

# The Local Resources in Albania as Instruments to Increase the Autonomy of the Local Institutions

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## Abstract

The current Albanian Constitution (1998) defines communes and municipalities (local governments) as the basic units of local governments. Local governments are legal entities and perform all the duties of self-government, with the exception of those that the law gives to other units. There are a total of 373 local governments units, consisting of 65 municipalities and 308 communes. While municipalities govern urban areas and the communes rural areas, there is no substantive legal distinction between them.

The fiscal decentralization reform in Albania has addressed the issue of adequate local resources proportional to the competences. The decentralization of functions were supported with an increase of financing opportunities either through the increase of transfers from the state budget or by adopting the new system of local taxes and fees, the latter one by providing total discretion to the local government in setting local tariff policies to cover the cost of their services. Unfunded mandates can represent a risk if not addressed in an appropriate manner.

In this article we are going to discuss about the local resources as instruments to increase the autonomy of the local governments versus the resources from the central government. The balance between the resources from the central government and the local own revenue should be, as much as possible equal.

**Keywords:** resources, transfers, budget, revenue, local.

## Introduction

Although a legal framework and financing system were established for local governments from 1992/93 (Law on Organization and Functioning of Local Governments, Law on Local Government Budgets), in fact, the responsibilities of local governments were very vaguely defined and subject to considerable control by the Central Government. The system of grants consisted of a dispersed system, with allocations made by each line Ministry, in a non-transparent, ad hoc manner. Grants were strictly conditional, and ensured a very minimum level of provision of public services, although constituting 95 percent of local budgets. Local government had only partial expenditure authority over 5 percent of incomes coming from own local taxes and fees, but had no incentive to collect additional funds. Such funds could be used only for non-wage operating

expenditures and investment, with approval of the Ministry of Finance in a system of public expenditure limits, with surpluses transferred to the State budget.

## **Methodology**

Some improvements are made during the last years in the development of the financial capacities of local governments through the Law on Taxes and Fees, as well as the development of an intergovernmental transfer scheme. Some improvements have been made, but the tax and fee capacity has not been fully utilized. The majority of communes and small municipalities still lack the knowledge and capacity to set up local tax systems. The intergovernmental transfers have contributed more to balance the regional disparities than fiscal equalization. Modifications in both areas are greatly needed to make local governments more effective in the financing and delivery of services.

But we still miss the arguments if the financial resources of the local governments are proportionally appropriate to their functions *visa-a-via* compared to the central government. That's way in this article we are going to make a full description of the local resources and at the end we will try to give some solutions regarding the proportionality of the local resources in order to give more autonomy to local entities as decision makers.

## **Analysis and Results**

From late 1998, the situation of local governments began to evolve with a central-local dialog on the need to implement local government and decentralization reform. During this period (1998), the new Constitution was approved by national referendum and Albania ratified the European Charter of Local Self-Government in 1999. In 2000, the National Strategy for Decentralization was adopted and has guided the subsequent steps of the decentralization reform. Since October 1, 2000, local governments are operating based on the new Local Government Law<sup>1</sup>.

Based on the above law, Albania is organized with two levels of local government, consisting of 12 regions, and 373 first level local government units, of which 65 municipalities (urban areas) and 308 communes (rural areas). Mayors and members of municipality/commune councils are directly elected, while regional councils consist of indirect representation, being formed from representatives of the municipal/commune councils in the region. National territorial structures include 12 Prefects, one in each Region, representing the authority of the central government in the territory, and territorial branches of some line Ministries.

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<sup>1</sup> Adopted 31-July-2000.

The competencies of local government are defined in three categories: own functions, shared functions and delegated functions. For their own functions, local governments enjoy full decision-making authority, but by the other hand this functions have to be covered entirely from the local finances. Own functions of municipalities/communes include basic local public services, such as solid waste, roads, public areas and parks, public lighting, water/wastewater, local economic development, local culture and sports. There is still a period of transition underway, particularly for the transfer of responsibility in water/wastewater.

