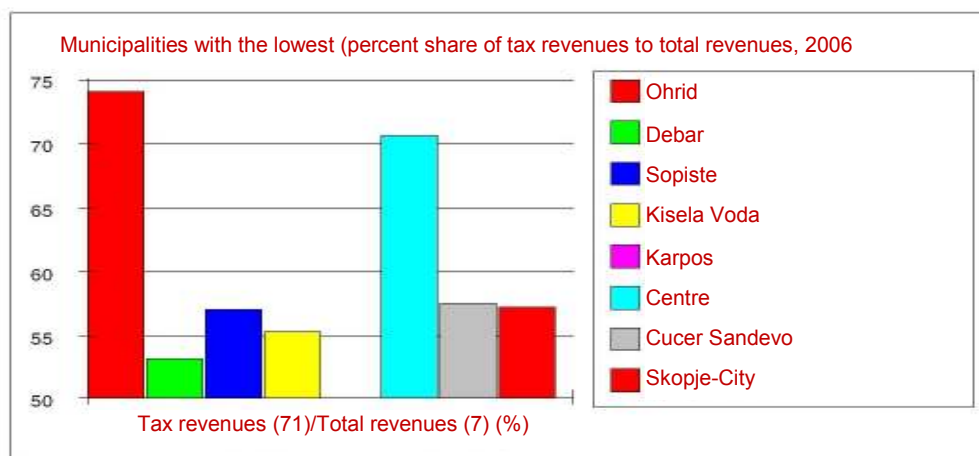
The graphs show municipalities in the revenue structure of which tax revenues have the highest/lowest share as recorded in the 2006 fiscal year. These two graphs confirm the statement that urban LSGUs record higher shares of tax revenues to total revenues, as opposed to rural LSGUs, where this share is much lower.

Graph 35



Note: The order of records in the graph and the legend come from the left to the right, and from the top downwards (appropriately).

Graph 36



Note: The order of records in the graph and the legend is from the left to the right, and from the top downwards (appropriately).

Transfers and donations (74) represent the biggest item in total revenues of rural municipalities in both fiscal years. In 2005, revenues from transfers and donations on national level had a share of 37,6% to LSGU revenue items. In rural municipality revenues, the share of transfers and donations (74) amounts to 64.35%, and to 33.62% in rural LSGUs when it comes to total revenues. In 2006, the share of

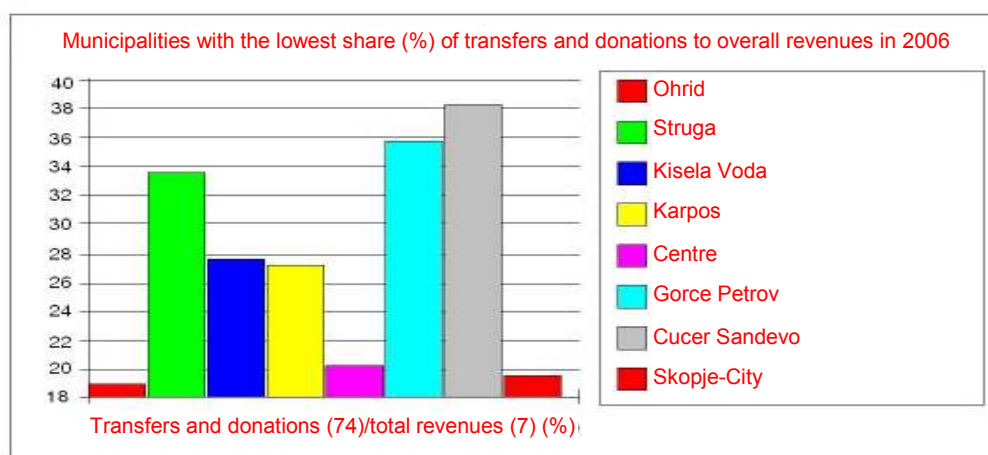
transfers and donations to the total revenues of rural municipalities amounted to 73.00%, and to 37.98% with urban municipalities. The National average of transfer and donation share to total LSGU revenue is 42.07 %.

Table 19

| Transfer and donation (74) share to total LSGU revenues | All LSGUs | Urban LSGUs | Rural LSGUs |
|---|-----------|-------------|-------------|
| 2005 | 37.16% | 33.62% | 64.35% |
| 2006 | 42.07% | 37.98% | 73.00% |

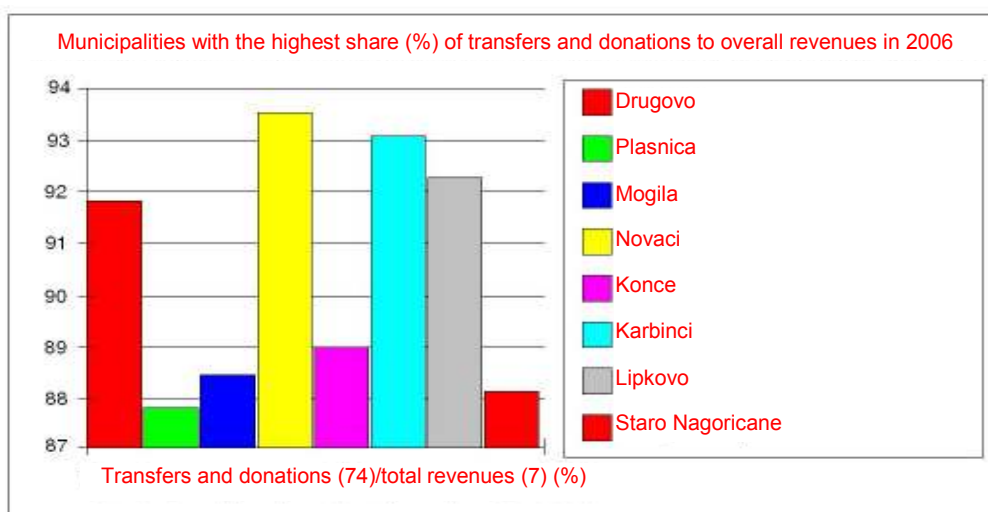
In the graphs below municipalities are presented in the total revenues of which the share is the highest of transfers and donations (74), as well as municipalities where this show was recorded the lowest in the course of the 2006 fiscal year.

Graph 37



Note: The order of records in the graph and the legend is from the left to the right, and from the top downwards (appropriately).

Graph 38



Note: The order of records in the graph and the legend is from the left to the right, and from the top downwards (appropriately).

On the basis of data obtained from the annual financial statement of all local self-government units in the Republic of Macedonia, the statement may be confirmed that transfers and donations (74) make up the biggest item in the revenue structure with rural municipalities; as concerns urban municipalities, the share of this revenue item to total revenues is much lower.

8.1.4. The share of municipal revenues to the Gross Domestic Product

One of the most often used and recognizable methods of determining the fiscal decentralisation degree in almost all developed countries is the share of local governments' total revenues to the Gross Domestic Product of a country. The table below shows the total revenues of all local self-government units in the Republic of Macedonia, processed as data from the annual financial statement of LSGUs. Recent 4 (four) completed fiscal years have been processed and absolute values have been expressed in denary and euro; presentation has been provided of the percent share of total LSGU revenues to the Republic of Macedonia's Gross Domestic Product (GDP). The Gross Domestic Product data represents data of the Republic of Macedonia's State Statistical Office.

The graph also shows per capita incomes of local self-government units in the territory of the Republic of Macedonia.

Table 19

| | 2003 | 2004 | 2005 | 2006 |
|---|--|--|---|---|
| LSGU revenue share to GDP | 1.77% | 1.87% | 2.01% | 2.65% |
| LSGU revenue amounts, expressed in EUR and MKD (NBRM) | 72.424.407 EUR 4.439.616.17 5 MKD | 80.788.252 EUR 4.952.319.87 4 MKD | 90.915.492 EUR 5.573.119.707 MKD | 131.079.846 EUR 8.035.194.59 9 MKD |
| Per capita incomes | 2.195 | 2.449 | 2.755 | 3.973 |

8.2. Expenditures of local self-government units

8.2.1. LSGU expenditures in 2005

In the 2005 fiscal year, the highest share of expenditures was recorded with Skopje-City (24.48%), Centre (7.57%), Tetovo (4.32%), with the lowest share having been recorded with the municipalities of Vranesnica (0.07%), Vevcani (0.08%), and Zrnovci (0.08%).

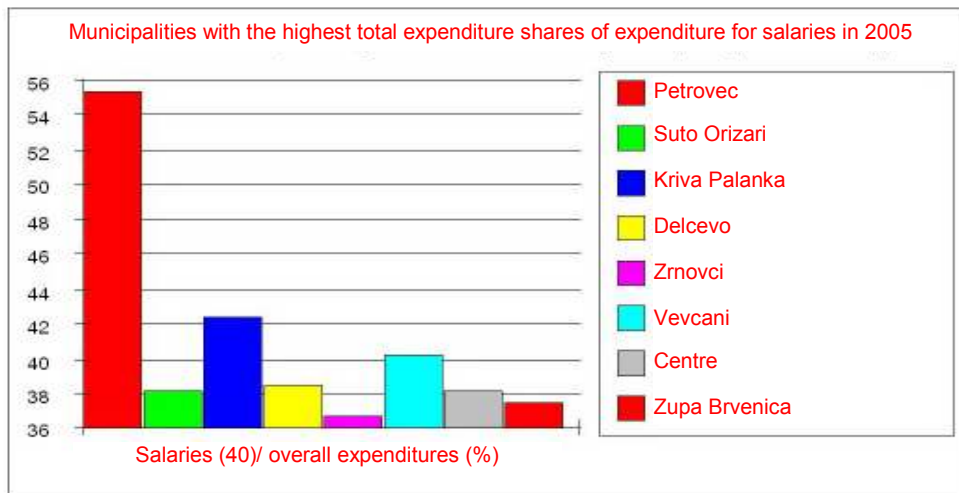
Per capita consumption in MKD within each municipality is the indicator provided by the database. The average per capita consumption in municipalities is 2.474 MKD. The highest *per capita* consumption was recorded with the municipalities of Centre (8.339 MKD), Gevgelija (6.195 MKD), and Dojran (4.297 MKD). The lowest *per capita* consumption was recorded with the municipalities of Aerodrom (406 MKD), Vrapciste (630 MKD), and Suto Orizari (688 MKD).

