

**“Analyzing factors influencing intergovernmental grants distribution in  
Western Balkans – the case of Albania and Macedonia”<sup>1</sup>**

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## Abstract

To the present time, fiscal decentralization represents a priority and challenge for most Western Balkan countries, which went through an intensive phase of reforming and decentralization in the early 2000'. In these countries local governments cannot fulfil their public and social functions and are still highly depended on the central government grant-aid funds. The level of funds being allocated to the local government units is based on intergovernmental schemes which risk being non-transparent and unfair, thus influencing negatively the equity and efficiency criteria of decentralization. Wide empirical evidences, in both developed and developing countries show that the distribution of grants across local governance units is influenced by politics and personal networking.

Similar to other Western Balkan Countries, decentralization is still a new reality in Albania and Macedonia. Despite the efforts for reforms, local governments remain financially dependent on the central government. Relevant studies show that both in Albania and Macedonia, where intergovernmental transfers' scheme is often characterized by the lack of transparency and corruption, transfers are seen from the politicians as an instrument to gain votes rather than a mechanism to improve equity and efficiency.

This study shows that the distribution of transfers to Local Government Units is influenced by political opportunistic behaviour. The earmarked grants are more likely to be subject to this opportunism – communes/municipalities that are lead by the same political party that make up the central government coalition, receive significantly more transfers compared to other communes/municipalities in both countries.

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## 1. Introduction and theoretical background

To the present time, fiscal decentralization represents priority and challenge for most Western Balkan countries, which went through an intensive phase of reforming and decentralization in the early 2000' (Dabla-Norris, 2006; Basta Fleiner et al, 2006). Despite the efforts for reforms, Western Balkan countries local governments still cannot properly fulfil their public and social functions and are still highly dependent on the central government funds.

Fiscal decentralization theories assert that the equity and efficiency criterion should be the basis for determining the intergovernmental transfers' effect on the regional disparities (Musgrave, 1983; Kessler and Lessmann, 2009; Dafflon, 2007) disregarding political inclinations and focusing instead on the economic rationale for the use of transfers (Sato, 2007). In many countries the level of funds allocated to the Local Government Units (LGU) is based on intergovernmental schemes which have not been in line with equity and efficiency criteria of decentralisation (UNDP, 2005; Dafflon, 2006). Empirical evidence, in both developed and developing countries show that the distribution of grants to LGUs is often influenced by political affiliation (Khemani, 2008; Sato, 2007) and personal networking (Reed, 2001).

On the other hand, empirical scholars of political economy (Inman and Rubinfeld, 1996; Sato, 2007) show that transfers are allocated by the central government following "opportunistic" pattern. There are two different ways of behaviour if political influence persists: (i) a risk adverse central government tends to deliver increased funding to communes and municipalities with "core supporters" such as the case of Argentina (Porto and Sanguinetti, 2001) and India (Cox and McCubbins, 1986; Khemani, 2004); and, (ii) a less risk adverse government will distribute more funding to regions where there are more "swing" voters with the purpose of obtaining additional electorate support in such regions (Dixit and Londregan, 1998).

There have been a number of reports expressing doubts over the fairness of funding distribution schemes in both Albania and Macedonia (Shehu, 2006; Schläppi et al, 2008; CESPI, 2011; Ferulio et al, 2008). Attempts to specify measurement of the allocation criteria have been sporadic and not transparent to the public (AFD, 2004), leaving room for opportunistic behaviour (e.g. related to elections, political affiliations to local governance etc). World Bank reports (2006 and 2007) have observed that the public payment systems in several countries in the Western Balkans have been performing far from European principles and good practice guides. Case (2001) finds that economic aid distributed to Albanian poor households from the central government are higher to core support communes. Another report finds that for influencing political decision-making in their favour, mayors and heads of communes still apply direct and personal links to central power holders (CESPI, 2011), which is more likely to take place if they belong to the same political network/coalition as that of the central government. Whereas Coplan (2011) finds a statistical influence of the political affiliation factor is the distribution of conditional grants in Albania.

Similar situation is reported also for Macedonia. There have been complains by mayors and municipality council members in that party interests heavily influence intergovernmental transfer schemes (Yusufi, 2006, Rockel, 2008). In addition to the political affiliation, another factor that could affect central government transfers to LGUs is ethnicity; however this aspect is not a subject of analysis of this paper.

Despite these concerns and claims, there has been limited research on Albania or Macedonia to empirically show whether political affiliation of local government or/and personal power of local government leaders influence biased distribution of funds, or if the bureaucracy allocates those funds in an impersonal, un-political and mechanistic manner. This study aims to analyze the factors impacting funds distribution from central to local governmental units. with special focus on political influence. The purpose is to investigate whether political affiliation of local government or/and personal power of local government leaders influence biased distribution of funds, based on descriptive statistical analysis of the intergovernmental data.

## **2. Institutional framework and historical background of decentralization in Albania and Macedonia**

### **2.1 Country profile**

#### ***Albania***

Republic of Albania has been a centralized economy during communist system which was established after WWII and lasted till early 1990'. Before the 1990's, Albanian Local Government, legally considered as "local bodies of government" rather than "local government bodies", were in charge of implementing the detailed economic planning within the framework of a highly centralized decision making system. The first democratic elections in the country, which marked the beginning of a multi-party democracy, took place in 1992. During the first years of the transition, little attention was paid to decentralization. The focus of the government<sup>2</sup> was on building the key institutions and reforming the economy.

#### ***Macedonia***

Republic of Macedonia, known as FYROM too, is a country that gained its independence in 1991 after the collapse of the former Yugoslav federation. Therefore, Macedonia, as the poorest economy of the federation, was separated from an economy centrally planned by the federation. Since its independence, in overall, the country has progressed significantly from the economic

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<sup>2</sup> Strategy for Decentralization, 1999.

and political aspect. Currently, Macedonia is known as a stable country. On this journey, it managed to become an open economy, well integrated into international trade, with a sound financial sector and prudent macroeconomic policies.

