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## FISCAL AUTONOMY OF LOCAL GOVERNMENT GOVERNANCE FLEXIBILITY AND RESPONSIVENESS

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### ABSTRACT

*In the context of processes of change that is included the Albanian state, the local governments plays an important role. Membership in various international bodies has given a special priority to this government. In the center of this paper is the analysis of fiscal decentralization of local government, specifically addressing the priorities, competences and responsibilities assigned to this government during this complex process. Local government is regarded as government closer to citizens, and for this the increasing of its competence, financial resources and an active community participation in decision making, will increase the responsibilities of power. This treatment is based on the legal framework of local government, taking a look at its changes over the years, analysing and decentralization strategy, also this process is treated even in economic framework based on different information sources. The article offers concrete conclusions based on the performance of this multilateral process and its implementation in local units of state, as the giving autonomy to local government unit turns them into self-governing bodies, fiscal decentralization laid to increased investment in local structure and to improve services to communities, to reduce tax evasion and increase public funding to strengthen the cooperation between central and local government.*

**KEYWORD:** *Autonomy, Decentralization, Local Governance, Decision Making, Financial Resources, Civic Participation, Increased Accountability.*

**JEL CLASSIFICATION:** *M49, M48, N40, N44*

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## 1. INTRODUCTION

### 1.1. Decentralization

Autonomy and decentralization of local government is a very important process for the democratic development of a country.

Swedish final report regarding for public administration in 2002 define decentralization as the process of political devolution, fiscal and decision-making from central government to local level.

This transfer of powers to local level makes this important process difficult to realize. This reform is stretched almost democratization worldwide, mainly in developing countries and in countries which come from deep political transformations (UNUP, 2002).

Challenges of local governance and Regional Development in 2002 observed the decentralization of power which is made to challenge the monopoly of central government decision making.

This reform aims to:

- make a more stable democratic system;
- increase government efficiency and effectiveness;
- stimulate the creation of a stable basis for economic development in local and national level;
- make more transparent governance;

- involvement of citizens in decision-making.

Through decentralization, central government transfers some of its powers at the local level. Already, the central government plays its role in the drafting of major and local commits a portion of their execution.

In this way the two levels are more efficient in performing their functions. Possession of own financial resources and their management at the local level promotes economic development (Boca, 2012), primarily in the local area later in the development of the whole country.

Decentralization strengthens the principle of transparency and accountability.

The principle of accountability works best at local level, devolution of power makes government more accountable for the implementation of its tasks.

Decentralization also increases the level of citizen participation in making major decisions and directly affecting the community.

As an integral part of democratization, this process is closely linked with the strengthening of citizen participation in decision making.

The principle of sub solidarity or rule closer to its citizens is the basic concept of decentralization. The decentralization process includes three levels:

- The deconcentration, reduces the volume of work of the center and bring government closer to citizens, deconcentration can be considered as the first level of decentralization.
- Delegating responsibility and authority sends to perform certain functions in institutions or semi-autonomous state agency established locally.
- The transfer represents the highest level of decentralization. Transfer refers to the situation in which central government transfers political authority, financial and administrative, quasi-autonomous units in local government.

## 1.2. Dimensions of Decentralization

Political decentralization refers to the situation in which political authority and powers transferred from central government to the local.

Fiscal decentralization implies the transfer of responsibility for revenue and expenditures from central to local.

Administrative decentralization consists in the transfer of authority, responsibility and decision-making resources for public service delivery by central government to lower levels of government.

## 2. THE ROLE OF DECENTRALIZATION IN CIVIC PARTICIPATION IN DECISION-MAKING

Decentralization of local government is a process whose application brings results, which affect almost every aspect of human activity.

Goventa and Valderrama (1999) considered that one of the goals of this process is to bring citizens to the decision-making. European Charter of Local Autonomy entitles citizens to be participants in local governance.

Instituti i Politikave Efektive Publike, “Decentralizimi i Pushtetit në Vendet e Evropës Juglindore” take in consideration that decentralization of local government is based on the principle of sub solidarity, in providing services closer to citizens these services must comply with the requirements and needs of them.