At this point, indicators will be presented of municipal expenditures for salaries, rents and refunds (40), goods and services (42), and capital expenditures (48).

If salaries, rents and compensations (4) effectuated by local self-government units in 2005 are taken into account, it may be noted that, on national level, 13.96% of total expenditures were spent in 2005 in the case of all local self-government units in the country. There are municipalities having spent much more than this average, such as the municipalities of Petrovec (55.32%), Kriva Palanka (42.46%), and Vevcani (40.27%). The following municipalities spent less than the average: Centre (5.2%), Skopje-City (5.78%), and Gevgelija (8.11%).

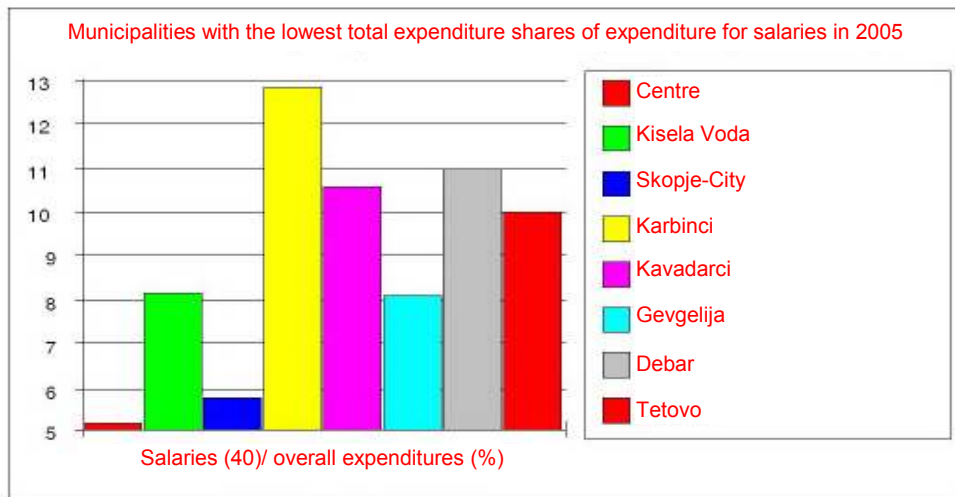
Graphs bellow present local self-government units having the highest and lowest the total expenditure shares with salaries, rents and refunds (40).

Graph 39



Note: The order of records in the graph and the legend is from the left to the right, and from the top downwards (appropriately).

Graph 40

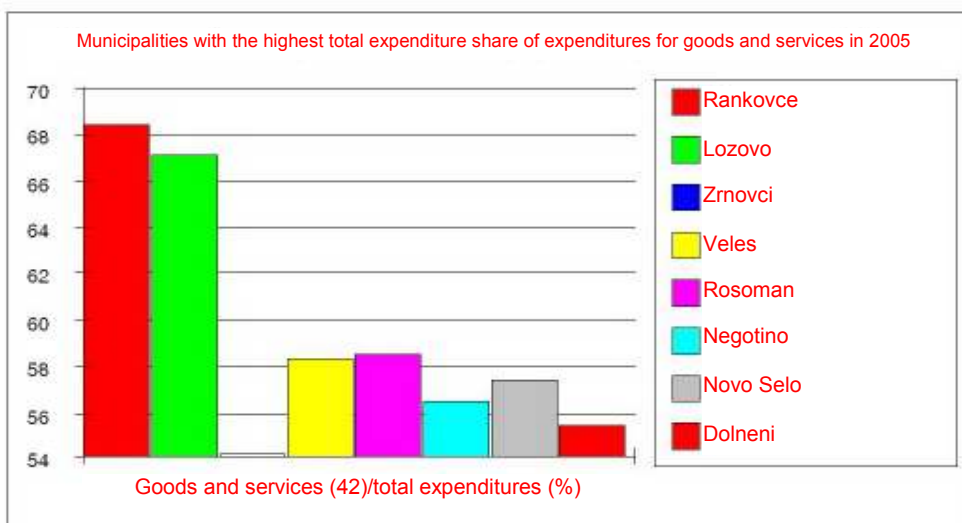


Note: The order of records in the graph and the legend is from the left to the right and from the top downward (appropriately).

Municipal expenditure average for goods and services (42) amounts to 31.06% .The following municipalities recorded expenditures higher than the average mentioned: Rankovce (68.5%), Lozovo (67%), Rosoman (58.59%), and Veles (58%); the following municipalities recorded expenditures lower than the average mentioned: Debar (8.92%), Gevgelija (14.45%), and Centre (15.73%).

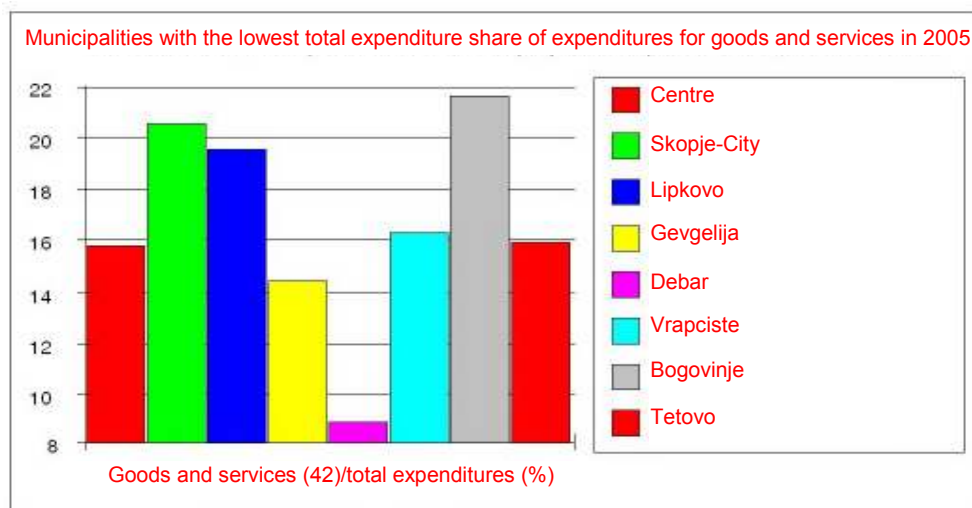
Graphs below present local self-government units having the highest and lowest the levels of expenditures for goods and services (42) within their total expenditures for 2005.

Graph 41



Note: The order of records in the graph and the legend is from the left to the right and from the top downward (appropriately).

Graph 42

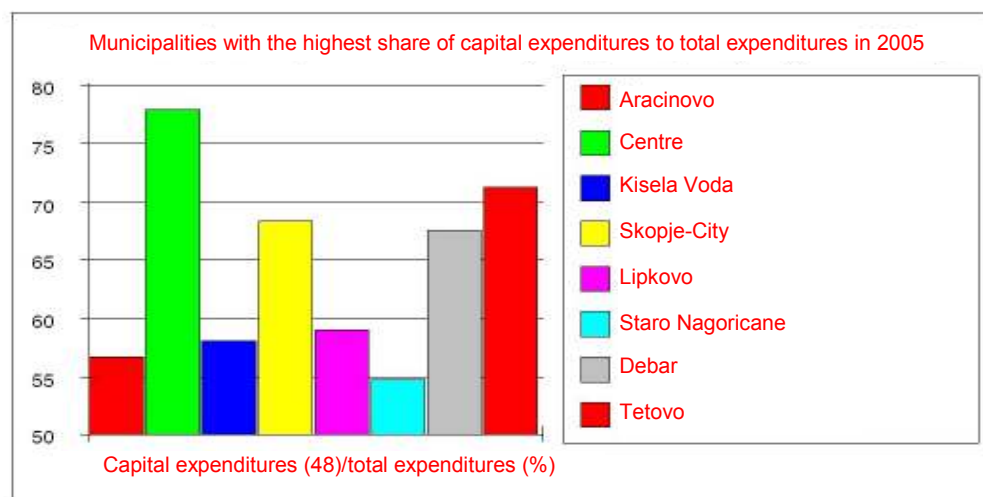


Note: The order of records in the graph and the legend is from the left to the right and from the top downward (appropriately).

Capital expenditures (48) play a significant role in municipalities' total expenditure: their share to this category is 48.89%. Higher percent shares of capital expenditures to total expenditures were recorded in the following municipalities: Centre (77.80%), Tetovo (71.32%), and Skopje-City (68.33%). Lower levels of capital expenditures in terms of average consumption were noted with the municipalities of Kratovo (0.15%), Krivogastani (0.42%), and Petrovec (0.55%).

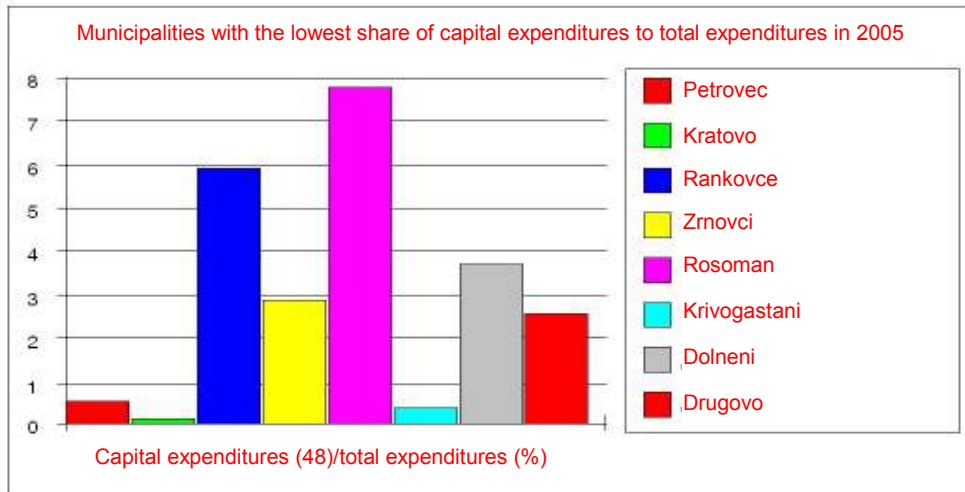
The graphs show local self-government units having the highest and the lowest share of capital expenditure in total expenditure.