Macedonia is a parliamentary democracy. It has a unicameral 120 chamber elected every four years with an executive government composed of a coalition of parties. Since August 2004, LGUs<sup>3</sup> structure changed and it allowed for changing the local boundaries and giving more local authority to areas dominated by Albanians. Currently, the local government structure is exercised through 75 municipalities plus 10 other municipalities under the umbrella of City of Skopje municipality which has a distinct status.

## 2.2 Historical background of decentralization

### *Albania*

Albania has embraced for the first time the concept of decentralization in the late nineties following two fundamental events: the 1998 constitution and the European Charter of Local Self-Government. The government drafted the first National Strategy for Decentralization<sup>4</sup>, adopted by the Council of Ministers in 2000, whose goal was to implement the provisions of the Constitution of Albania regarding decentralization, consistent with the principles of the Charter of Local Self-Government of the Council of Europe.

This ambitious strategy was followed by an intensive legal reform. During 2000-2002 several laws were passed by the parliament in order to build the legal framework of decentralization. In fact 2002 was considered as “year zero” for decentralization in Albania (Levitas, 2011). Although the path was new and hard, the reforms undertaken during this period were considered successful taking into consideration the centralized legacy of the country and the transition periods it passed through.

In 2005 a political rotation took place: the coalition lead by the Democratic Party took office after 8 year of socialist party led government. This political change marked a slowdown of the reforms (Levitas, 2011). Since then, the decentralization reforms focused on the (ongoing) process of property transfer from central to local government, local borrowing, budgetary planning system and internal control and audit. Despite the decentralization reforms over the last 15 years, there is still a lot to be done to achieve fiscal autonomy and independence of the local units.

### *Macedonia*

Local government is prescribed as the fundamental part and value within the Constitution of Republic of Macedonia in 1991 (by article 8 and articles 114-117)<sup>5</sup>. The article 114 of the

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<sup>3</sup> Another name used for municipalities is local government units or LGUs.

<sup>4</sup> National Strategy for Decentralization, 1999.

<sup>5</sup> Official Gazette of Republic of Macedonia, Constitution Nr.52/1991 and Nr.31/98.

Constitution defines the municipalities as Local Government Units (LGU) and guarantees the right of citizens to establish forms of local self government. In 1996, the Government in Macedonia adopted the Law on Territorial Organization<sup>6</sup>. Later, in November 1999, the Government of Macedonia adopted a new strategy and started to reform the system of local self-government. The reforms were lead by the Ministry of Local Self Government as the eminent authority responsible for coordination of the activities defined by the new policy. Thus, these reform processes were disrupted in 2001 due to internal conflict in the country.

In 2001, following the amendments to the Constitution<sup>7</sup> and the Ohrid Framework Agreement (OFA) signed in August 2001, the new Law on Local Self-Government<sup>8</sup> was adopted, and the decentralization process officially started by adoption of the Law on Regional Development in July 2005<sup>9</sup> and the Law on Financing Local Self-Government Units.

The Law on Financing Local Self-Government Units emphasized that the transfer of financial resources from the Budget of Republic of Macedonia to the Budgets of the Municipalities will be transferred in three subsequent phases<sup>10</sup>. In advance, LGU's obtained the right to reconstruct and consolidate their administrations in advance within a so called *Zero Phase*. This phase facilitated municipalities to determine and collect their own revenues, involved improvement on procedures for budget planning and its implementation, strengthened cost control mechanisms and assisted to development of a reporting system to the central government budget.

In *the first phase*, municipalities gained the right to administer revenues coming from their own sources and from the central government grants (Levitas, 2009). In this phase, a transparent criteria and methodology was prescribed for the distribution of capital, earmarked and block grants, funds received for delegated competencies and Value Added Tax (VAT)<sup>11</sup>. Furthermore, earmarked grants were prescribed as the main source of local government units in order to finance the cost of maintaining primary and secondary schools, cultural institutions, child care, elderly care and fire-fighters (Nikolov, 2004).

The transition into *the second phase*<sup>12</sup> of fiscal decentralization is based on the capacity of each municipality to demonstrate good financial results in the first phase (Novovic, 2011). Furthermore, earmarked grants were transformed into block grants which are distributed on

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<sup>6</sup> Instead of 34 municipalities; the territory of the country was administratively divided into 123 municipalities and the City of Skopje as a separate local government unit.

<sup>7</sup> Official Gazette of Republic of Macedonia, Amendment to the Constitution of Republic of Macedonia, Nr.91/2001.

<sup>8</sup> Official Gazette of Republic of Macedonia, on Local Self-Government Nr.5/2002.

<sup>9</sup> Official Gazette of Macedonia Law on Regional Development Nr. 63/2005.

<sup>10</sup> The Law on Financing Local Self-Government Units, articles 44,45 and 46.

<sup>11</sup> The allocation formula is defined within the Ministry of Finance of Macedonia referring to the budget of each next fiscal year; and is intended to finance specific activities defined by law (article 10 of the Law on Financing Local Self-Government).

<sup>12</sup> By 2008 51 of LGU's has entered to second phase.

sectoral level; with a specific formula calculated on annual basis and intend to cover the operation and maintenance cost of LGU's<sup>13</sup>.

## 2.2 Local government system

### *Albania*

C commune, municipalities and regions, which are organized in two tiers/levels. Communes and municipalities are the basic units of local government, while the regions represent the second level.<sup>14</sup> The structure of government in Albania places most emphasis on municipalities and communes (Schroeder, 2004).

- *First Level:* Municipalities are defined as local government units usually located in the urban area, while communes are generally situated in rural area. There are presently 65 municipalities, which usually correspond to urban areas, and 308 communes which correspond to predominantly rural areas. Communes and municipalities have a representative and an executive organ directly elected every 4 year period. The representative organ of communes and municipalities is the Council, while the executive organ is the Chairman of the commune or the Mayor of municipalities.