Beci (2004) by recognizing the needs of citizens, local government units "broadcast" their needs to the central government, sustain that the citizens become participants in formulating policy

When citizens control the major decisions of local government and are free to make their contribution in the design, construction and changes to the governance of the city, then citizens are considered active actors of governance.

Decentralization of local government is a reform, which involves a separation of functions between central and local government, with the main goal over the responsibilities of decision-making closer to citizens.

This approach makes government-level shortest path of transformation in response to requests. This leads to avoidance of bureaucracy. Now citizens are easier to participate in local governance.

Decentralization is considered as an integral part of democratization, which is passing through a vertical division of power between government units towards agreements that promote representation.

Through decentralization, increase communications tools available to citizens. Granting political autonomy, administrative and financial, local government requires the addition of road capacity and communication with citizens, because it is close links with the government to citizens.

To have a successful government, citizens should be considered as active actors in decision-making and not as subjects who simply choose their governing bodies.

### **2.1. Fiscal decentralization**

Fiscal decentralization in institutional context, relates to the whole economic development, the nature of the legal system, the continuity of the process of economic and political reforms in financial organization's and monetary institutions, and with the economic differences across regions and population groups.

For performing effectively decentralized functions, the local governments must have, *first*, sufficient income derived locally or transferred from central government; *second*, full independence in decision making on the use of these revenues (Burki, Perry and Dillinger).

Through fiscal decentralization is aimed at:

- Ensuring the necessary financial resources for local government to exercise the functions prescribed by law;
- Providing the necessary local authority in setting local taxes and their use;
- Improving the allocation of financial schemes of unconditional transfers to the state budget allocates to local government;
- By applying equalization schemes, reimbursement of local government units with insufficient financial, means to ensure public services to local communities;
- Development and harmonization of local economic development strategies with regional strategies and national development under the Projekt Udhëzimi për Decentralizimin, Tiranë 2001.

The goal of fiscal decentralization is to create more local revenues to provide support in improving the quantity and quality of local services which leads to strengthening local accountability and the concept of community, is one that sets the local priorities and participates in the implementation of them.

Local government financial principles are intended to ensure accountability and autonomy in the functioning of local government.

This is achieved through:

1. Creation of rights over a variety of sources such as taxes, income taxes and other local funds transferred from the state budget;
2. Granting authority to collect revenues independently;

3. Sufficient allocation of funds from central government and the fulfillment of all prescribed standards;
4. The right to develop, adopts, implement and manage their annual budgets.

Fiscal decentralization can take many forms, including:

- Self-funding or coverage of costs through revenues from user;
- Co, in which users participate in providing services and infrastructure through monetary contributions and labor;
- Increase local revenues through direct or indirect taxes or sales of assets;
- Intergovernmental transfers of general revenues from taxes collected by central government;
- Making loans from lending institutions and donors.

## **2.2. Increase the accountability of local government**

Local government accountability increases the response to the interests and needs of citizens, so they have more confidence on bodies government.

One of the factors that increase responsibility is the distribution of resources and public services in the best manner possible. To increase the responsibility, the citizens should know the requirements, their needs, in order to return to the issue per priority from government.

Being responsible requires a degree of autonomy, which constitutes a fundamental guarantee for the fulfillment of democratic standards in the exercise of their functions by.

The level of autonomy and remains the most essential indicator in determining the accountability.

The transfer of functions provides the highest quality services to the citizens at a local level, preferably as close to them.

Citizens are interested that the services provided close to them, to be high of quality.

Transfer of functions to local governments is an ongoing and flexible process.

The guiding principle in the transfer of functions is to increase the accountability of local government unit, but it requires real conditions and opportunities as financial autonomy and the development of adequate human and administrative.

Automatically, the financial autonomy returns the local government bodies in competent and responsible in the well-management of local finances, which means that local units decide on those issues they consider as priorities and which are most urgent needs of local citizens, to allocate their funds.