Graph 43



Note: The order of records in the graph and the legend is from the left to the right and from the top downward (appropriately).

Graph 44



Note: The order of records in the graph and the legend is from the left to the right and from the top downward (appropriately).

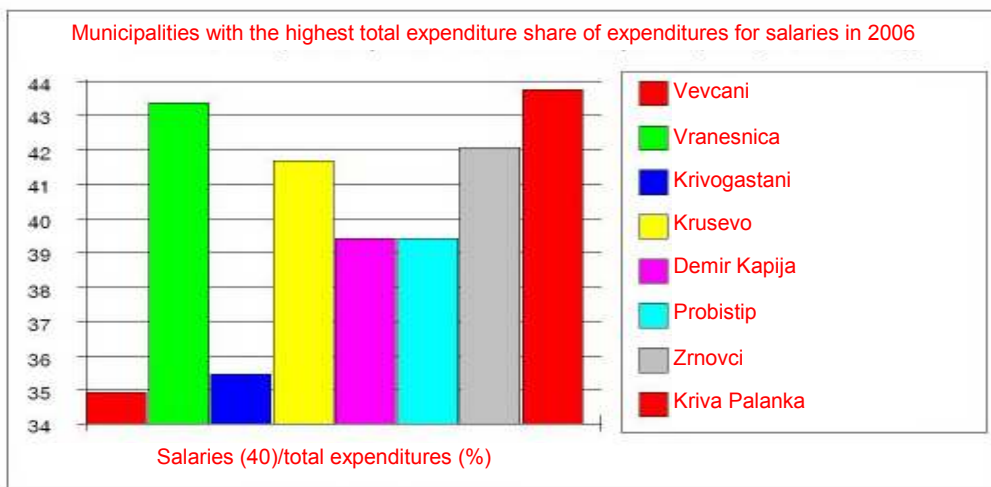
8.2.2. LSGU expenditures in 2006

In the course of fiscal 2006, the following parameters were obtained on expenditures incurred by local self-government units in the Republic of Macedonia:

The total expenditure share of local self-government units' costs for salaries, rents and refunds (40) on average amounted to 13.96%. The following municipalities recorded higher expenditures with this item than the Macedonian municipal average: Kriva Palanka 43.74%, Vranesnica 43.35%, and Zrnovci 42.08%. The following municipalities recorded expenditures for salaries, rents and refunds (40) lower than the Macedonian expenditure average: Centre 5.96%, Ohrid 8.36%, and Kisela Voda 8.99%.

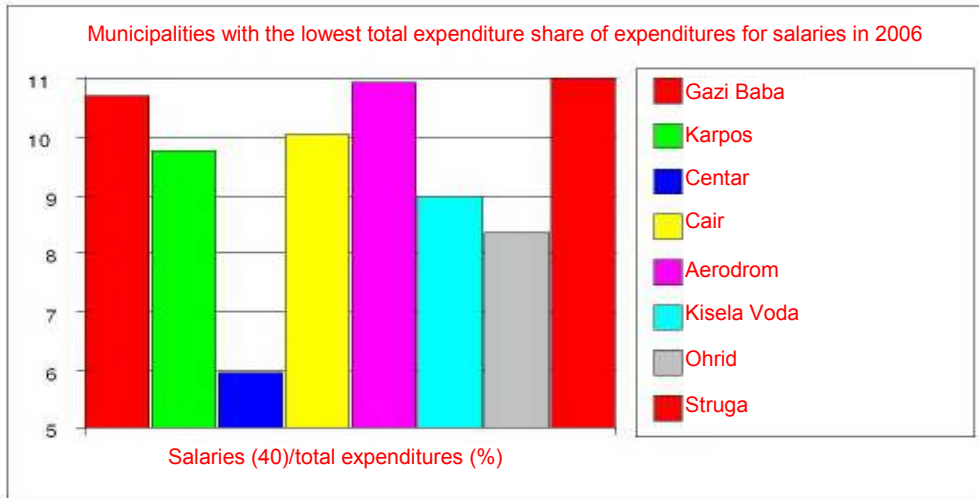
Graphs below show municipalities having recorded the highest and the lowest shares of salaries, rents and refunds (40) in total expenditures.

Graph 45



Note: The order of records in the graph and the legend is from the left to the right and from the top downward (appropriately).

Graph 46



Note: The order of records in the graph and the legend is from the left to the right and from the top downward (appropriately).

The table below shows the recent 4 (four) fiscal years and the average shares of expenditures for salaries, rents and refunds (40) to total expenditures within local self-government units in the country.

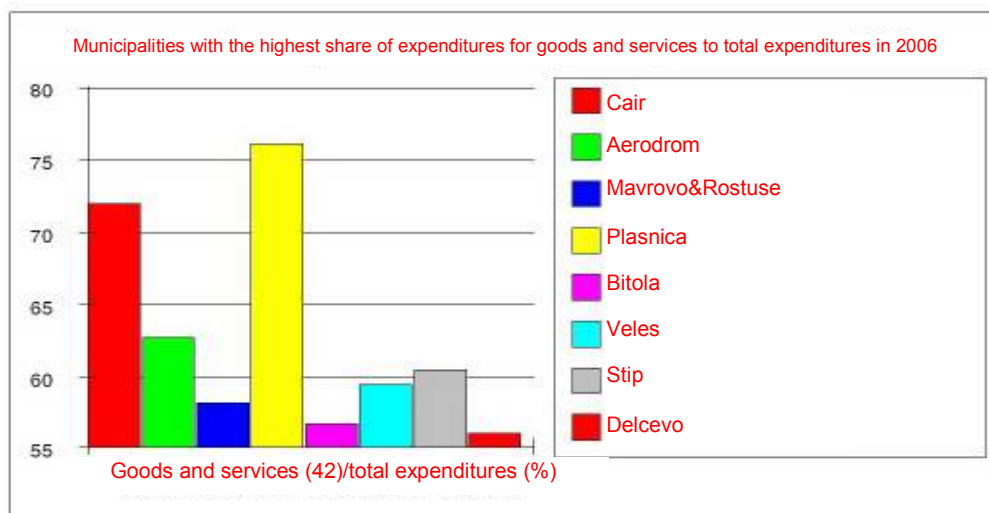
Table 20

| Year | 2003 | 2004 | 2005 | 2006 |
|---|--------|--------|--------|--------|
| Share of expenditures for salaries, rents and refunds (40) to total LSGU expenditures | 13.18% | 11.83% | 13.96% | 15.92% |

Expenditures for goods and services (42) are one of the major expenditure items to total expenditure figures of municipalities in the Republic of Macedonia. In 2006, the share of mean consumption of goods and services (42) to total expenditures represented 45.92%, meaning it was the biggest expenditure item in municipal budgets. The following municipalities recorded the highest values of expenditures for goods and services (42) within total expenditures: Plasnica (76.14%), Cair (71.92%), and Aerodrom (62.73%). The following municipalities recorded the lowest values of expenditures for goods and services (42): Ohrid (23.68%), Gradsko (26.61%), and Debar (27.67%).

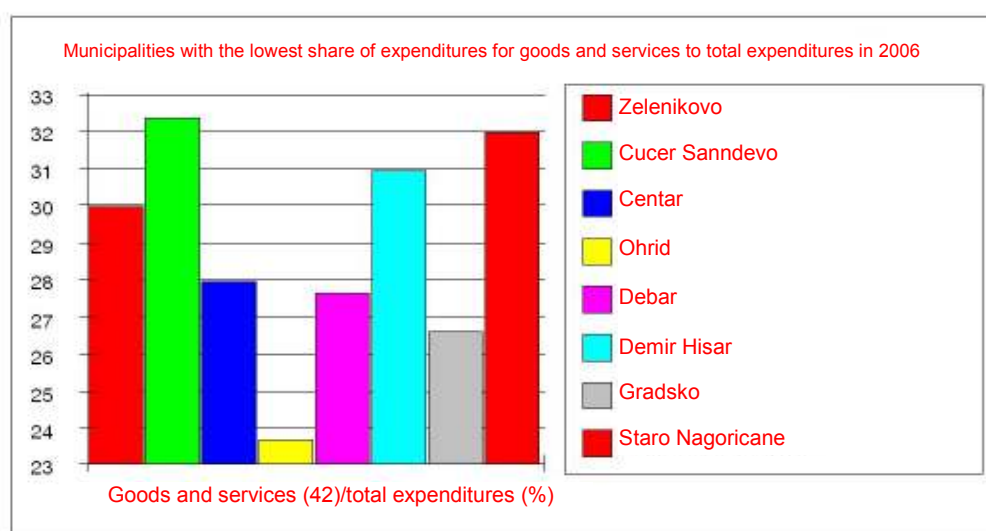
The graphs below present local self-government units having the highest and the lowest levels of expenditures for goods and services (42) within their total expenditures for 2006.

Graph 47



Note: The order of records in the graph and the legend is from the left to the right and from the top downward (appropriately).

Graph 48



Note: The order of records in the graph and the legend is from the left to the right and from the top downward (appropriately).

The table below presents the average share of expenditures for goods and services (42) to total expenditures of local self-government units in the Republic of Macedonia in the recent 4 (four) completed fiscal years.