Municipalities and communes exercise three types of *functions* in compliance with the regional and national policies: exclusive, shared and delegated functions. They have full administrative, service and investment powers and responsibilities on the *exclusive functions* regarding infrastructure and public services, social cultural and recreational functions, local economic development and civil security.

The other category of functions, such as pre-university education, public health, civil protection etc, shared with central government, which provide benefits to the whole nation, even if the principal beneficiaries are the residents are considered as *shared functions*. On the other hand, central government may authorize or impose the commune/ municipality to perform functions as its agent: *delegated functions*. Actually<sup>15</sup> the mandatory delegated functions are: the civil registry office<sup>16</sup>, the land protection and management section<sup>17</sup> and business registration centres<sup>18</sup>.

Regarding the *revenues*, LGU can impose local taxes and tariffs. By law<sup>19</sup> communes and municipalities have limited discretion regarding the type or rate of local taxes<sup>20</sup>, while they

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<sup>13</sup> The allocation formula is defined within the Ministry of Finance of Macedonia referring to the budget of each next fiscal year (article 12 of the Law on Financing Local Self-Government).

<sup>14</sup> Art 108 of Albanian Constitution.

<sup>15</sup> Guidance Nr.7/1, dt 29.2.2012 "On the preparation of the local budget".

<sup>16</sup> Regulated by Law nr 10 129, dt 11.5.2009 "On the civil registry office".

<sup>17</sup> Regulated by Law nr.8752, dt 26.3.2001 "On the creation and functioning of land protection and management section.

<sup>18</sup> Regulated by Law nr 9723, dt 3.5.2007 "On the national business registration centre".

<sup>19</sup> Law Nr 9632, dt 30.10.2006 "On local tax system".



have full autonomy regarding the type, amount and administration of local fees such as cleaning fee, fee on the use of public space/area, billboard fee, street lighting fee etc.

In addition to local revenues, communes and municipalities receive funds from national sources in the form of grants, which may be unconditional or conditional transfers and which exceeds self generated income for most communes and municipalities.

- *Second level:* The 1998 constitution established a new tier of local government: the region, which represents the second level of local government. The region is an entity composed by several communes and municipalities. There are 12 regions in the country (Table 1).

The representative organ of the region, the Regional Council, is composed of representatives of communal and municipal Councils. The executive authority of the region is vested by the Chairman and Board of the Regional Council, elected by the members of the council. Albania's Regional Councils are weak, because the absence of a specific law on regions. They are governed by indirect elected councillors and have no direct revenue raising authority (Schroeder, 2004; EU, 2006).

Regional government represented by the regional councils has the authority to use various sources of *revenues*, such as unconditional transfers, conditional transfers and regional taxes as defined by law. Part of the regional revenues derives from communes and municipalities under its jurisdiction, defined as form of "quotes of membership".

In addition to the organs of LGU's the Council of Ministers appoints a *prefect* in every region as its representative<sup>21</sup>.

Table 1: LGUs in Albania

Number	Regions	Municipalities	Communes	Population
1	Berat	5	20	141,994
2	Dibër	4	31	137,047
3	Durrës	6	10	262,785
4	Elbasan	7	43	295,897
5	Fier	6	36	310,331
6	Gjirokastrë	6	26	72,176
7	Korçë	6	31	220,357
8	Kukës	3	24	85,292
9	Lezhë	5	16	134,027
10	Shkodër	5	28	215,347
11	Tiranë	5	24	749,365
12	Vlorë	7	19	175,640
	Total	65	308	2,800,138

Source: INSTAT, 2011

<sup>20</sup> For all other taxes, communes/municipalities are given by law the tax base and the boundaries of the tax rate in discretion of the LGU council.

<sup>21</sup> Art 14 of Albanian Constitution and Law nr 8927, dt 25.07.2002 "On the prefect"

## *Macedonia*

Law on Local Self-Government is complemented by the Law on Territorial Organization of LGU's<sup>22</sup>; the Law on Financing Local Self-Government Units<sup>23</sup>, the Law on City of Skopje determines the phases on financial delegation of power and the dynamics on providing financial resources to municipalities. Hence, the law on Territorial Organization combined the 123 municipalities into the present 84 municipalities; in addition City of Skopje was separated as a city-wide local government (Feruglio, et al., 2008). One positive aspect of these processes is that Government has put in a place comprehensive key ministries and associations in order to design and operate according to the European charter on Local Self-Government. This overall process was chaired by the Ministry of Local-Self Government and envisioned by the secretary general of the Association of the units of Local Self- Government (ZELS), State Secretaries of all ministries, and Head of sector for European Union Integration and the Commission for the Monitoring and Assessment of LGU's<sup>24</sup>. Furthermore, in line with the Law on Financing Local Self-Government Unit, Monitoring and Assessment Commission supervised exceptionally significant and complex activities of the LGU's (OSCE, 2007).

Table 2: Type and Number of Local Governments

Type of local governments	Number of Local Governments (2004)	Number of local governments (1991–2002)
City-municipalities	33	116
Village-municipalities	41	0
City of Skopje municipalities	10	7
City of Skopje	1	1
Total	85	124

**Source:**Law on Territorial Organization of the Local Self-government in the Republic of Macedonia of August 11, 2004.**Note:**According to the law a city, has more than 3,000 residents (city-municipality); a village-municipality has less than 3,000 residents.

As a result of these reforms, Government of Macedonia has realized and introduced significant legislative procedures in order to manage the process of decentralization. Pursuant to Constitution, and to the Law on Local Self-Government of Macedonia, LGU's gained significant responsibilities for the following areas: urban and rural planning, managing the operations of LGU's, effective mechanisms to cooperate between municipalities and government itself; protection of local self-government units, fostering economic development of the local communities, development of education and culture; support sports and recreation; provide

<sup>22</sup> Official Gazette of Republic of Macedonia, Law on Territorial Organization of LGU's, Nr.55/2004.

