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Fiscal Decentralization and the Impact of Disbursing Value Added Tax Income to Local Self-Government Units in the Republic of North Macedonia

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Abstract. Decentralized systems give priority to the role of citizens in the government decision-making process, which through various forms, provide better services. This phenomenon motivates policies in the social system, in order to promote democracy, transparency and accountability. The paper gives a short explanation of the Decentralization types, processes as well as Fiscal Decentralization. But the focus is on Fiscal Decentralization in the Republic of North Macedonia (RNM), especially its first two phases and the outcomes of revenues for municipalities through the case study of Gostivar. A short explanation is given on how the signing and ratification of the European Charter of Local Self-Government and the signing of the Ohrid Framework Agreement in 2001 create a legal framework upon which the decentralization system in RNM is based. Lastly, the paper focuses on the Methodology for VAT distribution and its impact as well as a current shortcoming of the model.
Keywords: Fiscal decentralization, Local self-governance units, Public finance, Public revenues, VAT, The legal framework

Introduction

Decentralization has become a global trend, which has aroused worldwide debates and discussions as well as the interest of many scholars, that define it as a “positive phenomenon.” Some of the main research on decentralization include improving economic efficiency, cost efficiency, increasing accountability and resource mobilization (Prud'homme, 1995). However, some researchers argue that none of the aforementioned can be achieved if the needs and preferences of the citizens do not reflect on the government budget and institutional capacity of government is not meager. From this prism, decentralization can lead to increased costs, reduced efficiency in service delivery, higher inequality, and macroeconomic instability (Prud'homme, 1995).

The process of decentralization in the Republic of North Macedonia (RNM) started with the signing and ratification of the European Charter of Local Self-Government (ECLSG) and the Ohrid Framework Agreement (OFA), which forced the RNM to make constitutional changes and bring forth a legal framework for the process of decentralization. This paper explains the development of the decentralization process

as a reform in the Republic of North Macedonia, as well as the impact and efficiency of decentralization in the local public revenue system. Of particular interest for this paper is the process of fiscal decentralization, especially the model of distribution of value added tax to the local government, which is transferred from the central government to the local units in the form of grants. Achieving economic efficiency, equity and macroeconomic stability can be considered among the key issues of Fiscal Decentralization, which is an important node of decentralization. Hopefully, this paper will aid the further study of the model and give basis on whether the same model could be used in other counties of the region.

Decentralization and its types

Decentralization¹ is an antipode of central organization, a process whereby the power in an organization (public or non-public) is disbursed in other parts (in our case in the local government units), in order to reduce the concentration of political, financial and administrative power of the central government.

The term decentralization can be understood and perceived differently depending on the context of use and the goal of the decentralization. Nonetheless, a general description is that decentralization is the transfer of authority and responsibility of public functions from central government to the local level. In a decentralized system, the role of citizens is considered, who through various forms can participate in the decision-making process to provide better public services. In fact, decentralization takes into consideration the right of the citizens of a country to participate in the management and administration of public affairs, and this right is exercised directly and more efficiently at the local level rather than at the central level. This phenomenon motivates policies in the social system, in order to promote democracy, transparency and accountability. Decentralization is also the transfer of authority and responsibility for public functions from the central government to subordinate or almost independent governmental organizations or to the private sector (Litvack & Seddon, 1999). It covers a wide range of concepts and types be it political, administrative, fiscal or market, which have different characteristics, political consequences, and conditions for achieving success.

