ALBANIA:
DECENTRALIZATION IN TRANSITION
(in Two Volumes)

Volume I: Summary Report and Matrix of Issues and Options

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ACRONYMS AND ABBREVIATIONS

ADF Albanian Development Fund
ALT Agricultural Land Tax
CAS Country Assistance Strategy
CoM Council of Ministers
DSU Direct Spending Unit
EAR European Agency for Reconstruction
EU European Union
EU European Union
FY Fiscal Year
GDP Gross Domestic Product
GED Group of Experts for Decentralization
HII Health Insurance Institute
IMF International Monetary Fund
ISU Indirect Spending Unit
LSBT Local Small Business Tax
MoF Ministry of Finance
MoLGD Ministry of Local Government and Decentralization
NCD National Committee for Decentralization
NFDI National Forum for Decentralization Implementation
NSSED National Strategy for Social and Economic Development
PRSC Poverty Reduction Strategy Credit
PEM Public Expenditure Management
PIT Personal Income Tax
PTT Property Transaction Tax
QFA Quasi-Fiscal Activities
SPT Simplified Profit Tax
TRHA Tirana Region Health Authorities
UNDP United Nations Development Program
VAT value-added tax

Vice President:  Shigeo Katsu
Country Director:  Orsalia Kalantzapolous
Sector Director:  Cheryl Gray
Sector Manager:  Helga Muller
Task Team Leader:  João C. Oliveira
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This report is intended to contribute to the debate on the decentralization strategy in Albania, and to stimulate a broader discussion on its challenges as the process moves ahead. Issues, recommendations and a possible road map discussed in this report are presented as options currently open to the country, and as a technical contribution to the ongoing debate. This report incorporates inputs from the Authorities and the donor community, but it does not necessarily represent their official position or that of the World Bank.

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Albania: Decentralization in Transition

EXECUTIVE SUMMARY

I—BACKGROUND AND ISSUES

1. After almost half a century of an extremely centralized government, Albania started on a path of political decentralization with the first local democratic elections held in 1992. Despite the significance of this initial political move towards increased democratic representation, the local administrative and fiscal autonomy remained very weak. However, the decentralization process received a second boost in the late 1990s. Between 1998 and 2000 the country formally ratified to the European Charter of Local Self-Government, incorporated its key principles into the new Constitution, and passed legal reforms for local self-governments.

2. The formal adoption of the local self-government principles consolidated the political decision for a decentralized government structure, under the laws of Albania as a unitary country. The new organic laws on the “Organization and Functioning of the Local Governments” (Law # 8652/00) and on the “Administrative-Territorial Division” (Law # 8653/00) discontinued the old District Councils, reducing the state’s direct political influence over the local governments’ businesses. This clearly established a solid legal framework that would allow for functional decentralized administrative and fiscal structures, which would include the self-governing regions, municipalities, and communes.

3. Although Albania is far from completing the design of political, administrative and fiscal decentralization that would be able to satisfactorily improve service delivery, governance and accountability, it has to be acknowledged that considerable progress has been made in establishing the basic institutions and legal framework, as well as in implementing policies towards decentralization. Since 2000, important institutional arrangements have been put in place, regulations have been adopted, and initial policy reforms have been implemented on several fronts. These actions have included: (i) the establishment of the (inter-ministerial) National Committee on Decentralization (NCD), supported by the Technical Group of Experts on Decentralization (GED) with international expertise; (ii) the adoption by the NCD of the Strategy of Decentralization and Local Autonomy; (iii) the approval of a new law on the role of Prefects and their relationship to the local authorities; (iv) the approval of the Law on Immovable State Properties, the Law on the Transfer of State Properties to the Local Authorities, and the
creation of the Agency for Inventory and Transfer of Public Properties; (v) the transfer of several key exclusive functions to local authorities (including some minor functions transferred to the regions) as defined by the law on local governments; (vi) the establishment of a formula-based unconditional grant distribution mechanism (partially replacing conditional, earmarked transfers); and (vii) the adoption of a critical package of fiscal reforms in 2002 (including the local small business tax, the simplified profit tax, property taxes, and a system of local fees and charges) which expanded local government revenue autonomy.