<sup>23</sup> Official Gazette of Republic of Macedonia, Law on Financing Local Self-Government Units Nr.61/2004, 96/2004 and 22/2007.

<sup>24</sup>The Commission was established in January 2007. Its role is to monitor and assess the extent to which a municipality has fulfilled the conditions of decentralization.

social protection, health protection, fire fighting services; responsibilities for financial management and tax collection.

Other line ministries have played a more specific role related to the nature of the decentralized responsibility. Ministry of Finance role has been more significant due to the importance of fiscal decentralization as the major challenge for decentralization process itself. Even though, one expects that Ministry of Finance plays the most active role among other ministries; municipalities give a different scenario in the 2011 survey on Decentralization carried by OSCE. On a scale of 1-Bad, 2-Good and 3-Excellent, municipalities have rated their cooperation with MLSG as the lowest (2.1), followed by Ministry of Finance (MoF) with 2.3, and the highest for ZELS (2.6) (OSCE, 2012)

There is no direct feedback mechanism where municipalities contribute to the decentralization process itself. The only mechanism of such feedback is ZELS or *Association of the units of local self-government of the Republic of Macedonia* with members of all of the country's municipalities. Often, ZELS is seen as the main voice of municipalities. ZELS is established about 40 decades ago, on April 26, 1972. During the accelerated phase of decentralization developments (2005-currently), ZELS has contributed actively for the development of the decentralization process and building local democracy. In addition to the bridging role of state and local government dialogue, ZELS has contributed tremendously in establishing inter-municipality cooperation and cooperation with local authorities at international level.

International bodies have played a very important role especially by monitoring, evaluating and training the local officers. OSCE Mission to Skopje has contributed to the decentralization process by monitoring the OFA implementation. Within this mandate, in 2006, it undertook the initiative of monitoring the decentralization process itself. The output of this initiative was in the form of yearly reports that offered the stakeholders more insights into the benefits and challenges of the decentralization process. These reports are concluded in a very valuable report of Decentralization Assessment Report 2006-2011. The USAID Macedonia has played a significant role in the sector of Democracy and Local Governance. It has financed long-term projects that have elevated the financial management capacity and accountability of municipalities. UNDP in collaboration with ZELS and MLSG in collaboration (financer) with Norwegian government signed the Inter-Municipal Cooperation Grant Scheme Agreements in November 2009.

Normatively, the country has to keep decentralization in the top of its political agenda, due to the low level of fiscal decentralization. In addition, decentralization is seen hand in hand with the Ohrid Framework Agreement (OFA), because, OFA is considered as one of the agreements that ended the 2001 conflict by giving the right (among other rights) to manage to all of the local government units including those of Albanians and other ethnic groups in the country. Thus, transferring grants from central level of government to LGU's, where some municipalities are ethnically divided, inevitably raises political questions. Currently, the MLSG is working on implementing the *Programme for Implementation of the Decentralization Process and Local*

*Self-Government Development in the Republic of Macedonia 2011-2014*(MLSG, 2011)and the corresponding action plans are adopted (EC, 2012).

## 2.3 Intergovernmental transfers to local governments

### *Albania*

The system of transfers local government receives from central government was implemented in 2002 by the organic law. The scheme of the transfers has been subject to constant change over the years.

The size of the total pool of intergovernmental transfers is still nowadays not tied to any central government revenue source or index, it is rather determined every year by the state budget (Levitas, 2011; Schroeder, 2007; Shehu, 2006).

LGUs receive funds from the central government in the form of conditional and unconditional grants.

#### *Conditional grants (earmarked grants)*

According to the organic law, conditional transfers are state funds allocated to LGUs for a specific purpose, to achieve national objectives and to perform the functions central government delegate to local government and share with it. LGUs do not have discretion in using conditional transfer, as it can be allocated for the purpose, in the amount and according to the rules set by the central government<sup>25</sup>.

During the years the conditional transfers system has changed considerably in 2006 and 2010.

In 2006<sup>26</sup> a new type of condition grant for investment was introduced: the competitive grant. This type of grant was further reorganized, in 2010, under the umbrella of the Regional Development Fund.

Currently LGUs receive conditional transfers in the form of:

- 1- Conditional transfers for delegated/shared functions
- 2- Competitive grants by the Regional Development Fund.

*Conditional (earmarked) transfers for delegated/shared functions* consist on transfers, for either operational or capital expenditures, allocated to LGUs by the line ministries for the delegated and the shared functions. Conditional grants are part of the structural budgets of the line ministries, which has the discretion on allocating the grants across LGU according to few guidelines criteria given by law.

*Regional Development Fund*, established in 2009<sup>27</sup>, is financed by the state budget as an allocation mechanism to support public investments at regional and local levels through a

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<sup>25</sup> Law nr 8652, 2002, "On the organization and functioning of local government".

<sup>26</sup> Law nr 9464, 2005, "On the state budget of year 2006".

competitive grant system. It constitutes a key instrument for regional development<sup>28</sup>. The Fund is composed by competitive investments grants in 8 sectors such as: local infrastructure, education, public health, agro food market buildings, water supply and sanitation, irrigation and drainage and forestation. To be eligible for this fund LGUs compete based on different criteria made public in the budget law. The criteria, specified by law, are as follows:

- The degree of compliance with the national and regional development strategies
- The degree of impact on reducing poverty and improving access to basic services
- Number of beneficiaries directly and / or indirectly by the project
- Level of collecting local taxes and fees,
- Technical quality of projects proposed
- The project must benefit more than one local unit

A committee, headed by the Prime Minister and composed by the Line Ministers and Representatives of Local Associations, is responsible for selecting the projects proposed by LGUs on a competitive base.

#### *Unconditional Grants*

The unconditional transfers are defined in the organic law<sup>29</sup> as state budget money given to the LGUs for performing exclusive and shared functions. The main purpose of unconditional grants is the equalization of revenues across LGUs. LGU have complete independence in administrating unconditional transfers. These transfers are part of the autonomous local budget and may be used either for expenditures or capital investments.