Political, administrative, fiscal and market decentralization can manifest in different forms in different countries, within the country and even within sectors. All these factors must be carefully considered before deciding whether a project or program should support the reorganization of financial, administrative, and service delivery systems. Differentiation of different types of decentralization is important as it sheds light on its many dimensions and the need for coordination, but on the other hand these concepts overlap with each other. Such reforms for decentralization have been undertaken in both developed and developing countries, whereas in post-communist transition countries, decentralization appears as a direct result of the transition from the socialist economic system to the market economy (Wallich, et al., 1995). This has been influenced by factors including the general economic situation, legal order, economic,

¹ Etymologically derived from two Latin words (de meaning of/from and central - meaning center)

political and cultural reforms. According to Kälın, there are four main reasons for strengthening local governance:

- **Accountable and efficient administration** - central level failures in service delivery often come not due to lack of money, but due to an inefficient use of available resources, where relevant factors can be geographical distance (brings forth the issue of the central level lacking information on local needs and problems) and psychological distance between central level officials and the people they lead.
- **Better Local development** - In many countries the main motive for decentralization is the potential for local development because citizens are encouraged to successfully design and implement their local projects.
- **Democracy and protection of liberty** - the right to elect leaders at the central level is part of democracy, but democracy also includes the ability to influence decisions that directly affect a person's life. Local government can provide those aspects of democracy that the central level cannot provide.
- **Protection of minorities** - if local constituents think money is theirs, then they are more likely to be vigilant about spending the money and using it more efficiently as they feel it is their own finances in the country; especially when minorities leave some collective zones (Kälın, 2002).

Principles of decentralization:

In decentralization theory, the conceptual framework is derived from the theory of "fiscal federalism," which deliberates on efficiency, fairness, and sustainability of intergovernmental fiscal relations. The following four basic principles are derived from it for "fiscal evolution" to emerge (Musgrave, 1984):

- **Fiscal Equality or Financial Competence** - This principle is based on the right to decide on the level and nature of the necessary expenditures to be taken by that level of government, that is responsible for financing those expenditures. Lower levels of government should be responsible for all assets (tax revenue, non-tax revenue and borrowing, including intergovernmental transfers).
- **Subsidiarity** - Higher levels of government should commit to government functions only when lower levels of government cannot perform their functions effectively. According to this principle, "the exercise of public responsibilities should, in general, belong more to the authorities closest to the citizens" (Musgrave, 1984). Namely, the local governments will provide services that benefit the local jurisdiction and in the prism that gives priority to increasing the efficiency of public services and an efficient allocation of resources in the economy.
- **Justice/Equality** - Fiscal policy should aim to reduce regional "inequalities" in countries where regions/ethnicities with higher tax bases and lower costs coexist with entities with lower tax bases and higher needs for expenses. The level of equalization must maintain appropriate fiscal initiatives to promote its economic development. According to this principle, entities with low tax capacity should be entitled to transfers. The equation should not contradict the previous two principles. This means that grants should only equate revenue with functions performed more efficiently by local authorities.

- **Fiscal Autonomy** - Lower levels of government should be autonomous in establishing and enforcing an appropriate legal framework, which will contain the above principles. Higher autonomy corresponds to full freedom based on tax collection and tax rates, whereas lower autonomy corresponds with conditional grants.

The decentralization process

The process of decentralization began at a rapid pace during the 1990s, mainly through financial institutions (International Monetary Fund and the World Bank) and by multilateral and bilateral institutions. In some Western countries, the revision of the existing system of fiscal relations between different levels of government resulted from the demand for greater autonomy for certain regions (i.e., Canada and Germany). In post-communist transition countries, a new system of fiscal federalism has been established, so decentralization in these countries is seen as a key dimension to national transition from a central economy to a market economy. Therefore, reforms in relations between central and local authorities are of particular importance due to their close link to efficient resource mobilization, privatization, social security and stabilization in these countries.

Decentralization as a wave of globalization has affected most countries in the world and is complemented by various reforms according to the needs and strategic goals of each country, that creates its own model. This indicates that in some developing countries (i.e., Argentina, Brazil, India), fiscal federalism was considered especially in terms of its compatibility with macroeconomic and political stabilization (political pressure to democratize society) (Ebel, 2001).