Table 21

| Year | 2003 | 2004 | 2005 | 2006 |
|--|--------|--------|--------|--------|
| Share of expenditures for goods and services (42) to LSGU total expenditures | 35.08% | 27.46% | 31.06% | 45.92% |

The share of capital expenditures (48) to total expenditures of local self-government units is very high. The levels of this share vary with years. The table below presents the average shares of capital expenditures (48) to LSGU total expenditures in the recent 4 (four) completed fiscal years.

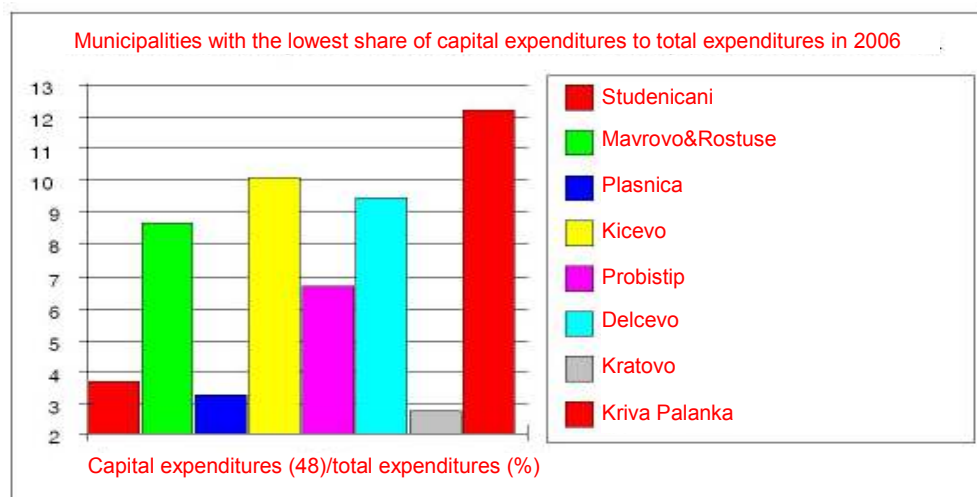
Table 22

| Year | 2003 | 2004 | 2005 | 2006 |
|---|--------|--------|--------|--------|
| Share of capital expenditures (48) to LSGU total expenditures | 43.91% | 55.95% | 48.89% | 34.43% |

In 2006, the average share of capital expenditures (48) to total expenditures of local self-government units in the country amounted to 34.43%. The following municipalities recorded values higher than the national average in this regard: Centre (64.58%), Ohrid (64.06%), and Cucer Sandevo (50.58%). The following municipalities recorded values lower than the national average: Kratovo (2.77%), Plasnica (3.31%), and Studenicani (3.73%).

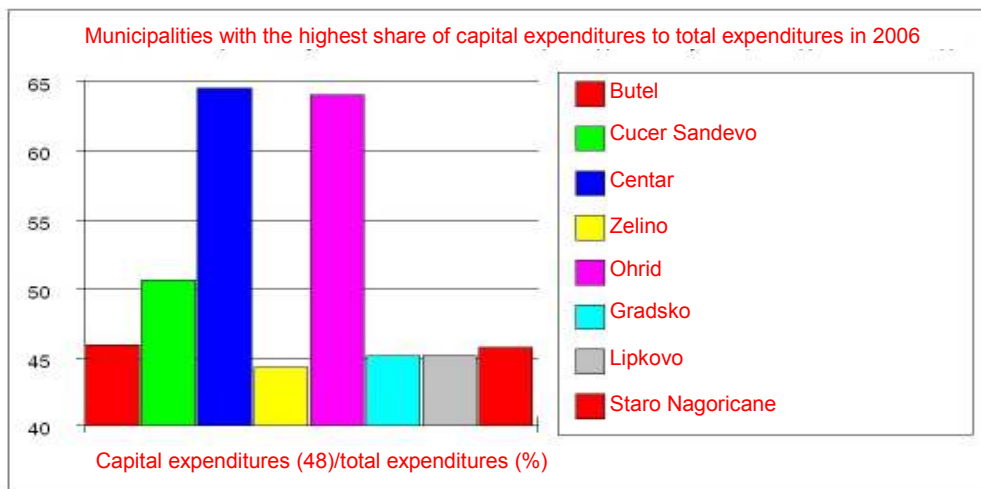
Graphs below present local self-government units with the lowest and highest the percent shares of capital expenditures (48) to overall expenditures in 2006.

Graph 49



Note: The order of records in the graph and the legend is from the left to the right and from the top downward (appropriately).

Graph 50



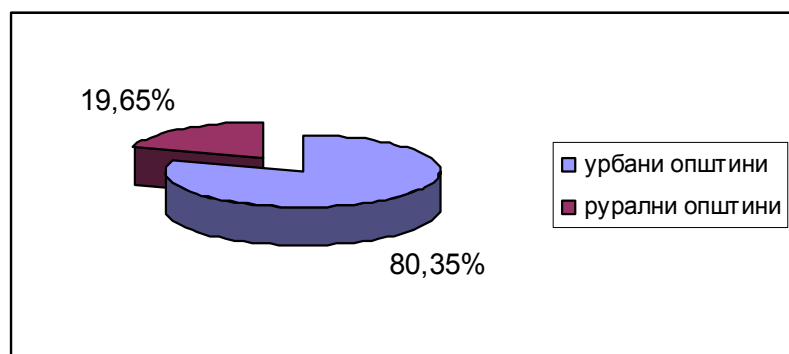
Note: The order of records in the graph and the legend is from the left to the right and from the top downward (appropriately).

8.2.3. Analysis of urban and rural LSGU expenditures

An analysis can also be made of expenditures recorded in local self-government units the centre of which is a town (urban ones) or a village (rural ones). The comparison includes the 2005 and 2006 fiscal years.

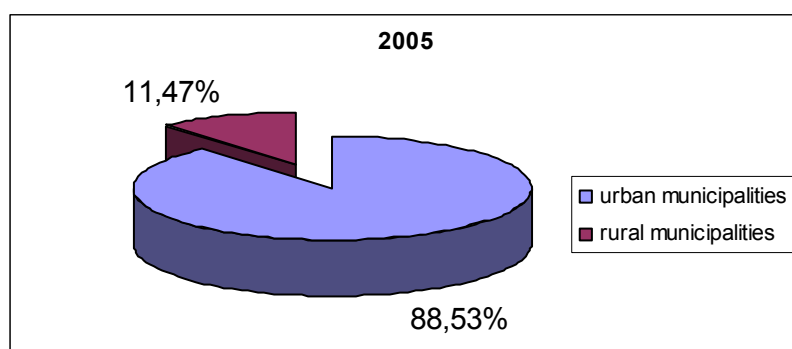
Out of the total population, the distribution of inhabitants by urban and rural municipalities is the following:

Graph 51



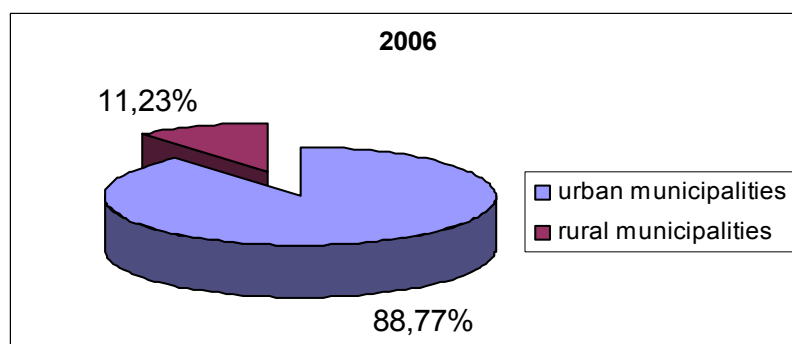
In the course of 2005, the total expenditures share of urban and rural municipalities in the country was as follows:

Graph 52



In the course of 2006, the total expenditures share of urban and rural municipalities in the country was as follows:

Graph 53



In 2005, the total expenditure share of expenditures for salaries, rents and refunds (42) amounted to 12.62% and 24.32% with urban and rural municipalities respectively. In 2005, the national average (urban and rural LSGUs) share of expenditures for salaries, rents and refunds (42) to total expenditures of all LSGUs amounted to 13.96%.

In 2006, the salary-, rent- and refund- based expenditure share to overall expenditure amounted to 15.09% in urban municipalities, 22.42% in rural municipalities, and 15.92% on the national level.

Table 23

| Share of expenditures for salaries, rents and refunds (40) to total LSGU expenditures | All LSGUs | Urban LSGUs | Rural LSGUs |
|---|-----------|-------------|-------------|
| 2005 | 13.96% | 12.62% | 24.32% |
| 2006 | 15.92% | 15.09% | 22.42% |

On the basis of data contained in graphs contained in the previous chapter regarding the shares of expenditures for salaries, rents and refunds (40) to total expenditures of

local self-government units in 2005 and 2006, it may be concluded that these shares tend to be much lower in urban local self-government units – as opposed to the situation in rural self-government units, where the share of expenditures for salaries, rents and refunds (40) to total expenditures tends to be much higher. The difference in overall expenditure shares of shares for salaries, rents and refunds between urban and rural municipalities decreased in the course of 2006.

Expenditures for goods and services (42) have been one of the highest costs local self-government units have incurred in recent years. In 2005, average expenditures for goods and services on national level were the second in size; in 2006, these expenditures took the first place in the list of expenditures on national level in terms of local self-government units.

In the recent two fiscal years (2005 and 2006), expenditures for goods and services (42) were higher in urban municipalities than in rural ones. Expenditures for goods and services recorded in urban and rural municipalities in the recent two fiscal years come close to average expenditures for goods and services on national level.

In 2006, a small difference was recorded in the average consumption per this item between urban and rural local self-government units in the country.