Unconditional grants are distributed across communes, municipalities and regions according to a formula, made public with the annual state budget law. The grant is divided in two sub-pools: the transfers for the communes/municipalities and the transfer for the regions. In the first years of the formula implementation there was also a third sub-pool: the compensation fund, which was abolished in 2006. The exact proportion between the sub-pools has changed during the years, but always the mayor part is devoted to communes and municipalities (approximately 90%) (see Table 3).

Table 3: Evolution of the coefficient of the formula for unconditional grants

<b>Type of grants</b>		<b>2002</b>	<b>2013</b>	
<b>To Regions (9%)</b>	<b>General Grant</b>	Fix amount	25%	10%
		Population	15%	28%
		Geographic index	30%	30%
		Road index	30%	32%
	<b>Compensation Fund II</b>	12%	-	

<sup>27</sup> Law nr 10190, 2009, “On the state budget of year 2010”.

<sup>28</sup> UNDP report, 2010, Assessment of Design and performance, recommendations for improvements and support in reforming the Regional Development Fund.

<sup>29</sup> Law nr.8652 “On the organization and functioning of local government”, Art 19/2.

To Municipalities/Communes (91%)	General Grant	Fix amount	4%	-
		Population	63%	70%
		Land area of commune	4%	15%
		Urban areas (without Tirana)	21%	15%
		Tirana	10%	-
	Fiscal Equalization	yes	yes	
	Compensation Fund III	5%	0%	
Compensation fund I		4%	-	

Administrative data are gathered since 2000, where the legal base for the functioning of the local government units was created and when conditional and unconditional fund started to be distributed by the central government. A quick view of the aggregated data shows that the level of total revenues has increased fourfold in this decade. However the same growth has not been observed if the trend is expressed in terms of percentage of GDP in which case LGUs revenues has been doubled achieving 3,1% of GDP in 2011. (Table 4) The data show an increase of the local total revenues as a % of the state budget especially from year 2009. This increase may be subject to the introduction of the new transfer: competitive grant. This trend is noticed even if we calculate the % intergovernmental transfers have over the total state budget.

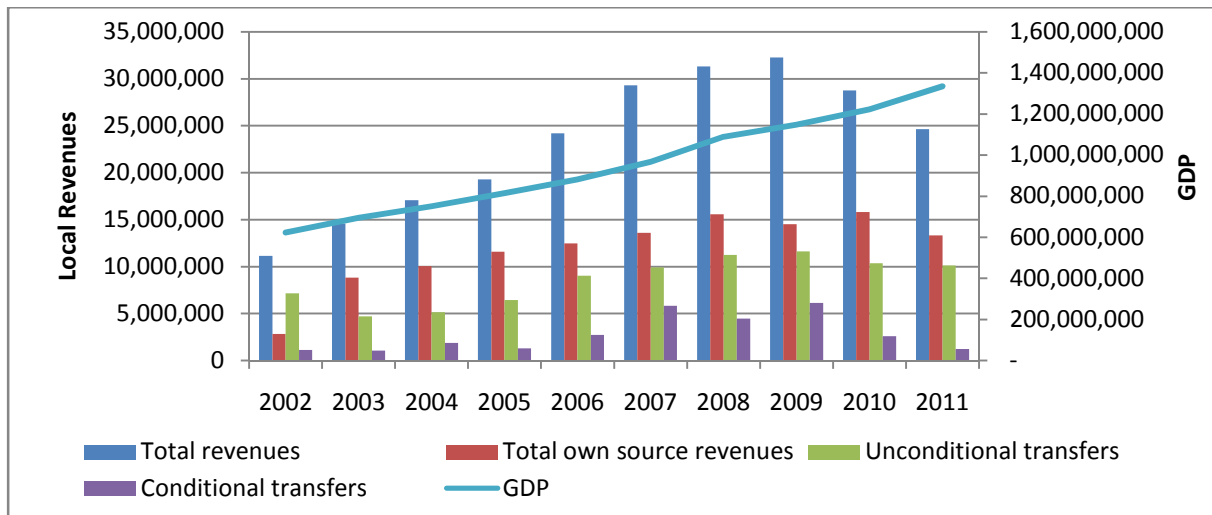
Table 4: The evolution of Local Government Finances 2002-2011

Year	LGU revenues/ GDP	LGU own revenues/ total state revenues	Intergovernmental transfers/ total state expenditures
2002	1.8%	1.8%	4.3%
2003	2.1%	5.3%	2.9%
2004	2.3%	5.5%	3.2%
2005	2.4%	5.7%	3.3%
2006	2.7%	5.4%	4.5%
2007	3.0%	5.4%	5.5%
2008	2.9%	5.3%	4.5%
2009	2.8%	4.8%	4.7%
2010	2.4%	4.9%	3.6%
2011	1.8%	3.7%	2.8%

Source: Albanian Ministry of Finance, Instat

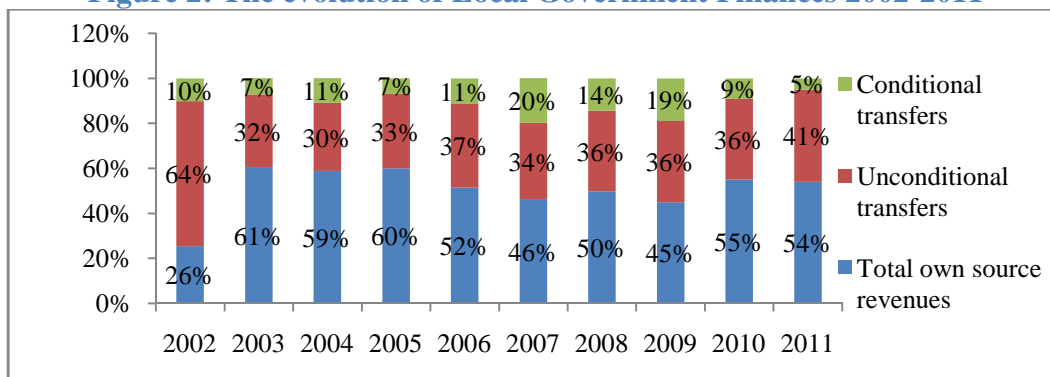
We can see the trends of the local finances in the figure below. Since 2008 all type of local revenues are decreasing with conditional transfers shrinking the most. One explanation is the financial crisis, although the trend of GDP in this period remains upward.