The main goal of fiscal decentralization is to increase the efficiency in bringing public services. This objective can be achieved if only, local authorities will have guaranteed and secure incomes and a real degree of autonomy.

This is a prerequisite for local accountability. Certainly the fiscal reform is a recent separation from the previous financial structure, characterized by a high degree of fiscal centralization in decision making.

Fiscal decentralization strategy, as presented in the new Organic Law of Local government is a window of opportunity to increase local autonomy.

The law stipulates the following:

a) National fiscal policy will provide fiscal self support of the power of the local government through diversified sources of income (Article 15).

b) Local governments (including counties, cities and municipalities) have the authority (as determined by a special law) to levy taxes and other non-tax revenue in order to execute their functions (Article 15, 16, and 18);

c) Local governments are eligible to receive funding from national sources such as transfers of unconditional and conditional (Section 15, 17, 18).

d) For purposes of investment, local governments are eligible to borrow under the conditions defined by law (Article 16 and 73).

It should be emphasized that the Organic law Budget no. 8379 states that "local authority are entitled to borrowing only from the government."

In decentralized systems by fiscal terms, the autonomy of revenue expenditure autonomy than provided by their significant resources and predictable revenue, is a necessary incentive mechanism for accountability units.

Sufficient degree of autonomy of revenue provides local authorities the necessary instruments to reduce the vertical fiscal imbalances and providing their financial priorities.

### **3. LOCAL GOVERNMENT REVENUES**

Local governments should possess financial autonomy, which means that they have the right to collect and spend revenue for service delivery that they are responsible for.

The main goal of fiscal decentralization is the increase of efficiencies for the provision of public services. This objective can be achieved only if local authorities guarantee secure incomes and a real degree of autonomy, so that priorities for spending can be planned and executed with precision.

#### **3.1. The future of local autonomy objectives of Albanian government on fiscal decentralization**

For the Government of Albania, decentralization is one of the priorities and major challenges. The government will implement the decentralization reform, in accordance with the European Charter of Local Autonomy, as an improvement of the quality of governance in direction of efficiency and effectiveness, as well in direction of strengthening accountability and increased autonomy of local government units.

The objectives are:

1. The expansion of fiscal autonomy to municipalities and to set and collect their own taxes and fees. Transfers from the state budget to local authorities will increase 3-4 times compared to today's level by performing in a transparent and objective, based on analytical formula.

2. Will be completed the process of transferring the properties into local governments, and in priority: water-supply, roads, public companies with local character and socio-cultural facilities.

3. It will be put into effect the concept of common functions in education, health, environment, housing, social services, public order and road traffic, for which local governments will take autonomous decisions. Allocation of funds to local governments in these public sectors will be conducted in an objective and transparent way.

4. Intervention to improve legislation.

5. Institutional intervention.

6. Consolidating local capacity.

#### 4. CONCLUSION AND RECOMMENDATIONS

Decentralization of local government is an important process in the democratic development of the country. It is defined as the process of political devolution, fiscal and decision-making from the central government at the local level.

As one of the most important reforms, decentralization of power has several objectives.

It aims to make sustainable the democratic system, making challenge to the monopoly of decision-making.

As a result of this process we have separation of functions between central and local government, this increases the efficiency and the transparency in government. While services come closer to citizens, they can more easily control it.

This brings increased accountability of local governments, as well to local community and to central government.

Fiscal Decentralization aims at providing the necessary financial resources for local governments to exercise the functions defined in the law.

Fiscal decentralization is a substantially uniform, which means that local resources are greater than those from national fiscal resources of the state budget.

This reform aims to create more revenue for local government to provide local support in improving the quantity and quality of local services.

This can be achieved with the use of transfers that are income transfers to the central government at the local level.

Sharing their conditional grants and unconditional grants are mechanisms by which central government operates.

Fiscal decentralization reform, aims at strengthening the unconditional transfers as grants that bring local autonomy and accountability of local-level bodies.

1. Accountability is a key component of fiscal decentralization reform and the basic concept that must guide the fiscal reform.