Table 24

| Share of expenditures for goods and services (42) to LSGU total expenditures | All LSGUs | Urban LSGUs | Rural LSGUs |
|--|-----------|-------------|-------------|
| 2005 | 31.06% | 30.09% | 38.60% |
| 2006 | 45.92% | 46.16% | 43.80% |

Capital transfers (48) in the recent several fiscal years have been an expenditure item with the highest share to average expenditures of local self-government units. In 2005, capital expenditures (78) were much higher in urban municipalities than in rural ones. In the course of the 2006 fiscal year, a decrease was recorded of almost 15% in the average share of capital expenditures to municipalities' total expenditures.

The average share of capital expenditures to total expenditures in urban and rural local self-government units in 2006 was higher in urban municipalities.

Table 25

| Share of capital expenditures (48) to LSGU total expenditures | All LSGUs | Urban LSGUs | Rural LSGUs |
|---|-----------|-------------|-------------|
| 2005 | 48.89% | 51.40% | 29.52% |
| 2006 | 34.43% | 34.92% | 30.55% |

Author:
Mr. Goran Angelov M.A. Sasho Manasov

9. CONCLUSION AND RECOMMENDATIONS

Final objective of this research is to assist local and central authorities in the Republic of Macedonia to improve the system of financing the local self-government. Taking into consideration that the decentralisation process is to improve the quality of living in the country, existence of sustainable financial system is necessary to monitor the competences of the local self-government in the Republic of Macedonia.

All subjects related to the system of financing the local self-government in the Republic of Macedonia are covered by the research and results achieved. The Report includes a number of recommendations on different subjects concerning the local self-government fiscal system; in addition it includes general recommendations considered to be useful to great extent when building sustainable financial system of the local self-government in the Republic of Macedonia.

According to the research accomplished in certain areas, recommendations by subject units are indicated below:

9.1. Structure and scope of competences of the local authorities in the republic of Macedonia

Based on the research accomplished in this area, the following recommendations are enclosed, which can be further discussed and debated:

- Whether only monotype municipality model is to exist, or also a polytype municipality model should be considered in the future so that for different types of municipality different scope of competencies may apply;
- It may be expected to further reopen the issue on territorial organization of the Republic of Macedonia, aimed at reducing the number of municipalities;
- Better definition of competences between Skopje-City and the municipalities in Skopje, i.e. to significantly increase the competences of Skopje-City, so as in addition to being competent for the general urban plan, to have competence for detailed urban plans and issue of construction licenses for which the municipalities of Skopje are currently in charge.
- Implementation of the institute "delegated competence" along with the necessary amendments to the material laws in the areas that may be delegated to the local authorities.
- It is necessary to make analyses on the capability of the state to delegate certain competences at least in municipalities having higher capacities.

9.2. Transfer of competences

The Law on Local Self-Government of 2002 has significantly increased the competences of the local self-government in the Republic of Macedonia. We have new competences for which local authorities are responsible as of 1 July 2005, from the period of real commencement of implementation of the new competences provided for in the Law on Local Self-Government. Since very different types of municipalities exist in the country, which differ in number of inhabitants, territory size, financial and human capacities, natural wealth and etc., the transfer of competences significantly depended on the existing structure in the regional ministries that were decentralized, i.e. competences for which they are responsible, and their

accomplishment is transferred to the local authorities in the decentralisation process. However, on the basis of the analysis accomplished, it may be concluded that the level of the competence accomplishment, according to the list of competences referred to in the Law on Local Self-Government (Article 22) is different and that complete accomplishment of the competence is not achieved in any area. Furthermore, it is worth mentioning that there is no case of delegating competence to the mayors of municipalities by the state bodies.

With regard to the area of transfer of competences, according to the research accomplished, the following recommendations and conclusions are provided:

- To increase the level of accomplishment of the competences in municipalities, in particular in the area of urban planning and issue of construction and utility licenses, taking into consideration the fact that by “exception of the issue of construction licenses” the municipalities were in disposal of those competences even prior to the adoption of the Law on Local Self-Government;
- Results of the research indicate to the need for transfer of the state construction land owned by the municipalities or transfer of the right to manage thereto, in particular referring to the implementation of the local economic development partially accomplished by the municipalities;
- Data referring to major disparities among municipalities in the part of the adequate amount of financial assets to fully implement the competences indicate to the need of improving municipality financial state, and interim taking into account the existing overdue debts which the municipalities are facing.

Taking into consideration the transfer of competences in the area of education as well as the problems the municipalities are facing, the following recommendations and instructions are aimed at enhancing the efficiency and effectiveness of their accomplishment:

- To assess the capacities for good conduct of municipalities intended for eliminating the auspice “political decision” and “marketing undertaking”
- To perceive the municipality situation, challenges and capacities and to strictly define and make difference of the roles of all factors on central, local and social level
- To regulate municipality property right of school premises/land
- To appoint employed persons responsible for implementation of the competence related to education, in those municipalities they are not appointed yet
- To draft priority plans and assessments on indispensable investments in the maintenance of the infrastructure of central and regional schools
- To resolve the issue on rationalization of school networks to the forthcoming of the second phase of decentralisation.

9.3. Own (source) revenues

According to the European Charter of Local Self-Government (Council of Europe) ratified by the Republic of Macedonia, and which is a constituent part of the Macedonian legislation, sources of financial assets for funding local authorities must be appropriate to the competences the local authorities are in charge of. A part of the sources for funding local authorities should derive from local taxes, fees and refunds, for which, according to the national legislations, local governments alone determine the rate and sources of financial assets, so as to be numerous and flexible enough to

respond to the local government needs. The major novelty introduced in the beginning of the decentralisation is the new competence obtained by the local governments to administer local taxes, fees and refunds thus increasing the multi-level responsibility in the whole process of administering local, own source revenues. According to the research accomplished relating to the source, own revenues of the local self-government, the following recommendations are provided:

- Competences for which local authorities are responsible must be subject to measurement of predictable and real costs thus obtaining real picture of the price of each of the competences in each of the municipalities in the Republic of Macedonia;
- Rise of the share of local taxes and fees in the total municipality budget thus local governments obtaining higher level of independence from the central government;
- Establishing better mechanisms for making public the entire municipality financial management;
- Enhancement of the services provided by the local self-government units and public enterprises and institutions they have established, and which are responsible for accomplishment of the municipal competences;
- In near future to commence serious research of the possibility to increase the percentage of income tax in the system of financing local self-government; The Value Added Tax – VAT would serve for equalization among the municipalities;
- Possibility to introduce additional sources for financing the local self-government units, as a part of the profit tax;
- Property tax rate should be increased on a long-term basis, by amending the laws; In the first phase to give incentive to the local authorities in the Republic of Macedonia to increase the rates of the local taxes, fees and refunds to a maximum permitted level;
- Different exemptions from tax payments related to property, permitted by the state, and on the basis of the applicable laws, to be indemnified to the communities, in which those exemptions from property tax payment have been made, by the central governmental institutions;
- To stimulate the local self-government units that have not assessed or reassessed the property in their territory, to accomplish thereto as soon as possible;
- To stimulate inter-municipality cooperation among the municipalities in the area of administering local taxes, fees and refunds;
- Central governmental institutions such as Ministry of Finance, Ministry of Interior, State Authority for Geodetic Works, Central Register to provide free of charge information to local self-government required for administering source revenues.

9.4. Governmental transfers

Major part of the revenues realized by the local self-government units in the country derive from the so-called governmental transfers by way of earmarked grants, block grants, capital grants and other transfers (VAT) performed by certain governmental institutions of the local self-government units in the Republic of Macedonia. Dependence on governmental transfers is rather sizeable, and in particular in small

municipalities in the country, in which very often governmental transfers are expected to settle some current expenses relating to the work of the municipal administration. According to the research accomplished concerning intergovernmental transfers, the following recommendations are provided below:

- In the future, to carry out in-depth analysis of intergovernmental transfers, paying particular account to their structure and scope;
- To carry out serious research on national level relating to the level of costs necessary for the so-called new competences for which municipalities are responsible, intended for the costs incurred by the municipalities when implementing the competences aimed at enhancement of the service quality;
- Income tax (personal tax) to be seriously taken into consideration as a possible stable and predictable source for financing the local self-government in the country, by its increased participation in the revenues of the local self-government units;
- In the distribution of the subsidies/grants deriving from the Value Added Tax – VAT, to take into account only objective criteria, and to abandon political and subjective criteria and influences; To analyse the level of VAT rate, transferred to the local self-government (3%), and to really assess the optimal rate level to be transferred to LSGUs;
- Block grants that will be transferred to LSGUs to fail to follow the destiny of earmarked grants, where the money transferred is much scarce than before the commencement of the decentralisation and real costs for realization of those competences;
- To settle the issue on financing fire prevention as extraordinary significant and serious competence lacking block grants or stable legal solution;
- Local self-government units to reinforce their capacities for administering of taxes and management of financial resources they have in disposal;

9.5. *Indebtedness*

Within the last 15 years, indebtedness of the municipalities in the Republic of Macedonia was performed in non-transparent and rather closed manner practiced by a large number of local self-government units. Municipalities incurred debts particularly with construction companies performing certain construction works and activities as well as with companies delivering goods and providing services in municipalities. These debtor-creditor relations very often were not regulated with debt payment plan and many of those indebtednesses of municipalities have negative judicial settlement for the municipalities, and as a result municipalities go through double burdening with both basic debt and interest rates and court costs. It seems as if there is no real indebtedness with financial institutions in the country in the past years, except for some cases of short-term small-size loans and credits.

The Law on Financing of the Local Self-Government Units, for the first time that a certain law intended for local self-government, regulates possibilities, manner and procedure for indebtedness of the local self-government units in the Republic of Macedonia.