Decentralization modeling is extremely difficult as it can affect many aspects of public sector performance, as well as cause a few other implications of a different nature. Fiscal goals are not the only aim of decentralization as the latter seeks to enhance national integrity and political stability in order to ensure equality for different people in different countries.

Decentralization in the Republic of North Macedonia (RNM)

After gaining independence from Yugoslavia in the 90s, the Republic of North Macedonia started with major reforms in the legal as well as economic system. An important component of the decentralization strategy in RNM was the adoption of a legal framework that allowed different roles and responsibilities at all levels of government. With the signing and ratification of the European Charter of Local Self-Government², as well as the signing of the Ohrid Framework Agreement in 2001, the Republic of North Macedonia was obliged to amend the Constitution. In accordance with the Constitution, it was required to form a legal framework for the decentralization system, which stated that local governments must have the right to judicial protection to ensure the free performance of its obligations and duties, as well as compliance with

² Republic of North Macedonia signed and ratified the European Charter in 1996 and Parliament ratified it in 1997

the principles of local self-government set out in the Constitution and other domestic legislation.

The Ohrid Agreement obliged RNM to adopt the Law on Local Self-Government Units, which defines the content, goals, organizational structure, and competencies of municipalities. The legal framework of the decentralization system obliges the Macedonian Parliament to adopt the Law on Territorial Organization, the Law on Financing of Local Self-Government Units, and the Law on Property Tax, as well as other laws that are based on delegated competencies. The decentralization process in the Republic of Northern Macedonia started to be implemented in the summer of 2005 and enabled local self-government units to take on greater responsibilities and competencies.

Regardless of the reasons (political, economic, technological), decentralization has occurred everywhere, at different rates and in different ways. This world trend is based on the principle of subsidiarity³ (where municipalities have the right in their territory to perform tasks of public interest and local importance, which are not excluded from their competencies or are not within the competence of central government bodies) and the understanding that results in improved efficiency in the provision of public services, i.e., with more efficient distribution of resources in the economy.

Fiscal Decentralization

Fiscal decentralization includes the transfer of competencies from the central to the local government and at the same time the transfer of funds/monetary assets to realize the competencies transferred from the central to the local government, as well as autonomy in the realization and administration of local revenues (Tommasi, 2004).

According to (Tanzi, 2002) et al. "[f]iscal decentralization can be defined as a process of transferring/shifting responsibilities of public revenues and expenditures, between different levels of government, with some autonomy in revenue and expenditure competencies."

Fiscal decentralization encompasses the issuance of certain competencies to the elected bodies at the local level, to determine within certain areas determined by law the possibility to set the taxable level for some specific local taxes, as well as the right to use these revenues, according to the needs of the respective communities (Bahl, 1999).

According to (Nicoletta, et al., 2007) the basic idea that drives fiscal decentralization is "[the] creation of an adequate and stable logical system of local revenues, but without creating additional costs for national finances and that is in line with fiscal and macroeconomic policies." Thus, according to (Nicoletta & Anderson, 2008) the system of fiscal decentralization consists of four main pillars, which are:

1. **Determining the sources of source revenue** of the local government and the distribution of revenues between the central and local government - this pillar defines which revenues will be collected by the municipalities themselves, what part of them

³ Subsidiarity principle is best described in the 4th Article of the European Charter for Local Governance according to which public competencies should be exercised by those authorities which are closest to the citizens

will be a transfer from the central government and which taxes will be passed entirely as government revenue.

2. **Defining responsibility for expenditures**, which defines the exclusive expenditures of the municipalities, the functions delegated by the central government and the expenditures which will be performed by both joint parties
3. **Fund transfer system between central and local government** - refers to funding provided to local units by the central government on a conditional (conditional transfer) or for any local government (unconditional) need.
4. **Local borrowing / lending as a financing option** - The local government can also rely on this type of financing, although it seems that the burden of borrowing would fall on the central government again, which means that macroeconomic stability could be weakened if local government structures are allowed to borrow in the market and are unable to repay it. In this case, this effect of decentralization can lead to an increase in the country's debt and destabilize the economy. However, if local authorities are restricted in their freedom to borrow from private capital markets, then decentralization will not pose a challenge to macroeconomic stability.