4. Although the country has taken a political decision to decentralize fiscal and administrative decisions, and for that end can now count on a minimum institutional base and a reasonably strong legal framework, it should be noted that Albania is at a crossroads. The implementation of policy reforms has been uneven and is lagging behind schedule. This has been partially due to weak implementation capacity, to institutional and structural constraints, and to political and bureaucratic stumbling blocks in the reform process. Actually, while in some areas progress has been substantial (as noted in the previous paragraph), in other areas reforms that would facilitate decentralization have met with difficulties or resistance. For example, the specific competencies of regions, municipalities and communes, as well as the drafting of the new Law on Local Budget and the new Law on Local Finance (including the badly needed national tax sharing arrangement) are still undecided. Overall, for Albania to successfully implement a sustainable intergovernmental fiscal relations system, it still must address certain critical challenges, including the following:

   a. **The lack of implementation capacity and weak institutions**, has delayed the adoption of decentralization measures, since there is a fear that this may disrupt the delivery of local public services and/or may have an unfavorable impact on fiscal accountability.

   b. **The fragmentation of local government units and the undefined role of the regions**, which could complicate a uniform attribution of responsibilities and could affect local public service delivery efficiency, fiscal transparency and fiduciary accountability.

   c. **The lack of a clear definition of specific responsibilities** and decision-making powers, especially for shared functions, which has led to inefficiencies, because of duplication or under-provision of services.

   d. **The insufficient local revenue autonomy**, which has negatively affected fiscal and political accountability of local authorities directly to citizens.

   e. **The inefficient transfer/grant system**, which renders the local government financing system unpredictable (and which still reflects a “gap-fill” type of approach), since it remains dependent on undesirable political and bureaucratic maneuvers.

5. This “Albania - Decentralization in Transition” report provides: (i) a stocktaking of the decentralization process in Albania; (ii) a discussion of the conditions for sustainable intergovernmental fiscal relations under a certain degree of local fiscal autonomy; and (iii) a roadmap on how to proceed in critical cross-cutting intergovernmental finance matters. The study is intended to support the development of a consistent decentralization strategy in Albania and provide inputs to Bank’s operational interventions (including the CAS, the PRSC, and sector operations).

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1 Including the absence of central coordination and the reluctance of the central bureaucracy to relinquish decision-making power on micro-managing local public services.
6. This Executive Summary specify the strategic directions for reform and cover the above identified main issues under the following headings: Strategic Directions; Implementation Capacity and Institutions; Territorial Division and the Role of the Regions; Assignment of Responsibilities; Revenue Autonomy and Accountability; and Fiscal Imbalances and the System of Transfers. Section VIII provides suggestions towards a road map for reforms.

II—STRATEGIC DIRECTIONS

7. In order to implement a sustainable decentralized administrative and fiscal system, the Government of Albania must publicly spell out a feasible reform agenda that it intends to implement in the near future. One option is for the Government to review its current decentralization implementation program, make it consistent with its National Strategy for Social and Economic Development (NSSED), and focus the reform agenda (see the next sections of this Executive Summary) on the following general strategic directions:

   a. **Boosting the credibility of the government’s decentralization strategy** by maintaining the momentum of its reform implementation agenda and definitively consolidating in practice the legally adopted multilevel public administration structure.

   b. **Defining and attributing the specific responsibilities of local governing units asymmetrically,** on the basis of pre-established objective criteria of eligibility. This would imply empowering local managers and authorities with sufficient capacity, incentives and autonomy, and ensuring their commitment to policy outcomes through enforceable meaningful legal instruments.

   c. **Creating the conditions for the improvement of local government accountability to the citizens,** by promoting local fiscal autonomy on the basis of the appropriate, efficient and fair assignment of local revenue sources.

   d. **Using the transfer system as an effective policy instrument** to compensate for regional economic disparities and fiscal imbalances, and to achieve for each sector (including education, health, social assistance, infrastructure, utilities) nationwide and local objectives (in terms of public expenditure priorities and service provision, in quantity, quality and accessibility), in a transparent, congruent and efficient manner.