**Figure 1: Local finances and GDP trends**



During the period 2002-2011 the composition of LGU revenues has been changing due to the legal changes emerging from the Organic Law and the transfer of the responsibilities deriving from the amendment of this Law. Since the introduction of the Regional Development Funds scheme, the conditional transfers have experienced a shrink going from 19% to 5% of the total local revenues. Local governments own source revenues experienced a small decrease trend since 2003. However from 2003 to 2011 no strong changes can be noticed in the composition of local governments. This is a ring bell which announces that still a lot is to be done toward decentralization and local units' autonomy. (Figure 1)

**Figure 2: The evolution of Local Government Finances 2002-2011**



Source: Albanian Ministry of Finance, data provided upon request

## *Macedonia*

Before the adoption of the reform-oriented laws on LGU financing, there were numerous problems that hindered the proper functioning of the intergovernmental finance system in Macedonia (Yusufi, 2006). There was no possibility for LGU's to gain their own *fiscal autonomy* in order to be funded by their own revenues and local taxes defined by themselves. Moreover, according to Yusufi (2006) there was no framework legislation governing municipal finances in the country. Furthermore, a survey conducted by the OECD member states in 1983 supports the argument that LGU's should be granted with additional responsibilities concerning developing fiscal capacities and should gain sufficient fiscal sovereignty for raising their revenues and for spending. In addition to objectivity, transparency, stability the newly established system of LGU financing introduced a system which also provides autonomy and significant rights to municipalities in order to maintain their own policies within their competence field (OSCE, 2007).

Alongside of these measures, the articles 8 - 13 of the Law on Financing of Local Self Government (2004)<sup>30</sup> envisages the following type of transfers from central government to LGU's: a) earmarked grants, b) block grants, c) capital grants, d) incomes from Value Added Tax (VAT) and e) delegated competence grant.

- *Earmarked grants* - are used for funding actual activity, and supplied by the competent ministries and funds for appropriate project or programme<sup>31</sup>. The criteria for the distribution of these grants are established annually by the responsible line ministries through an ordinance (or by-law) adopted by the Government of Macedonia each fiscal year. Thus, the allocation formula of the earmarked grants is not defined.
- *Block grants* - are used for funding actual competences defined by the Law Financing of Local Self Government Units within the article 22 points 5, 7, 8 and 9. According the Law, line ministries and the funds adjusts the methodology of the allocation of the block grants which is based on a *formula* by using appropriate indicators of the requirements for each sector<sup>32</sup>. Hence, the Government of the Republic of Macedonia will pass Statutory Regulations for the methodology of determining and the allocation of the block grants in accordance with the Ministry of Finance. Furthermore, block grants are considered as substitution to earmarked grants in the second phase of decentralization process; and are considered as *de facto* instruments to be used by governments to equalize the financial distribution to LGU's.
- *Capital grants* - are used for funding (LGU) investment projects and are provided on the basis established and approved by the Government of Macedonia annually for selected

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<sup>30</sup> Official Gazette of Republic of Macedonia ,The Law on Financing Local Self-Government Units, Nr.61/2004

<sup>31</sup>Those grants are established for fire-fighting, education, social care and for culture.

<sup>32</sup>Block grants are foreseen to finance LGU activities within the sector of education, social care, culture, health care and fire-fighting.



municipalities<sup>33</sup>. Moreover, the Public Roads Fund, the Ministry of Transport and Communication and the Ministry of Local Self-Government<sup>34</sup> and other line ministries disburse capital grants for municipal investment projects. Thus, these grants are distributed mostly on political decision.

- *Incomes from Value Added Tax (VAT)* - is allocated to municipalities as an unconditional grant used for general purposes. The amount transferred to municipalities is calculated as 3% of the collected VAT realized in the previous fiscal year<sup>35</sup>. Thus, Commission for the Monitoring and Assessment of LGU's established a specific methodology and criteria for the distribution of VAT. According this formula VAT grant allocation is calculated as 65% of population, 27% the surface area of the LGU's as km<sup>2</sup>, 8% the number of settlements within the LGU and fixed amount of 3 million MKD<sup>36</sup> to each LGU. Moreover, this grant is set as *equalization tool* and aims to narrow the revenue disparities between rural and urban LGU's.
- *Delegated competence grant*- is used for financing the competence delegated by an organ of the State Administration to the Mayor of LGU's. The amount is determined by the respective organ of the State Administration in the Budget of the Republic of Macedonia and gives significant competencies to the Mayor of LGU's to execute it.

Although, Macedonia has made a great progress as far as legislation is concerned; the decentralization remains a priority, especially from the adoption point of view of fiscal decentralization legislation. The decentralization process is still in the midst of the process, because all of the municipalities, except one, are currently in the second phase of decentralization. Even though, there are more delegated management responsibilities to LGU's; establishing strong municipal infrastructure remains so, a paramount challenge to an increasing fiscal decentralization.

### **3. Preliminary empirical findings of political affiliation influence on intergovernmental transfers**

#### ***Albania***

The hypothesis of the study is that the distribution of conditional and unconditional transfers in Albania is made according the political affiliation and objectives that the incumbent may have in communes/municipalities, based mainly on the voting behaviours. In order to observe for these trends there has been carried an evaluation of the value of the transfers before and after the election year if more money is allocated in per capita terms to the politically affiliated LGU

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<sup>33</sup> Official Gazette of Republic of Macedonia ,The Law on Financing Local Self-Government Units, Nr.61/2004,Article 11.