Fiscal Decentralization in the Republic of North Macedonia

Fiscal decentralization in the Republic of Northern Macedonia has been implemented in accordance with these established principles (Republic of North Macedonia, n.d., p. Article 44):

- Gradual transfer of competencies in line with the capacity of municipalities to acquire these competencies.
- Proper and adequate provision of the means for efficient and uninterrupted execution of the transferred competencies, and
- Reduction of funds in the Budget of the Republic of Northern Macedonia for the functions that will be transferred to the competencies of the municipalities.

In the Republic of Northern Macedonia, fiscal decentralization included two phases, which passed through various challenges.

1.1 The first phase of fiscal decentralization

The first phase of fiscal decentralization began to be implemented in July 2005, in which, within the legal framework, it is necessary to meet these conditions (Republic of North Macedonia, n.d., p. Article 45):

- Adoption of regulations and methodologies for the transfer of funds from VAT, capital as grants and as intended.
- Settlement of remaining obligations of municipalities.
- In the municipal administration to have at least two employees with adequate qualifications, who will work in the field of financial management.
- In the municipal administration to have at least three employees with adequate qualifications, who will work in determining and collecting taxes.

The first phase of fiscal decentralization involved the acquisition of competencies in financing and managing local government revenues under the Law on Financing of Local Self-Government Units such as (Republic of North Macedonia, n.d., p. Article 4):

- Property Tax as predefines in the (n.d.)
- Local tax
- Local compensations determined by law
- Revenues from self-contributions
- Revenues from fines determined by law
- Other revenues foreseen by law
- Donations
- Grants from the RNM budget and from the budgets of the funds

The fiscal decentralization impact can be seen from one of the case studies, Gostivar (Municipality in Northwest RNM), whose data comes from the financial reports of the Municipality of Gostivar⁴. In the underlying table we will illustrate the realization of the budget for 2004 compared to 2005, 2006 as well as underlying coefficients used for 1st phase of decentralization. The budget comparison takes into consideration the years 2004, 2005, 2006 in order to do a more effective pre-post comparison of the data for the municipality as the fiscal decentralization started in July of 2005.

Table 1. Municipality of Gostivar Pre-Post 1st phase of Fiscal Decentralization

| Type of Revenue | Budget Realization , 2004 | Budget Realization , 2005 | Budget Realization , 2006 | Coef. for year 1 | Coef. for year 2 |
|---|---------------------------|---------------------------|---------------------------|------------------|------------------|
| Property Tax | € 183,400.00 | € 433,758.00 | € 789, 108 | 2.365092694 | 1.819235611 |
| Local Tax | € 37,300.00 | € 126,292.00 | € 146, 246 | 3.385844504 | 1.157998923 |
| Communal Charges | € 103,880.00 | €114,300.00 | €121,950 | 1.100308048 | 1.066929134 |
| Revenues from Construction Tax | € 385,650.00 | €1,106,600.00 | €2,267,500 | 2.869441203 | 2.049069221 |
| Non-Tax-Revenues | € 182,200.00 | € 66,694.00 | € 90,450.00 | 0.366048299 | 1.35619396 |
| T. Revenue by Municipality in 1 st phase | € 892,430.00 | €1,847,644.00 | €3,415,254.00 | 2.070351736 | 1.848437253 |
| VAT revenues | | € 225,100.00 | € 473,100.00 | | 2.101732563 |
| Income Tax | | € 44,176.00 | € 73,400.00 | | 1.661535675 |