8. These overall decentralization strategic directions are consistent with the NSSED, which establishes that “by the end of the 2003-2006 period, the Government will have completed the decentralization process …” including the “…transfer of assets and the total transfer of financial and fiscal competencies …, the definition of the shared functions and the clarification of the position of the local government … (in education, health service, social assistance, civil defense, etc.), … the reform of the administrative-territorial division, …and the strengthening of the municipalities and communes … aiming at enhancing inter-communal cooperation.”

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2 That is, in accordance with their respective implementation capacity.


4 See Section VIII of this Executive Summary.
9. Policy implementation capacity and intergovernmental and donor cooperation in Albania are weak. Therefore, improving implementation capacity, especially at the local level, is a necessary condition for proceeding successfully with decentralization. Too rapid decentralization without the proper capacity and institution building (including improved intergovernmental and donor cooperation) could jeopardize governance and exacerbate the disruption of local public services delivery (in both quantity and quality). Such an outcome would run counter to the very objectives of decentralization. Therefore, a well designed government decentralization implementation strategy is necessary—one that factors in capacity and institution building accordingly.

10. One problem affecting capacity—and this has been exacerbated by the recent migration outflows of population—is that the administrations of small municipalities and communes have found it difficult to retain young, talented professionals, who are leaving in search of better employment opportunities, wages and living conditions. This migration has constituted a major challenge for those communities in the northern and southern regions, from where migration to the central regions and abroad takes place. This challenge is particularly important in view of the absence of a national capacity/institution building program at the local level. Institutional weaknesses are particularly acute in the area of budgeting, where accounting procedures are de facto not uniform, where planned and executed budgets usually diverge, where auditing (if any) is not regular, and where monitoring and evaluation are practically nonexistent.

11. In addition, not all ministries have been satisfactorily responsive in decentralizing functions and competences in pace with the decentralization strategy. Understandably, central ministries’ new role may involve relinquishing some of their current decision-making power in many aspect of local public service delivery, and taking on a more proactive role in essential new central functions of planning, regulating, coordinating, and overseeing responsibilities such as policy formulation, the setting of standards and regulations, and monitoring, control and evaluation.

12. Moreover, the pre-1998 Constitution/pre-2000 local self-government Law paradigm under which the central government and some donors still operate may alienate local authorities and civil society by excluding their inputs in the prioritization of local resource allocation. Sometimes donors have conducted negotiations for locally implemented assistance projects/programs at the ministerial level, without sufficient direct involvement on the part of local governments, NGOs and the civil society. Under such a paradigm, donor assistance may end up obstructing, instead of assisting a sustainable implementation of the Government’s decentralization strategy.

13. The report suggests that the Government may want to consider addressing the above issues regarding implementation capacity and institutions by adopting a set of complementary institutional reforms that can remove the remaining hurdles that are impeding or delaying the implementation of the degree of administrative and fiscal decentralization that could be sustainable. Such a set of reforms should include the following:
14. **Shifting the paradigm of central government institutions from managing** local service delivery towards policy formulation, setting up standards and regulations, and exercising monitoring, controlling and evaluation more effectively. The implementation of this reform approach is critical for the continuation of decentralization in Albania (see Section VIII, A of this Executive Summary). The Government may consider implementing this reform approach *immediately,* although the results may be expected to be fully effective only in the medium term.