Within the elaboration of the subject unit on municipality indebtedness, the following recommendations are provided:

- Short-term priority, establishing continuous link between local self-government units and banking system (banks and financial institutions) in the country;
- In-depth analysis of the capacities of local self-government units in the country relating to the possibility to pay off debts;
- Possible amendments to the existing legislation, which will facilitate the municipalities capable of indebtedness to accomplish thereto in simple manner;
- Creation of favourable banking conditions by the central financial and governmental institutions and promotion of the trust in the local self-government units by the banks;
- Local self-government units to draft actual and ordinary list of capital investments for which funds are necessary, obtained by way of indebtedness in the country or abroad;
- Creation of administrative capacities in municipalities for indebtedness management, creation of capital plans for investments and capital budget forecasts;
- Settling of overdue debts with which local self-government units are facing;
- Enrichment of the legislation with law on municipality insolvency.

9.6. Financial management

Since the beginning of the decentralisation of 1 July 2005, rules of the game in the area of financial management have significantly changed in the local self-government units in the country. Provided that, before the commencement of the decentralisation, the local self-government units had accounts in business banks, the decentralisation introduced treasury system of operations, so that municipality account migrated from business banks to the National Bank of the Republic of Macedonia. This research covers a large number of aspects of the financial management such as: budgeting process, accounting, treasury operations, financial reporting, internal control and audit.

The following recommendations may be provided deriving from the research accomplished in this area:

- To carry out extensive education of the municipal administration in charge of the financial management in the following areas: budget calendar in the budgeting process; proper planning of revenues and expenditures in the budget; manner of management of the fiscal municipal capacity; proper application of expressions/terms and terminology in the budgeting process; drafting fiscal strategy of LSGUs; practical application of the IASCBPS; drafting consolidated financial reports; LSGU property record; treasury operations; risk assessment and developing appropriate measures and activities for minimizing thereto; internal control system and continuous education of internal auditors.
- To enhance the level of LSGU transparency in the budgeting process by increasing the participation share in the budgeting process;
- Making policies on the access to information concerning budget realization, quarterly reports, audit reports, projections on future LSGU short- and medium- term fiscal activities by different forms and methods of their availability;

- Accelerating the process of appointment of responsible accountants and establishing units for internal audit or approval of internal auditors in LSGUs;
- Amendments to the existing legislation and introduction of penal provisions and fines for: non-observance of the budget calendar; failure to make public quarterly reports; failure to draft annual report and non-observance of the provisions relating to internal audit in LSGU;
- Finding out optimal solution on settling LSGU overdue debts;
- To take timely and suitable activities concerning proper and timely information on the available assets deriving from earmarked / block grants and their utilization by the predicted deadline;
- Extending the network of treasury offices in the country thus acquiring entire coverage of LSGUs;
- Increasing the possibility for electronic access of LSGUs to the Treasury of the Republic of Macedonia;
- Central governmental institutions (Treasury of RM and Ministry of Finance) to create possibilities for implementation of electronic signature and payment with budget beneficiaries;

9.7. Monitoring and coordination

Decentralisation process as a complex process extending for a long period is accompanied by fiscal decentralisation as an essential component for successful decentralisation. The fiscal decentralisation process is complex and complicated.

The following recommendations may be provided deriving from the research accomplished in the area of monitoring and coordination:

- Drafting Strategy for Fiscal Decentralisation, with clearly defined objectives;
- Drafting Action Plan as an operative document for implementation of the Strategy for Fiscal Decentralisation in the Republic of Macedonia;
- Introducing clear and transparent indicators to measure the progress of the decentralisation and fiscal decentralisation;
- Enhancing the level of trust between the central governmental institutions and local authorities;
- Continuous meetings between the representatives of the Government of the Republic of Macedonia and ZELS for the purpose of enhancement of the decentralisation;
- Strengthening the capacities of the Ministry of Local Self-Government and Ministry of Finance (sector in charge of local self-government);
- Strengthening the role of the Commission for Resolving the LSGU Problems with Overdue Debts;
- The Commission for Monitoring the Development of the System of LSGU Funding is on unsatisfactory level to gain the legal role in the LSGU financial system;
- By the end of the year and in the beginning of the next year to carry out in-depth analysis on the accomplishment of the LSGU competences.

ANNEX 1: Representative sample of the Questionnaire on the Assessment of the Fiscal Decentralisation Process in the Republic of Macedonia

Methodology approach on drafting this Questionnaire is based on the main pillars of the decentralisation process. Each of the sections of the Questionnaire elaborates the conceptual principles and evaluates the current situation in the municipalities.

QUESTIONNAIRE ON THE ASSESSMENT OF THE FISCAL DECENTRALISATION PROCESS IN MACEDONIA

The methodology of this questionnaire is grounded on the foundations of the decentralisation process. Each section of the questionnaire deals with the conceptual principles and assesses the current state of affairs in the municipality.

General data on the surveyed municipality

| | |
|-----------------|--|
| Municipality: | |
| Address: | |
| Telephone: | |
| Fax: | |
| Webpage: | |
| Contact Person: | |
| Position: | |
| Date of Survey: | |

Section 1:

Structure and scope of the competencies of the municipal governments in Macedonia

1. List the number of employees in the municipality according to their level of education:

| Secondary education | Post-secondary education | Higher education | Above higher education |
|---------------------|--------------------------|------------------|------------------------|
| | | | |

2. List the number of employees in the municipality according to the systematization acts:

| Secondary education | Post-secondary education | Higher education | Above higher education |
|---------------------|--------------------------|------------------|------------------------|
| | | | |

3. List the number of individuals who are performing part time work for the municipality (temporary work agreements etc):

4. List the number of cooperation agreements made with other municipalities in Macedonia and the specific area of cooperation:

5. List the number of sister municipalities from outside Macedonia:

6. How do you assess the implementation of the first phase of fiscal decentralisation in your municipality:

- a) Very successful
- b) Successful

- c) Satisfactory
- d) Unsatisfactory
- e) Very unsatisfactory

Comment: _____

7. What are the expectations of the second phase of fiscal decentralisation in your municipality:

- a) Very Big
- b) Big

- c) Average
- d) Small
- e) Very small

Comment: _____

Notes:

Section 2

Transfer of Competencies

1. To which degree is the competence of your municipality in the following areas fulfilled:

| No. | Area | Fully | Partially | Is not fulfilled |
|-----|-----------------------------|-------|-----------|------------------|
| 1. | Urban Planning | | | |
| 2. | Environmental Protection | | | |
| 3. | Local Economic Development | | | |
| 4. | Utilities | | | |
| 5. | Culture | | | |
| 6. | Sport and Recreation | | | |
| 7. | Social and Child Protection | | | |
| 8. | Education | | | |
| 9. | Health Protection | | | |
| 10. | Protection and Rescue | | | |
| 11. | Firefighting | | | |

Comment on question (1) regarding competence:

2. If you have answered question 1 with - partially: Which are the reasons for only partially fulfilling the competencies: (*several possible answers*)

- a) The municipal administration lacks administrative capacity
- b) The municipality lacks fiscal capacity
- c) Lack of financial means
- d) There is no need to execute the competence
- e) The number of inhabitants in the municipality is too small
- e) Specific characteristic of the municipality (urban, rural)

Comment on question (2) on competence:

3. If you have answered question 1 with – is not fulfilled: Which are the reasons for not fulfilling the competencies: (*several possible answers*)

- g) The municipal administration lacks administrative capacity
- h) The municipality lacks fiscal capacity
- i) Lack of financial means
- j) There is no need to execute the competence
- k) The number of inhabitants in the municipality is too small
- l) Specific characteristic of the municipality (urban, rural)

Comment on question (3) on competence:

4. Do you find that due to fulfilling municipal competencies the partially or not at all it is possible that individuals may relocate from your municipality into other ones?

- a) YES b) NO

Comment on possible relocation?

5. Complete the table with planned and needed means for executing competencies:

| No. | Competence | Funds utilized from the budget for this competence in 2006 | Estimate of the funds needed for discharging this competence |
|-----|--------------------------|--|--|
| 1. | Urban Planning | | |
| 2. | Environmental Protection | | |

| | | | |
|-----|-----------------------------|--|--|
| 3. | Local Economic Development | | |
| 4. | Utilities | | |
| 5. | Culture | | |
| 6. | Sport and Recreation | | |
| 7. | Social and Child Protection | | |
| 8. | Education | | |
| 9. | Health Protection | | |
| 10. | Protection and Rescue | | |
| 11. | Firefighting | | |

6. Which of the competencies listed above would be discharged at the central level rather than the local level?

- a) _____
- b) _____
- c) _____
- d) _____

7. Do you find that in addition to the legally defined competencies, there are other competencies which would be discharged better on the local level, rather than the central level?

- a) YES b) NO

7.1. If the answer to question (7) is "YES", please list the areas of competence:

- 1. _____
- 2. _____
- 3. _____
- 4. _____
- 5. _____

8. Is there a competence in your municipality which was delegated by an organ of the state government to the mayor of the municipality?