⁴ www.gostivari.gov.mk

| | | | | | |
|--|---------------|---------------|---------------|-------------|-------------|
| Conditioned Grant Income | | € 284,920.00 | € 821,606.00 | | 2.883637512 |
| Transfer Revenues for Capital Projects | € 338,980.00 | € 352,799.00 | € 133,800.00 | 1.040766417 | 0.379252776 |
| Total Revenues collected by Central Gov. | € 338,980.00 | € 906,995.00 | €1,501,906.00 | 2.675659331 | 1.65591431 |
| Total Revenues | €1,231,410.00 | €2,754,639.00 | €4,917,160.00 | 2.23697956 | 1.78504697 |

From the realized budget outcomes and the pre-post outcomes for the municipality we can notice an 82% increase from 2005 to 2006 (an annual year with 1st phase fiscal decentralization and 330% increase from 2004 (pre 1st phase decentralization) and 2006. From analyzing the table above we can conclude that the real indicator for increasing the realization of revenues, respectively higher collection of property tax and compensation, is the good and successful management of local government, which means that the determination and collection of property tax with the beginning of the first phase of decentralization is managed by the local government administration, while the determination and collection of personal income tax and value tax is managed by the central government administration.

Also, from this case study we see that decentralization affects the increase of total revenues of local government because revenues from personal income tax and value added tax for 2006 are in the amount of 563,550 euros and the same are not earmarked funds, whereas revenues from grants to finance running costs (primary, secondary, kindergarten, fire brigades, etc.) and revenues from central level transfers for the implementation of various projects are earmarked funds and they cannot be used for other project than their pre-defined project.

1.2 The second phase of fiscal decentralization

- The second phase of fiscal decentralization started in 2007, where in addition to the acquisition of competencies from the first phase of decentralization, it also includes the acquisition of competencies in the field of financing employees by users of budget funds (primary and secondary education employees, in kindergartens, in culture, fire brigades, etc.) The funds for financing these competencies are provided by the central government, which the central government transfers every month to the current account of the municipalities in the form of block grants. These funds cannot be used for any other purpose by the municipality. However, in order to move to the second phase of decentralization, the municipalities and the local government must meet these conditions: (Republic of North Macedonia, n.d., p. Article 46).Self-Governing conditions from the first phase of fiscal decentralization:

- Have adequate staffing capacity
- Show good results in financial performance in a period of at least 24 months.
- Timely and fairly inform the Ministry of Finance about the financial results,
- They should not have any remaining liabilities to the obligors that exceed the normal conditions for payment or have a reprogramming of the payment of the remaining liabilities from previous years.

Value Added Tax (VAT) distribution model in local self-government units:

The model of decentralization of public revenues in the form of grants faces large differences or fiscal "inequalities". One of the said 'inequalities' is the distribution of value added tax in urban, rural and in the municipalities of Skopje and the city of Skopje, as well as the distribution of grants intended for education according to the authorization provided by law.

According to the Law on Financing of Local Self-Government Units, VAT revenues are revenues of local government, which are transferred from the central government to the local government in the form of grants, to finance the competencies of the municipality, defined by law.

These funds are provided and calculated at a rate determined by the total amount of value added tax collected from the previous fiscal year. The rate set for calculating the amount of value added tax from one July 2005 was set at 3%, while since January 2010 the rate has been determined as 4.5% (Republic of North Macedonia, n.d., p. Article 9). For the distribution of value added tax revenues, there are criteria set out in the Regulation on the methodology for the distribution of value added tax, approved by the Government of the Republic of North Macedonia, on the proposal of the Minister of Finance and with prior consent of the Commission for monitoring the development for financing of municipalities.

Of the total amount of VAT revenues collected in the last fiscal year, 95% is allocated to the Municipalities and the City of Skopje, while 5% is used to finance municipalities, where the revenues planned in the basic budget of the municipality are lower than 25% of the average revenues planned in the basic budget for the municipality at the level of the Republic of North Macedonia. These funds are distributed linearly to the municipalities designated by the decision of the Minister of Finance twice a year for the fiscal year.