15. **Strengthening governance institutions, including building capacity,** is a sine qua non to effect the decentralization reform measures. This can be achieved by:
   a. reviewing the Organic Budget Law and making budgetary procedures and processes uniform at all government levels;
   b. empowering local authorities and managers with clear specific competencies on expenditures and revenues, and making them personally accountable before the law and the local citizens;
   c. designing and implementing a Law on Local Government Finance, which clearly regulates all intergovernmental relations, including tax sharing and access to borrowing; and
   d. adopting a national training program (for central and especially local authorities, officials and staff—on public finance, including budgeting, accounting, and fiscal and debt management) in collaboration with the Department of Public Administration (DOPA/Council of Ministers). The adoption of policy measures in all these areas of reform is desirable and feasible in the *short term.*

16. **Strengthening downstream monitoring and coordination** by setting up an independent “National Forum for Decentralization Implementation (NFDI)” to support the GED and the NCD in effecting the government’s decentralization agenda. The NFDI would be formed by all stakeholders (regional, municipal and communal governments, central government—including line ministries—donors, think tanks, and non-governmental and community development organizations), would convene on a quarterly period basis, and would aim at: (i) promoting communication, capacity building and management of information; (ii) disseminating best practices in a decentralized administrative structure; (iii) improving intergovernmental fiscal relations, by serving as a cushion to accommodate divergent interests and as a first point for conflict resolution; and (iv) helping accelerate the implementation of the Government decentralization strategy, by feeding back the work of GED and NCD with critical grass root information and suggestions for periodic policy adjustments.

17. **Promoting an increasing role for the private sector** (including local NGOs and civil society organizations) in the financing and the delivery of local public services. The more direct involvement of the private sector should be aimed at rationalizing the use of public resources, reducing waste and ensuring a sustainable supply of services (including utilities). Given the present conditions in Albania, and in order to avoid disruptions in service delivery, this should be implemented gradually and considered an objective to be satisfactorily achieved in the *long term.*

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5 In this report, policy reforms have the following time dimensions with regard to their desirable implementation: *immediate,* in the next three months; *short term,* in the year ahead; *medium term,* in the next two years; *long term,* when the necessary conditions are in place.
18. The current territorial division and the role of the regions have raised issues on both efficiency and political grounds, that is, on the grounds of whether the local administrative units (especially the communes) are not too numerous and of too small a size, and whether the Regional Councils have the legitimacy to play a relevant governmental role in Albania. The main arguments are as follows.

19. Although Albania is a small country (about the size of the state of Maryland and with only about 3 million inhabitants), its territory is formally divided into 374 first level local self-government units (65 municipalities and 309 communes). This entails a situation in which 48 percent of these self-governing units, representing 17 percent of the country’s population, are made up of communities of less than 5,000 inhabitants—or 54 percent and 30 percent, respectively, in the case of the communes. As with many other European countries in transition, this fragmentation raises concerns that go beyond economic efficiency arguments (e.g., economies of scale and externality spillovers) to include considerations of a political and an administrative nature. On the one hand, fragmentation means that the decision-makers are closer to the voters, which increases democratic representation, and, depending on the design of the decentralization of powers and incentives, may increase fiduciary and political accountability. On the other hand, excessive fragmentation tends to leave the smaller communities short of own financial resources, and administrative and technical capacities necessary to implement policies effectively and operate public services efficiently—an argument which runs against decentralization.

20. The discontinuation of the old Districts and their replacement by a second level of local self-government (i.e., the Regional Councils) constituted an innovative facet of the 2000 territorial-administrative reform. To the Regional Councils the law assigned the exclusive functions of planning and coordinating actions of regional interest and of delivering public services which could be delegated to them by the central government or the constituent municipalities or communes. In practice, however, the local regional government concept has as yet been perceived as an “empty box,” since the functions of the Regional Councils are still poorly defined, the Councils can count on no fiscal autonomy, and the central government and first level local governments are reluctant to delegate functions to the Councils. In fact, as the Regional Council members are not directly elected by all of the citizens in the region, they tend to lack accountability, and both Prefects and local Mayors (who are, respectively, appointed by the central government and directly elected by municipalities and communes) have questioned the legitimacy of the regional authorities on this basis. Mayors of larger municipalities, in particular, are unwilling to accept regional guidance, or intermediation in their dialogue with the central authorities, since they are usually capable of gathering a large enough audience of their own. In addition, central and line ministers are accustomed to operating locally under the paradigm of de-concentrated services in the territory and seemingly prefer to continue doing so.