- a) YES b) NO

8.1. If the answer to question (8) is "YES", fill in the following table:

| No. | Delegated Competence (scope) | Required Means | Transferred Means |
|-----|------------------------------|----------------|-------------------|
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |

Notes:

Section 3

Own Sources of Revenue

1. Fill in table 1 with information regarding own sources of revenue (from the final account):

| No. | Type of Revenue | Year | | | | | |
|-----|---|-------|-------|-------|-------|-------|--------|
| | | 2004 | | 2005 | | 2006 | |
| | | Plan. | Spent | Plan. | Spent | Plan. | Spent. |
| | Total revenues | | | | | | |
| 1 | Local tax revenues | | | | | | |
| 1.1 | Property tax revenues (713111) | | | | | | |
| 1.2 | Inheritance and gift tax revenues (713211) | | | | | | |
| 1.3 | Immovable property and related right turnover tax revenues (713311) | | | | | | |
| 1.4 | Revenues from other ownership taxes (713411) | | | | | | |
| 1.5 | Interest revenues (713512) | | | | | | |
| 2. | Local tax revenues | | | | | | |
| 2.1 | Communal tax revenues (71711; 717112; 717115; 717116; 717131; 717135) | | | | | | |
| 2.2 | Revenues from exploitation fees or fees for issuing activity performing licenses (718117) | | | | | | |
| 2.3 | Administrative tax fees (722315; 722316) | | | | | | |
| 3. | Local refund fees | | | | | | |
| 3.1 | Revenues from local construction land arrangement fee (717137) | | | | | | |

| | | | | | | | |
|-----|--|--|--|--|--|--|--|
| 4. | Ownership related revenues | | | | | | |
| 4.1 | Rent revenues (723914) | | | | | | |
| 4.2 | Property sale revenue (731116; 731112) | | | | | | |
| 5. | Revenues from grants (742) | | | | | | |
| 6. | Local voluntary contribution revenue (725917) | | | | | | |

2. Fill in table 2 with information regarding property taxes and communal fees:

| no. | Type of decisions | Year | | | | | |
|-----|--|--------|---------|--------|---------|--------|---------|
| | | 2004 | | 2005 | | 2006 | |
| | | Deliv. | Receiv. | Deliv. | Receiv. | Deliv. | Receiv. |
| 1. | Total number of delivered property tax decisions | | | | | | |
| 2. | Total number of delivered communal fee for company advertising decisions | | | | | | |
| 3. | Total number of issued decisions on immovable property turnover tax | | | | | | |
| 4. | Total number of delivered decisions with updated property tax data | | | | | | |

3. List the number of municipal employees who work on administering local taxes and fees:

4. Is the number of employees noted above adequate to successfully administer property taxes and communal fees?

5. Do you have an agreement in the area of administering taxes and fees with another LSGU or PRO?

If the answer is "YES", expand further - with whom and what kind of agreement?

a) YES b) NO

6. Do you conduct assessments of the properties subject to property tax?

a) YES b) NO

7. Do you have a Commission for the appraisal of property value?

a) YES b) NO

8. Does your Commission operate under the government issued methodology for the appraisal of the value of property taxes?

a) YES b) NO

8.1. If question (8) is answered with "NO", that please explain why this methodology is not being used?

Other comments?

Notes:

Section 4

Inter-Governmental Transfers:

1. Please list the scope, trend, and structure according to the type of transfer into your (municipal) budget from the central budget and the budgets of the funds:

| | 2003 | | 2004 | | 2005 | | 2006 | |
|---|--------|---|--------|---|--------|---|--------|---|
| | Amount | % | Amount | % | Amount | % | Amount | % |
| Transfers from the budget of RM (741112) | | | | | | | | |
| Transfers from the budgets of funds (741113) | | | | | | | | |
| Revenue from VAT (741115) | | | | | | | | |
| Earmarked grants (741116; 741117; 741118; 741119) | | | | | | | | |
| Capital grants (7412) | | | | | | | | |
| Block grants | | | | | | | | |
| Subsidies for delegated competencies | | | | | | | | |
| TOTAL | | | | | | | | |

2. Do you find that the structure and the quality of the transfers is well suited to the structure of the municipal competencies?

- a) Fully appropriate
- b) Could and should be improved
- c) It is not suitable neither in quality nor in structure
- d) Completely incompatible in comparison to the allocated competencies
- e) Other _____

3. Which fiscal sources (from central taxes) and at what amount would you find more adequate in enabling high quality of service in the allocated competencies?

- a) VAT revenues up to _____ %
- b) Income tax revenue up to _____ %
- c) Revenue from ownership and concessions _____ %
- d) Other revenues _____

4. Which criteria and at which level of importance (the end sum should be 100) do you find most appropriate for the horizontal equalization and end parity of the municipality?

- a) Number of inhabitants – with _____%,
- b) Surface of the territory of the municipality - with _____%
- c) The different levels of development in the settlements within the municipality - with _____%
- d) Developmental infrastructure - with _____%
- e) Other _____ - with _____%
- f) Other _____ - with _____%
- g) Other _____ - with _____%

5. Transfers are actualized:

- a) According to the planned timeline
- b) Usually there are minor discrepancies
- c) They are not actualized according to the planned timeline
- d) There is no independent system for actualizing transfers which is immune to daily politics

6. How do you assess the efficiency of allocated financial transfers from the central government?

- a) Very good
- b) Excusable
- c) Spontaneous
- d) Incidental
- e) Inefficient

7. Are the procedures associated with governmental transfers simple and efficient?

- a) Yes, they are simple and efficient
- b) Relatively simple and efficient
- c) Relatively complicated and inefficient
- d) No, they are very complicated and inefficient

8. Are the procedures associated with governmental transfers simple and efficient?

- a) Yes, they are very transparent
- b) Relatively transparent
- c) Transparency could and should be improved
- d) No, transparency is poor

Notes:

Section 5

Indebtedness

Note: Please fill in the tables 1-6 for each LSGU individually

Table 1. LSGU demography

| | 2003 | 2004 | 2005 | 2006 |
|--|------|------|------|------|
| Population | | | | |
| Yearly population Growth | | | | |
| Urban population as a %of the total population | | | | |
| Rural population as a %of the total population | | | | |
| Population concentration. Population of the centre of the LSGU as a % of the total population | | | | |
| Population under 18 as a % of the total population | | | | |
| Population between the ages of 18 and 65 as a % of the total population | | | | |
| Population older than 65 as a % of the total population | | | | |
| University graduates per capita | | | | |

Table 2. LSGU economy

| | 2003 | 2004 | 2005 | 2006 |
|---|------|------|------|------|
| Concentration of the economy. FIRST sector of GDP as a % of total GDP | | | | |
| Concentration of the economy. First TWO sectors of GDP as a % of total GDP | | | | |
| Concentration of the economy. First THREE sector of GDP as a % of total GDP | | | | |
| First biggest employer - sector | | | | |
| First biggest employer - % of total employed | | | | |
| Second biggest employer – sector | | | | |
| Second biggest employer - % of total employed | | | | |
| Third biggest employer – sector | | | | |
| Third biggest employer - % of total employed | | | | |
| Employment rate | | | | |
| Unemployment rate | | | | |
| Beneficiaries of social assistance | | | | |
| Price of purchasing per sq. meter of housing in the downtown area of the population centre of | | | | |

| | | | | |
|---|--|--|--|--|
| the municipality | | | | |
| Price of renting per sq. meter of housing in the downtown area of the population centre of the municipality | | | | |

Table 3. LSGU fiscal indicators (account in brackets)

| | 2003 | 2004 | 2005 | 2006 |
|---|------|------|------|------|
| Total revenues over GDP of the LSGU | | | | |
| Own revenues (71;72; 73; and 741114) over total revenue | | | | |
| Central government transfers (741112; 741113; 741115; 741116; 741117; 741211) over total revenue | | | | |
| Grants (742 + 743) over total revenue | | | | |
| Own revenue (71 ;72 ;73 и 741114) over central government transfers (741112; 741113; 741115; 741116; 741117; 741211) | | | | |
| Capital expenditures (48) over ongoing operational expenditures (40 ;42 ;46 ;47) | | | | |
| Tax revenue (711+713) over own revenue (71+72+73+741114) | | | | |

Table 4. LSGU expenditure indicators (account in brackets)

| | 2003 | 2004 | 2005 | 2006 |
|--|------|------|------|------|
| Total expenditures over GDP of LSGU | | | | |
| Capital expenditures (48) over total budget expenditures | | | | |
| Total LSGU capital expenditures (48) over capital expenditures of the central budget | | | | |

Table 5. LSGU financial indicators (account in brackets)

| | 2003 | 2004 | 2005 | 2006 |
|--|------|------|------|------|
| Investments (481+486) as a percentage of total expenditures | | | | |
| Indebtedness as a percentage of own revenues (71+72+73+741114) | | | | |
| Indebtedness as a percentage of current operational expenditures (71+72+74-7412-742) | | | | |

Table 6. Legal limitations on LSGU indebtedness (account in brackets)

| | 2003 | 2004 | 2005 | 2006 |
|---|------|------|------|------|
| Legal limit on total indebtedness (total budget of LSGU) | | | | |
| Actualized current operational revenues (71+72+74-7412-742) | | | | |
| Legal limit on yearly annuity (10% (71 +72+74-7412-742)) | | | | |

1. Have you adopted Capital Investment Plan in your municipality?

a) YES b) NO

2. Describe the total financial construction of the Capital investment plan for your municipality? (in MKD)

3. Which of the following approaches to collecting resources for capital investments do you find most suitable for your municipality?

Please highlight the advantages and shortcomings of each:

| | Advantages | Shortcomings |
|---|------------|--------------|
| Public Private Partnership | | |
| Commercial bank lending | | |
| Issuing bonds | | |
| Investments from the central budget | | |
| Investments from the municipal budget | | |
| Grants | | |
| Regional action by several municipalities | | |

Section 6

Managing Finances

PART 1: THE BUDGETING PROCESS

1. Has your municipality adopted a budgetary calendar?

- a) YES b) NO

1.1. If the answer is "NO" please provide further information: What were the reasons for not adopting a budgetary calendar? (*more than one possible answers*)

- a) We do not find it necessary to adopt a budgetary calendar
b) We are not familiarized with the procedure for adopting a budgetary calendar
c) Other (please explain)
-
-

2. Do you adhere to your budgetary calendar (if your municipality has adopted one)?

- a) YES b) NO

2.1. If the answer is "NO", please provide further information: What are the reasons for not adhering to the budgetary calendar? (*more than one possible answers*)

- a) The budgetary calendar was inadequately designed
b) We lack the habit of following the budgetary calendar
c) Other (please explain)
-
-

3. Do you receive the information needed for the budgeting process in a timely fashion from the central governmental?

- a) YES b) NO

Please explain: _____

4. Is your 2007 municipal budget adopted by 31st December 2006?

- a) YES b) NO

5. Do you apply the principle of participative budgeting (participation of the broader public)?

- a) YES b) NO

5.1. If the answer is “YES”, please expand:

How often do you organize public meetings (citizen meetings, NGO and business sector), in order to analyze the needs and the priorities of the citizens during the preparation of the draft budget?