Out of the total amount of 95% value added tax, 90% of the funds are distributed to all municipalities, without the municipalities of Skopje and the city of Skopje, while 10% of the funds are distributed to the municipalities of Skopje and the city of Skopje, of which 40% of the funds are distributed to the city of Skopje and 60% of the funds to other municipalities in the city of Skopje. According to the Regulation and

Methodology for the distribution of value added tax revenues, the following criteria are provided:⁵

- Based on the number of inhabitants of the respective municipality at a rate of 65% and cannot be lower than 50%.
- Based on the territorial area of the respective municipality at a rate of 27%.
- Based on the number of settlements of the respective municipality at a rate of 8%.

This form of tax distribution can be changed by a Decision of the Commission for the distribution of value added tax formed by the Government of the RNM. Based on the above criteria, the distribution of VAT revenues to municipalities is done according to the formula:

$$D_i = \frac{0.65 \cdot Efn}{BZn} \cdot Bz_i + \frac{0.27 \cdot Efn}{p_n} \cdot P_i + \frac{0.08 \cdot Efn}{BNMn} \cdot BNM_i \quad (1)$$

Table 2. Acronyms and Definitions

| Acronym | Definitions |
|---------|--|
| Di | Represents the grant to be distributed to said municipality |
| Efn | VAT for previous fiscal year |
| BZn | Total number of RNM inhabitants, excluding residents of City of Skopje and Skopje Municipalities based on the last population census |
| Bzi | Total number of inhabitants for the said municipality |
| Pn | Total territorial surface of RNM without City of Skopje and municipalities of Skopje |
| Pi | Territorial surface of municipality |
| BNMn | Number of settlements in RNM without Skopje City and Skopje municipalities |
| BNMi | Number of settlements in said municipality |

In the case study of Gostivar to check the amount of dotation the most recent VAT tax data are taken and based on aforementioned legal framework the amount to be distributed is taken by firstly calculating the following:

$$\text{Total VAT for previous fiscal year} \cdot 4.5\% \quad (2)$$

$$\text{The adjusted VAT} \cdot 0.9 \quad (3)$$

$$D_i = \frac{0.65 \cdot 63,913,693}{1,515,621} \cdot 81,042 + \frac{0.27 \cdot 63,913,693}{2,436,849} \cdot 51,396 + \frac{0.08 \cdot 63,913,693}{1,715} \cdot 35 \quad (4)$$

$$= 2,689,713.04 \quad (5)$$

⁵ Criteria percentages are based on the Official Gazette of RNM nr.132/2019 (Decree for the methodology for dispersion of VAT revenues, that is approved by the Government of RNM every year that for every year decides on additional criteria.).

The Donations (Grant) distribution for City of Skopje follows the same methodology, with variables defined based on the Skopje city and city of Skopje municipalities based on the division in the (n.d.) as followed:

Table 3. Acronyms and Definitions for City of Skopje methodology

| Acronym | Definitions |
|---------|---|
| Di | Represents the grant to be distributed in the municipalities of the city of Skopje |
| Efso | VAT for previous fiscal year for the city of Skopje |
| BZsk | Total number of city of Skopje inhabitants based on the last population census |
| Bzi | Total number of inhabitants in the municipality of Skopje, where the dotation goes |
| PSk | Total territorial area of city of Skopje |
| Pi | Territorial surface of municipality in the city of Skopje for which the subsidy is designated |
| BNMn | Number of settlements in the city of Skopje defined by Article 11 of the Law on Territorial Division of RNM |
| BNMi | Number of settlements in designated municipality in the city of Skopje |

The transfer of VAT revenues from the Budget of the Republic of Northern Macedonia to the municipal budget is done in 12 installments, which must be transferred no later than the last day of the month for the previous month, except the last installment, which is transferred no later than December 15 of the current fiscal year. The municipality independently decides on the use of value added tax revenues. It is worth noting that the VAT distribution model suffers from old census data. Based on the three criteria mentioned above, the criterion based on the number of inhabitants, which grants VAT revenues of the respective municipality at a rate of 65% or a rate that cannot be less than 50% should not be a constant indicator.