Shared functions are a new concept of Albania's local government system, and they cover key sector areas such as education, health, social protection and public order; the respective roles of the central and local governments still need to be elaborated in separate sector laws. The problem with the shared functions is to find the right line between central government and the local government regarding the division of competences and the financial help.

The delegated functions are not specified exactly by law, but it can be any competence of the central government given by law or by contracts from the central government to the local government. These functions are entirely covered from the budget state.

The own functions of the regions include adoption and implementation of regional development policies. Other functions can be delegated to them by their constituent municipalities/communes, or by the central government.

Although local government autonomy is improving, in absolute terms, the total expenditures of local governments and those under full discretion of local governments are still low. There is a general opinion that the total spending of local governments does not correspond to their current and expected level of responsibilities. These opinions are mostly supported by comparison with other countries and largely present in political discussions.

The overall fiscal situation in Albania as well as the current level of decentralization of functions can explain the general low level of local governments expenditures. On the other hand, recent analyses undertaken related to fiscal decentralization demonstrate that, in aggregate terms, the decentralization of functions was mostly appropriately followed step-by-step by fiscal reform in order to avoid any under-funding off or excessive budget constraints on local governments <sup>2</sup>.

The financing of local governments has been changing every year. The first steps of reform (1998-99) included the introduction of the block grant for non-wage operating

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<sup>2</sup> Before concluding on under-funding or non-funding, it is necessary to clarify that under-funding refers only the case if, when a function is transferred to a local governments, it is not followed either by government transfers in the same amount as if it had remained under the responsibility of the central government nor through granting increased local autonomy in generating revenues through local taxes and fees.

expenditures (replacing part of conditional grants from line Ministries), the transfer of property tax on buildings from a national to a local tax and the ending of public expenditure limits. The present situation in local government finances and the latest steps in fiscal decentralization reform are further described below.

Establishment of appropriate fiscal authority and property rights in favor of local governments in Albania is the basis of Albania's Strategy for Decentralization and Local Autonomy. The action plan for implementation of the strategy recognizes that the schedule of decentralization of functions/responsibilities must be closely coordinated with the schedule of building substantial fiscal authority and property rights.

The basic law that regulates local governments organization and operation has defined a long-term profile of local governments. In addition to other issues, the law defines on one side, local responsibilities and functions and on the other side, local fiscal authorities and property rights. The relations and links between these two pillars are quite clear and sufficient to lead to the effective achievement of this profile.

Defining the profile of local governments in a law is the easiest task, while the realization of the final vision is a huge and difficult task. Although the law established an agenda for implementation, including some priority actions and deadlines, some of these have not been carried out according to the initial schedule. Nevertheless, there is a general consensus that the delays are due to the complications inherent in any decentralization project and the need to carefully resolve problems in advance rather than just transfer these problems to local governments<sup>3</sup>.

Regarding the property transfer, the process is regulated by two special laws adopted in 2001: i) law on state immovable properties and ii) law on transferring of immovable state properties to local governments. While the first regulates the regime of public property, the second regulates the process of transferring properties to local governments. As a basic principle, any immovable property that serves for the execution of a local own function will be transferred to local governments with full property rights. Those properties related to delegated functions will be under the use (no charge) of local governments but not as their property. As a result, immovable properties such local administrative buildings, roads, parks and other local public areas, water systems, landfills, cemeteries, schools, local forests, etc. will become property of local governments.

Due to an unrealistic evaluation of the burden of the process, the deadlines established by the law (two years) have proven to be too short. The process requires an initial inventory of the immovable properties (which had not been previously carried out). As a first step, in 2002 a symbolic action was taken with the transferring of city halls. In

<sup>3</sup> Hoxha A., Pigej J. Stability Pact Conference, Fiscal decentralisation in SEE countries, Case of Albania, Tirana, 8 September, 2004

2003, the approach changed to follow the order of the decentralization of functions. Thus, properties linked to own functions of local governments such as roads, solid waste equipment and sites, urban plots, public lighting, etc. are being registered and will be soon transferred by groups of local governments. Properties related to water supply and sewage are also following step-by-step the decentralization of these functions. The new approach appears to be yielding better results.