<sup>34</sup>Particularly Bureau for Development of Underdeveloped Regions in Macedonia.

<sup>35</sup> Official Gazette of Republic of Macedonia ,The Law on Financing Local Self-Government Units, Nr.61/2004,, Article 8.

<sup>36</sup> MKD is Macedonian Denar (national currency).

toward the party in power. During the last decade several elections processes took place (see Table 5).

Table 5: Parliamentary and local elections

Years	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Parliamentary elections	21-Jun01				Oct05				28-Jun09		
Local elections			12-Oct03				18-Feb07				8-May11

In Albania there are three parliamentary elections taking place in this period, namely June 24, 2001, July 3, 2005 and June 28, 2009 as well as the local elections of 2003, 2007 and 2011. In order to observe for a possible influence of elections in the transfers in per capita basis there has been observed in no-elections years there has been selected the years between local and central elections (2004, 2006, 2008 and 2010) which take place every four years.

Table 6: Unconditional Transfer per capita of communes/municipalities according to political affiliation of mayors

Year	Governing	Non Governing	P value (t-stat)
2004	1.95	1.95	0.944
2006	3.55	3.27	0.106
2008	3.77	3.63	0.456
2010	3.55	3.46	0.657

Source: Authors calculations based on data provided upon request by the Albanian Ministry of Finance

We did not find statistically significant changes between governing LGUs (those voting for the party governing the central government) and non governing LGUs (those voting for the opposition). The slight advantage in governing LGUs on per capita transfers unconditional evidenced in the years 2004, 2006 and 2008 and 2010 have proved to be statistically not significant (see Table 6).

On regards to the conditional transfers seems that communes which are run by the party in power are more apt to benefit compared with the communes which vote mainly against it. The difference of the conditional transfers in per capita between the “core” supporter communes versus “opposite” voters is huge in the first three rounds of years selected. A rapid increase in the value of per capita of this type of transfers in the year 2010 has been accompanied with a converging trend. However the p-value assessed using the t-stat show statistical significances proving good hints for further scrutiny toward a possible state clientelistic behaviour during both local and parliamentary elections (see Table 7).

Table 7: Conditional Transfer per capita of communes/municipalities according to political affiliation of mayors

<b>Year</b>	<b>Governing</b>	<b>Non Governing</b>	<b>P value (t-stat)</b>
2004	0.58	0.28	3.1E-05
2006	1.05	0.33	3.6E-11
2008	1.83	1.17	1.3E-03
2010	6.06	5.04	3.3E-03

Source: Authors calculations based on data provided upon request by the Albanian Ministry of Finance

### ***Macedonia***

The hypothesis of the study aims to identify the distribution of earmarked, block and capital transfers in Macedonia from central government to local government units. This study addresses the specificity and importance of the voting behavior of the “core supporters” particularly on local election periods in Macedonia. Especially this becomes an important political issue when ethnically divided municipalities (non-Macedonian) are analyzed. In order to observe these trends and objectives, there have been carried an evaluation of the value of the transfers before and after the election years in Macedonia. During the last decade several elections processes took place; there is one presidential election which took place in 2009, four parliamentary elections which took place in 2002, 2006, 2008 and 2011 and three local elections which took place in 2005, 2009 and lately in 2013. As a result, Macedonian parliament is leaded (governed) by one coalition political power (VMRO-DPMNE and DUI) since the parliamentary elections in 2006 (Table 8). In our study, local elections in Macedonia are taken as a precursor for the analysis. Especially, local elections in 2009 have made great and significant changes on LGU`s; since 2009 is the critical year where political power in majority of the municipalities (LGU`s) has changed. In the case of Macedonia it is observed that both parliamentary and local elections have influenced the transfers to LGU`s on per capita basis.

Table 8: Parliamentary and local elections

<b>Years</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2013</b>
Parliamentary elections	YES				YES		YES			YES	
Local elections				YES				YES			YES

The main purposes of this study is to find out: a) if there are significant changes between governing LGUs (those voting for the party governing the central government) and non governing LGUs (those voting for the opposition); b) if there are important changes between LGU`s whose major population is Macedonian and LGU`s whose major population is different from Macedonian. On the basis of the obtained data the transfers of earmarked, block and capital

grants to LGU`s are analyzed. The analysis covers the periods 2007-2012 with specific focus on the LGU`s political affiliation between 2005-2009 and between the period 2009-2012.

As regards earmarked transfers, in Macedonia there are observed significant differences between LGUs whose mayor is from the same party or coalition which is running the central government and LGUs whose mayor is affiliated to opposition. LGUs whose mayor is from the same party or coalition which is running the central government, tend to get up to two times as much earmarked transfers per capita compared to other LGUs - the gap is considerable through the years (Table 9). However, it is also observed that during decentralization process earmarked transfers are used as a political tool; where the allocation criteria have not been transparent to public.

Table 9: Earmarked transfers per capita according to political affiliation of mayor

<b>Year</b>	<b>Governing</b>	<b>Non Governing</b>
2007	554	866
2008	441	805
2009	1,188	469
2010	649	388
2011	525	359
2012	357	251

Source: Ministry of Finance of Macedonia, annual budget data in the period 2007-2012

On regards to the earmarked transfers distributed to the LGU`s whose major population is Macedonian and to the LGU`s whose major population is different from Macedonian<sup>37</sup>; it is observed significant changes in the amount of distributed earmark grants (Table 10). Thus, it could be concluded that these grants could not be considered as an equalization tool because jurisdictions remains weak and perhaps discriminatory.

Table 10: Earmarked transfers per capita according to ethnic affiliation of mayor

<b>Year</b>	<b>Macedonian majority</b>	<b>Albanian majority</b>
2007	801	473
2008	758	388
2009	1094	403
2010	639	303

<sup>37</sup> Municipalities different form Macedonian ethnicity between the period 2009-2012; **Albanian municipalities:** Arachinovo, Brvenica, Vrapchishte, Gostivar, Zhelino, Zajas, Lipkovo, Oslomej, Struga, Stunichani, Tetovo, Tearce, Plasnica, Saraj, Chair ; and Centar Zhupa (Turkish); Shuto Orizari (Roma).