The reasoning behind this is the fact that last census in RNM was in 2002 and the number of inhabitants is a biased and skewed indicator, especially with changes in population trends over the years. We can verify this by comparing the number of the population registered in 2002, which is 2,022,547 inhabitants (Statistical Yearbook of the Republic of Macedonia, 2009), with the number of the population in the Voters List of the Provisional Parliamentary Elections of 2020, where the number of the population with the right to vote is 1,808,131 (State Election Commission, 2019), even without the population number from zero to 17 years. Furthermore, the revenues of municipalities depend on revenue streams that are based on VAT, which are susceptible to worldwide financial crisis, i.e., 2008, or political crisis inside the state as was the case during 2018-2019 in RNM that had visible impact on VAT collection as can be seen in the following cases from three different regions in RNM:

Table 4. VAT revenues during the RNM political crisis for 3 municipalities

| Municipality | Type of revenue | Year 2018 | Year 2019 | Coef. of realization |
|--------------|-----------------|-----------|-----------|----------------------|
|--------------|-----------------|-----------|-----------|----------------------|

| | | | | |
|--|-----|---|---|---------|
| Gostivar | VAT | 2,689.713 € (Municipality of Gostivar, n.d.) | 1,637,032 € (Municipality of Gostivar, 2019) | -1.6430 |
| Manastir/Bitola (Kvartal Budget Report, 2019) | VAT | 2,198.111 € | 1,531,464 € | -1.4353 |
| Kisela Voda (Municipality of Kiselavoda, 2019) | VAT | 478,335€ | 364,765 € | -1.3114 |

Conclusion and Limitations

Decentralization in RNM started with a socio-economic and political motivations as the country left the communist sphere toward its journey for a more democratic society and free market. A further impetus was given by the Ohrid Framework Agreement for a more equal society among the multicultural society in RNM. The decentralization was initiated with the Constitutional amendments of 2001, the Law on Local Self-Government and other main laws of this corpus that included: The Law on Territorial Division of Municipalities and the Law on Financing of Municipalities. These laws were further supplemented with other legal regulations, which transferred competencies and funds from the central government to the local governments. The paper focused on the 1st phase and explored the 2nd phase of the Fiscal decentralization, the methodology and how the fiscal decentralization stages impacted the revenues of local governments. It also tried to assess the current limitations of the methodology which stems from biased population census information dating back to 2002. Since the beginning of fiscal decentralization in 2005 until now, within the frameworks defined by law, municipalities have generated steadily increasing revenues and are autonomous in implementing their competencies defined by legal norms. However, the current system of local public finances does not create opportunities to provide sufficient financial resources for municipalities, neither in volume nor in structure, which means that municipalities' own revenues are small, VAT transfers, tax on Personal income and funds from the Public Roads Fund are also insufficient for peripheral and rural municipalities. Therefore, it is necessary to introduce or incorporate new sources of financing including concession fees that have commercial purposes. According to the criteria for the distribution of VAT, one can conclude that based on the number of inhabitants of the respective municipality at a rate of 65%, municipalities have a higher realization of VAT. As a result, it is advisable for municipalities in the future to rate increase according to this criterion. Furthermore, during the distribution of VAT, according to the first criterion, obsolete data is used (2002 Census) which understandably is not a good representation of today's population characteristics in the country. The paper is exploratory in nature, focusing on initial data and there is potential for future research by considering more municipalities, year progression of revenues as well as tweaking the model for better efficiency models by adding new revenues such

as concession fees. Another potential further research would entail re-organization of rural-urban municipalities with the global trend of shifting population and consequently the revenues for municipalities would be more realistic to the situation on the ground.

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