The Albanian local governments perform several distinct categories of functions such as social sector, urban housekeeping and infrastructure service, administrative functions. While the social sectors consume the largest share of local budgets, local management responsibilities in this area are limited. Most of local government discretionary spending is devoted to expenditures on streets and rural roads, various urban housekeeping functions and administrative costs.

### **Shared functions**

Social Assistance<sup>4</sup> is largest single category of the local government expenditure. This mostly consists of a program of direct cash payments to low income households<sup>5</sup>. It is financed entirely by conditional (transfer) grants from the central government and is distributed according to guidelines issued by the Ministry of Labor and Social Protection. In principle, the conditional transfers, are allocated only for this purpose according to the number of eligible households in each jurisdiction (municipality/communes), on basic of defined criteria and number of beneficiary from central government. In practice, the local governments have been given the duty to exercise with discretions the way of allocation of these funds: to be given to the beneficiaries as social aid or as a salary for a part-time job<sup>6</sup> on the help of local government. Even the list of name is competence of the local governments<sup>7</sup>.

Primary and secondary education are component of the social sector. In practice, most of the burden of managing and financing this function is covered by the Ministry of Education. Teachers are employees of the Ministry of Education which funds the salaries and benefits of individual teachers<sup>8</sup>. Local governments are, however responsible for classroom construction, which is funded through conditional grants to local governments. Local governments are also responsible for the operating costs of school buildings-heating, lighting and building maintenance, which are financed from discretionary revenues.

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<sup>4</sup> One of the components of the Social Sector

<sup>5</sup> "Households" in Albanian language "ndihma ekonomike"

<sup>6</sup> Given the small amount of money

<sup>7</sup> Mucollari O., Local decentralization and Regionalism, Thesis of Doctorate, 19 May 20009

<sup>8</sup> Until 2008, local governments were responsible to distributing Government-financed salaries to individual teachers. By 2008, funding for teachers bypasses local government entirely. Salaries are instead paid directly to teachers by district offices of the Ministry of Education.

Other social services. Local governments also relatively minor sums on social, cultural and recreational services. These include the organization and management of sports institutions and the administration of institutions such as day care centers, elderly homes and orphanages<sup>9</sup>. The role of local government in health care is minor. Actually, the Ministry of Health owns and operates the entire system. The Health Insurance Institute funds all primary care, including salaries, pharmaceuticals, utilities, and building maintenance.

### **Own (exclusive) functions**

Urban housekeeping and Infrastructure Services is one of the component of the own functions. Local governments have considerably more discretion in the provision of urban housekeeping and infrastructure services. The recurrent costs of these functions are largely financed out of discretionary revenues, which local governments are free to allocate as they wish.

Roads, including urban streets and sidewalks, are the largest single item of spending in this category. Before 2003, most road construction and maintenance was a central government responsibility. Local spending on roads, if any, was financed through conditional grants. In 2003, rural communal and regional roads were transferred to the local governments. Spending on the construction and maintenance of roads and urban streets is now financed from local discretionary revenues and maintenance of roads and urban streets is now financed from local discretionary revenues, supplemented by competitive grants.

Solid waste management, street cleaning and park maintenance also consume a significant proportion of local government revenues. Tirana, for example, spends about ten percent of its discretionary budget on solid waste management and street cleaning and another ten percent on parks<sup>10</sup>. The problem with the categories above is that the costs of these services generally isn't cover by the fees that citizens pay for the services.

Responsibility for water supply is still in a process of transition. The local government organic law defines water supply as an exclusive function of local government. Many communes, in fact, have long operated free – standing water supply systems in villages. Until late 2007, however, most systems serving larger urban areas were owned by the Ministry of Economy and supervised by the Ministry of Public Works' General

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<sup>9</sup> Unfortunately these institutions are very rare in Albania.