* In the appropriate column please list the number of meetings and other kinds of events which are organized in your municipality:

| Type of Event | Number of Events per Year |
|---|---------------------------|
| Presentation in the municipality | _____ events per year |
| Meetings in the local communities, i.e. urban communities | _____ events per year |
| NGO and business sector | _____ events per year |
| Other: _____ | _____ events per year |

6. Was the draft budget publicly presented?

- a) YES b) NO

7. Was the meeting of the municipal council dedicated to adopting the municipal budget properly announced (7 days in advance), in order to inform the citizenry, NGO and business sectors and other budgetary beneficiaries?

- a) YES b) NO

8. The adopted budget and yearly report are presented to the citizenry?

- a) YES b) NO

8.1. If the answer is “YES”, please expand: How are these presentations conducted? (*more than one possible answers*)

- a) Allotted reception terms for meeting with the citizenry
- b) Through a citizens’ information centre
- c) Presentation before a public gathering of citizens
- d) Local media (TV, newspapers and other)
- e) Other (please explain) Webpage _____

8.2. If the answer to 8.1 is “NO”, please expand:

What were the reasons why the budget and the yearly report were not presented to the citizenry?

(*more than one possible answer*)

- a) The draft budget was not prepared on time
- b) The meeting of the council for adopting the budget was not scheduled on time
- c) The Council members could not agree to adopt the budget
- d) Other (please explain) _____

9. Please list in percentages (%) the realized revenues and expenditures of the 2007 municipal budget compared to the planned revenues and expenditures, up to and including 30.06.2007:

- a) Realized revenues are _____% from planned revenue
- b) Realized expenditures are _____% from planned expenditures

10. If the realization of revenues and expenditures is not in line with your predictions, could you describe the reasons why this is the case?

Note _____
Note _____
Note _____

11. Did your municipality conduct a rebalance of the 2006 budget?
a) YES b) NO

11.1. If the answer is "YES", please expand:
List several rebalances which were conducted and for which period?
(more than one possible answer)

Period _____ number of rebalances _____
Period _____ number of rebalances _____
Period _____ number of rebalances _____
Period _____ number of rebalances _____

12. Is your municipality faced with the problem of left over debt from preceding years?
a) YES b) NO

12.1. If the answer is "YES", please expand:
What is the amount of debt owed, up to and including 30.06.2007

Note amount _____ den

13. During this year, is there a foreseen payment of left over debt from preceding years?
a) YES b) NO

13.1. If the answer is "YES", please expand:
What percentage of the debt will be paid off and what percentage does that constitute of the total budget?

Percent of debt _____%
Percent of total budget _____%

Your comment regarding this question:

14. Was your municipal account ever blocked/is it blocked now?

a) YES b) NO

14.1. If the answer is "YES", please expand:

What are the reasons for the past or current blocking of your account?

Note _____

Note _____

Note _____

15. Has your LSGU adopted a fiscal strategy, and if so for which period.

a) YES b) NO

Note the period _____

16. On 31- 12 – 2006, did your final account show a positive balance for the account earmarked grants?

a) YES b) NO

16.1. If the answer is "YES", please list the amount, programme, and the reasons explaining why.

Note _____

Note _____

Note _____

16.2. If the answer is "YES", please expand::

Have you conducted a rebalance to reallocate the means form the positive balance.

a) YES b) NO

16.2.1. If the answer is "YES", please expand:

How many times have you conducted a rebalance up to and including 30 - 06 -2007?

Note _____

Note _____

PART 2: ACCOUNTING

1. Does your LSGU dully apply the accounting principle „cash reporting“?

a) YES b) NO

2. Does your LSGU have prescribed accounting policies?

a) YES b) NO

3. Does your LSGU supplement its financial reports with detailed explanations of the noted conditions?

a) YES b) NO

4. Do you have the established practice to produce in supplement to the financial reports also notes on the financial reports?

a) YES b) NO

5. Do you find that you adequately apply the International Accounting Standard on a Cash Basis for the Public Sector?

a) YES b) NO

5.1. If the answer is "NO", please list the reasons for this:

6. Do you have established policies to present the condition of the means (property), requests, and obligations of the LSGU?

a) YES b) NO

6.1. If the answer is "NO", please explain further:

7. In your past practice, have you found any significant difficulties in determining the ownership of municipal property and their reporting in financial reports.?

a) YES b) NO

Please explain further:

8. In your past practice, have you found any significant difficulties in the procedure for reporting capital transfers from central government or grants from Macedonia or abroad?

a) YES b) NO

Please explain further:

9. In your past practice, have you prepared consolidated financial reports (including budgetary beneficiaries, establishments and companies which are the property of LSGU)?

a) YES b) NO

Please explain further:

10. Do you find that the current format of the final account of the budget of the LSGU is adequate and that it provides the necessary information, i.e. do you find that the current format should be altered?

a) YES b) NO

Please explain further: _____

11. Please list anything that you may find important and was not covered by the questions above:

PART 3: TREASURY MANAGEMENT

1. Have you had any problems in the practicing of the treasury system of R.M?

a) YES b) NO

1.1. If the answer is "YES" please, clarify if the problem was connected with:

- a) Executing transfer orders
- b) Opening of account
- c) Approval of plans
- e) Other (please explain):

2. Is the instruction for the manner of treasury management sufficiently clear and applicable?

- a) YES b) NO

2.1. If the answer is "NO", please clarify further what you would like to see change:

3. In your opinion, should there be more treasury offices, and if so what would be the optimal number?

- a) YES b) NO

4. Did you report outstanding obligations in your quarterly report for the Second Quarter (form K.2)?

- a) YES b) NO

4.1. If the answer is "YES", please list the amount and what it corresponds to:

5. Do you report the outstanding obligations with the O1 form, within 10 days after they occur?

- a) YES b) NO

5.1. If the answer is "NO" please name the reasons why:

6. Do you actualize the payments on the registered obligations according to the time plan noted in form O1?

- a) YES b) NO

6.1. If the answer is "NO", please explain the reasons:

7. Does your LSGU use electronic access to the Office of the Treasury of RM?

a) YES b) NO

7.1. If the answer is "NO", please explain the reasons:

8. Do you find that it is necessary to develop the system of electronic signature and electronic payment is necessary?

a) YES b) NO

8.1. If the answer is "NO", please explain the reasons:

9. What would be the measures needed to improve the efficiency of treasury operations?

- a) Electronic payments using email.
- b) Increasing the level of communication between LSGU and the Treasury.
- c) Increasing the competencies of the local treasury offices.
- d) Other (explain)

10. Has your LSGU opened a depository account?

a) YES b) NO

10.1. If the answer is "NO", please list the reasons:

11. Please list anything that you may find important and was not covered by the questions above:

Part 4: REPORTING

1. Has the LSGU drafted and adopted specific policies for accessing information in regard to the implementation of the budget of the LSGU and the financial reports of the LSGU?

- a) YES b) NO

Please explain further:

2. Has the LSGU established a framework for the timely publication and distribution of the information noted above?

- a) YES b) NO

Please explain further:

3. Do you have specific policies for the manner of presenting the before mentioned information, with the aim of promoting transparency in LSGU operations?

- a) YES b) NO

Please explain further:

4. Do the budgetary beneficiaries regularly submit monthly financial reports to the mayor of the LSGU?

- a) YES b) NO

Please explain further:

5. Do the budgetary beneficiaries include, in supplement to the monthly financial reports, also the explanations for the implementation of financial plans?

a) YES b) NO

Please explain further:

6. Do you have an established practice to submit the quarterly reports in a regular and timely fashion to the municipal council and the competent ministry?

a) YES b) NO

Please explain further:

7. How do you inform the public of the content of the quarterly financial reports?

8. Do you have an established policy and practice to submit data regarding outstanding obligations (i.e. municipal indebtedness) in a regular and timely fashion to the competent ministry and the public?

a) YES b) NO

Please explain further:

9. Do you have the established practice to prepare a yearly report on the work of the LSGU?

a) YES b) NO

Please explain further:

9.1. If the answer is "YES", please explain what problems you encountered while preparing the same:

10. Please list anything that you may find important and was not covered by the questions above:

5: INTERNAL CONTROL AND AUDIT

1. Have you undertaken actions to assess the risks faced by your LSGU?

a) YES b) NO

Please explain further:

2. Have you undertaken measures to establish effective internal control procedures over the entire operations of the LSGU?

a) YES b) NO

Please explain further:

3. Have you undertaken measures to prescribe and implementing practice measures of Ex-ante (preceding), payment control and Ex-post (succeeding) financial control in LSGU operations?

a) YES b) NO

Please explain further:

4. Has your municipality designated an authorized accountant?

a) YES b) NO

Please explain further:

5. Has your municipality designated an authorized auditor?

a) YES b) NO

6. If your municipality does have an internal auditor/s, please answer: Does your municipality take actions for the employment/termination of internal auditors on a fulltime basis unlimited duration contract?

a) YES b) NO

6.1. If your municipality has employed an internal auditor, please answer:
How many audits has he/she completed during 2006, compared to the total number of files subject to audits, and how many audits has he/she completed up to and including 30.06.2007?

a) Completed audits for the period 01.01.-31.12.2006 _____, the total number of files audited is _____.

b) Completed audits for the period 01.01.-30.06-2007, the total number of files audited is _____.

7. List the proportion of the total expenditures which were audited, compared to the total expenditures of the LSGU budget:

-total audited expenditures _____/total expenditures of the LSGU budget.

8. List several audit reports prepared for the period from 01.01. to 31.12.2006, i.e. from 01.01. to 30.06.2007, and are the same presented to the public?

9. Your comment with regard to the functioning of the system of internal control and internal audit:

Annex 2: Revenues and Expenditures for 2005 and 2006