Giving autonomy to local government units turns them into self-governing bodies. This means that these local units are able to give priority to their expenses by listing the needs and demands of the community, but it requires parallel responsibility on local authorities.

Responsibility lies in the management of grants to central government and better public services citizens. Accountability increases the transparency of governing bodies. It necessarily requires the completion of fiscal capacity therefore a real degree of autonomy.

2. Since the late 90s, Albania has made great pass on drafting a legal basis and institutional framework for implementation of a general structure of fiscal decentralization.

The Albanian government has formulated and ratified a decentralization strategy, which is in line with the European Charter of local autonomy and the Constitution of the country.

These served as a starting point for drafting the 8652 law "On Organization and Functioning of Local Government" which laid the foundation for fiscal decentralization. He made significant the transition of functions and funds (especially unconditional grants) from central government to local government units, providing to them a legal fiscal autonomy, so they can make their own decisions in the interest of local community

3. In decentralized systems in fiscal terms, fiscal revenue autonomy, is a necessary mechanism for local accountability.

This mechanism provides to the local authorities the necessary tools to reduce fiscal imbalances, forecasting and planning their financial priorities. The fiscal reform of 2002 was made aiming to strengthen the local tax system, to create a sound base of revenue to local government units. This fiscal package shuffled determining the sources of revenue.

On this basis, fiscal decentralization has led to increased investment in local structure and to improve services to communities, to reduce tax evasion and increase public funding to strengthen the cooperation between central and local government.

4. Located in the path of democratic transformation, the Albanian state has devoted many importances to the fiscal decentralization and autonomy last years.

In conclusion we can say that fiscal decentralization in Albania is one of the most important reforms to democratize the country.

This reform is aimed at a clearer division of functions and responsibilities of both levels of government, and in some way requires a degree of autonomy to local level.

Autonomy brings responsibility, which means that the local government units decide to carry the costs for citizens, and must take responsibility over the quality and quantity of the services offered. All these principles are the basic elements that should guide reform of fiscal decentralization in Albania, which is in the early stages of development.

To have performance for the implementation of reforms, the government program should focus on applicable implementation of institutional relations to and incentive mechanisms that can create a healthy framework of accountability for public service delivery at local level, affecting the ability of stability macroeconomic and storing it.

A gradual increase in autonomy of local fiscal revenue, the authority to perform (freedom of establishment) applying parallel to the fiscal transparency and vertical control mechanisms, delivers improved efficiency and accountability.

Fiscal decentralization reform should be guided by the principle that "finance should follow responsibility."

This means that, to move forward the reform should be assigned rapidly specific powers, especially common functions.

Law on the financial structure of local government can be formulated and implemented only after defining clearly the responsibilities (law includes: taxes, fees, shared taxes, transfers and lending).

The main recommendations are as follows:

1. Determining the role of regions for skills and greater accountability. It should become clear that the structure of local government there is an intermediate level, in the sense of hierarchy. Counties, and cities and municipalities are units of local government, which differ only by their specific jurisdictional responsibilities. The role of the regions must be determined, by the urgency, to designate specific responsibilities.

2. Implementation of special functions, defining clear programs to complete the transfer of specific responsibilities (this includes civil protection, urban planning, land management, housing, protecting the local environment, sanitation) and solving pending issues for the determination of responsibility for capital investment.

3. Determination of special powers for the common functions of local authorities and setting national criteria, service standards and financial resources that should be made in accordance with the National Strategy, for the sectors of local government.

4. Review the setting of common and delegated functions and consideration of amending the Organic Law, redefining the functions of the fields with clear national benefit (such as veterinary services, some health care services and social assistance to poor in the categories of functions in common with those delegated).

5. To determine the specific powers of local authorities for education and health, redefining the functions delegated back to common functions such as the Organic Law says.

6. Creating conditions for increasing the responsibilities of local government by promoting local fiscal autonomy under proper and fair determination of local revenue sources.

7. Improving the distribution of conditional grants.

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