<sup>10</sup> Data on local spending on urban services is difficult to measure due to the way it is categorized. The Albanian treasury classifies functional expenditures on the basis of the IMF's Government Finance Statistics (GFS) methodology. Functions such as solid waste management, street cleaning and park maintenance fall under the GFS's housing and community services category but this category also includes the construction, rehabilitation and maintenance of the housing stock (whether publicly or privately owned), urban planning and street lighting. Water supply, but not sewerage or solid waste collection, is also included in the GFS's definition of housing and community development but is treated separately in the Albanian data.

Directorate for Water and Sanitation (GDWS)<sup>11</sup>. It provided operating subsidies and grants for capital investment directly to all of them. The Government is now in process of transferring the utilities to local governments (or consortia of local government in the case of companies serving more than one jurisdiction<sup>12</sup>). The Government also intends (and is realizing) to phase out operating subsidies to the companies till when these companies will be able to finance themselves. This function is very problematic and this is the reason that is still not yet concluded as an own function, but still remain a central government function. Some of the reason are: the problem of managing the company between one ore more entities (municipality and communes); the bad conditions of the water supply company; the debts that this company have with KESH (Albanian Power Corporation), and the situation were the company is situated<sup>13</sup>.

### **Administrative Functions**

Local governments also carry out variety of administrative functions. This category is intended to include only the functions of the chief executive and the legislative branches, including personnel management, financial administration, tax administration and the payment of debt service. In 2006, “general public services” consumed 37 percent of local government discretionary spending. This may be an overstatement. In Albania, smaller local governments are said to report a wide range of expenditure under this category, including their entire wage bills. This is another problem that smaller local governments (municipality/communes) are facing now, because their expenditures are much more bigger than their revenues. This means that these entities are not autonomous, but they depend entirely from central government.

### **Revenue Assignment**

Law 8652 provides that local governments are financed with revenues from locally derived taxes and fees, funds transferred from the central government, in part to achieve vertical and horizontal equalization, and funds derived from shared national taxes. The law also provides that local governments shall be “be authorized to borrow funds for public purposes in a manner that is consistent with the conditions established by law.” There has been considerable progress in the area of local taxes and fees, although there is still room for further reforms in this area. Existing policies governing the unconditional transfer provide for significant vertical and horizontal equalization. Conditional transfers to fund investments are not transparent or predictable and

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<sup>11</sup> Document of Word Bank, Albania, Local Finance, Policy Note, June 5, 2008

<sup>12</sup> Tirana is one of them, and this is one of the reason that the Municipality of Tirana refuse to take the supervision and the control of this service in cooperation with other communes.

<sup>13</sup> Mucollari O., Local decentralization and Regionalism, Thesis of Doctorate, 19 May 20009.

generate significant regional disparities. Finally we have the local borrowing law that authorize the local government to borrow<sup>14</sup>.

Local governments derive their revenues from variety of sources<sup>15</sup>. Roughly half of local government revenues come in the form of conditional grants. As noted above, this includes funding for social protection. While the local revenues can be allocated by local government as they wish and need. The central government can control only the implementation of law. Discretionary revenues increased dramatically between 2000 and 2006. This is partly due to growth in unconditional transfers but also due to changes in legislation, which have increased the taxing powers of local governments.

## Conclusion

The local government is an instrument very democratic for the realization of self government from the citizens. But, in order to have the so called “real self government”, is needed not only decentralization of competences but even decentralization of resources. In this process the Albanian legislator have done a good work till now, but still there is enough work to do. We need to keep in mind without fiscal decentralization there is no autonomy and no local institutions or local decisions. As we analyze during this article there are still some problems to re evaluate and to find the solution.

There is need to:

- Formalize by law the consultation between the national and local governments;
- Implement a fiscally sound framework for local borrowing;
- Expand and strengthen the process of competitive allocation of investment grants;
- Clarify the assignment of functions in health and education;
- Adopt and implement a clear Government policy in the water sector;
- Evaluate and consider better the property tax.

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<sup>15</sup> We mentioned some of them above.



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