2011	504	276
2012	338	156

Source: Ministry of Finance of Macedonia, annual budget data in the period 2007-2012

On contrary, in the case of block transfers per capita, differences between LGUs whose mayor is from the same party or coalition which is running the central government and LGUs whose mayor is affiliated to opposition are not considerable and consistent over time (Table 11). It is also remarkable to underline that these inconsistency occurs since municipalities parallel were receiving earmarked and block transfers from the central government<sup>38</sup>.

Table 11: Block transfers per capita according to political affiliation of mayor

<b>Year</b>	<b>Governing</b>	<b>Non Governing</b>
2007	1047	1172
2008	4600	4695
2009	5275	6513
2010	6211	6939
2011	6983	6850
2012	7024	6798

Source: Ministry of Finance of Macedonia, annual budget data in the period 2007-2012

On regards to the block transfers distributed to the LGU`s whose major population is Macedonian and to the LGU`s whose major population is different from Macedonian<sup>39</sup>; it is not observed any significant changes. Hence, it is important to emphasize that block grants are distributed on formula basis which is transparent to public. In this regard almost all municipalities are treated on equal basis (Table 12).

Table 12: Block transfers per capita according to ethnic affiliation of mayor

<b>Year</b>	<b>Macedonian majority</b>	<b>Albanian majority</b>
2007	1081	1102
2008	4632	4753
2009	5418	5454
2010	6367	5522
2011	7186	5974
2012	7221	5979

Source: Ministry of Finance of Macedonia, annual budget data in the period 2007-2012

<sup>38</sup> By 2008 only 51 LGUs succeeded to enter to the second phase of decentralization -of total 85-. By 2012 only Plasnica municipality is recorded in the first phase.

<sup>39</sup> Municipalities different form Macedonian ethnicity between the period 2009-2012; **Albanian municipalities:** Arachinovo, Brvenica, Vrapchishte,Gostivar, Zhelino, Zajas,Lipkovo, Oslomej,Struga, Stunichani, Tetovo, Tearce,Plasnica, Saraj, Chair ; and Centar Zhupa (Turkish); Shuto Orizari (Roma).

As regards capital grants, it is observed that there are significant changes in the amount distributed to LGUs whose mayor is from the same party or coalition which is running the central government and LGUs whose mayor is affiliated to opposition. In addition, these grants are distributed on political decision approved by the Government of Macedonia on annually basis. Nevertheless, it should be noted that due to political reasons and non-respondent authorities only data between the period 2006-2009 is available; thus it allows accurate estimations despite the short term span<sup>40</sup> (Table 13).

Table 13: Capital transfers per capita according to political affiliation of mayor

<b>Year</b>	<b>Governing</b>	<b>Non Governing</b>
2006	344	486
2007	583	549
2008	1041	520
2009	585	311

Source: World Bank and USAID project data in the period 2006-2009

On regards to the capital transfers distributed to the LGU`s whose major population is Macedonian and to the LGU`s whose major population is different from Macedonian<sup>41</sup>; it is observed significant changes in the amount of distributed capital grants (Table 14). Thus, it could be concluded that these grants could not be considered as competitive since decision on its allocation remains political.

Table 14: Capital transfers per capita according to ethnic affiliation of mayor

<b>Year</b>	<b>Macedonian majority</b>	<b>Albanian majority</b>
2006	237	237
2007	609	389
2008	830	410
2009	579	352

Source: World Bank and USAID project data in the period 2006-2009

<sup>40</sup> It should be noted that there is a project ongoing as “Skopje 2014” where significant amount of money is transferred to this project as well (however it is almost impossible to detect the amount because of political issues).

<sup>41</sup> Municipalities different form Macedonian ethnicity between the period 2009-2012; Albanian municipalities: Arachinovo, Brvenica, Vrapchishte, Gostivar, Zhelino, Zajas, Lipkovo, Oslomej, Struga, Stunichani, Tetovo, Tearce, Plasnica, Saraj, Chair ; and Centar Zhupa (Turkish); Shuto Orizari (Roma).

## 4. Conclusions

Decentralization is a new reality for the Western Balkan countries which are making efforts to adhere to the European rules of decentralization to reinforce the autonomy of local government. However local governments still remain very dependent financially from the central government. Often in these countries intergovernmental transfers are used from politicians as an instrument to gain votes rather than a mechanism to improve equity and efficiency. Relevant studies show that this may be the case for Albania and Macedonia where intergovernmental transfers' scheme is often characterized by the lack of transparency.

This study shows that the distribution of transfers LGUs is influenced by political affiliation. More specifically, we observe a statistically significant difference in the conditional grants per capita received by the Albanian communes and municipalities whose mayors belong to same political coalition which runs the central government. Also in Macedonia these differences are considerable – the municipalities whose mayor is from the governing party gets the double of the earmarked funds per capita compared to the other municipalities. Thus, municipalities that mainly vote the party in power are more apt to benefit more grants/funds from central governments compared to other LGUs. On the other hand, we find no significant difference in unconditional transfers between communes in terms of political affiliation in Albania or Macedonia, which indicates that this type of grant has been less affected by political opportunism.

Although the results presented are descriptive statistics, they are a good signal to further scrutinize the factors influencing intergovernmental grants. In the next steps of the research we will conduct econometric analysis of the data, controlling for other factors influencing the grants scheme. This study will be also complemented with interviews with experts of decentralization and representative of the communes and municipalities. The interviewees will not only shed light on the perception of the stakeholders regarding political manipulations of the scheme, but will also cast light into the influence of another potential important factor in the allocation of intergovernmental grants, such as personal network and power of the LGU's representative.

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