21. Overcoming the administrative fragmentation of local governing units is possible either by implementing the compulsory amalgamation of the smallest units (especially the communes), or by promoting incentives (including financial incentives) which encourage various forms of voluntary associations among the local governments. The former approach may
have the advantage of being more effective and simple to operate from the center, but it runs the risk of confronting local traditions and may also create political turmoil, since it may be perceived as imposed from the top down. The latter approach, by definition, is more efficient since it respects local traditions and preferences, but tends to take longer to complete (if it is implemented at all) and is more complex to monitor centrally. Given the political sensitivity of the issue, the Government of Albania may consider taking a flexible approach (considering conditions and timing) by:

a. assigning responsibilities (and the corresponding resources) to local self-governments asymmetrically, that is, according to their respective capacity of delivering the specific local public service efficiently; and
b. articulating incentive instruments (including direct technical support, training, and financial/fiscal support) in such a way that eligible jurisdictions could easily realize that voluntary amalgamation/association could increase efficiency and make them better-off permanently, as well as improving their chances to access EU concessions later on.

22. Establishing the regions as effective governing authorities will require a clearer assignment of their responsibilities and a commensurate degree of fiscal autonomy in order to ensure greater efficiency and accountability. To this effect, complementary measures should be implemented in the medium term in order to clarify the role of the regions by:

a. re-examining the advantages/disadvantages of the indirectly elected Regional Council members—for example, whether the current local regional governments (i.e., a kind of local government association) could be as effective as a truly self-governing regional government (i.e., a directly elected intermediate level of government);
b. submitting, de facto, the role of the Prefects to the requirements of the new Law # 8927/2002, and discontinuing the traditional prevalence of the Prefects in matters of local interest;
c. considering adopting the compilation of statistical information in conformity with EU’s Nomenclature for Statistical Territorial Units (NUTS); and
d. evaluating any current and prospective regional semi-autonomous agencies (e.g., Tirana Region Health Authority-TRHA) for consistency and proper coordination with the decentralization reforms.

V—ASSIGNMENT OF RESPONSIBILITIES

23. The provision of public services in Albania is in a transitional phase, from a highly centralized, hierarchically de-concentrated system inherited from the previous regime to a decentralized decision-making structure formalized by the 2000 legal reform. This legal reform represented a turning point in intergovernmental fiscal relations, which, inter alia, broadly assigned responsibilities to local governments. Although considerable efforts have been made in this direction and some progress has been observed in the years following the reform, political difficulties and bureaucratic stumbling blocks do exist, and thus there is still a long way to go to bring the basic legal reforms into satisfactory practical implementation.
24. By and large, the new organic local government law associates responsibilities with the theoretical concept of benefit areas, and it is broadly consistent with the practical principle of subsidiarity adopted by the European Union (i.e., local governments are assigned responsibilities for services that benefit the local jurisdiction, so that authorities will be accountable to their own local constituents). However, the law assigns only generic responsibilities to local governments according to three categories of public functions: exclusive, shared, and delegated functions.

25. Exclusive functions are those in which the local jurisdiction is the main beneficiary of the public services. These include mainly local infrastructures and public utilities, but also some areas of social services, housing, recreation, sports and cultural activities, as well as local traffic regulation, public transportation, public sanitation, civil security, and local development planning. Shared functions are understood as those in which major externalities may occur in the provision of the public service (i.e., the benefit area is likely to extend beyond the local jurisdiction that provides the service). The following are broadly defined as shared functions by the organic law: pre-school and pre-tertiary education, emergency/primary health care, public health protection, social assistance and poverty alleviation, public order and civil protection, and environmental protection. Nevertheless, the precise definition of competences to be attributed to local authorities is still pending further specific regulation. Finally, delegated functions are those for which the state (the principal) can attribute, by means of law or agreement, to the local authorities certain competences (e.g., delivery of services, payment of benefits) according to prescribed standards, in which case the local government essentially acts as an agent in the delivery of the specified services.

26. Although the organic local government law has established a sound foundation for the assignment of expenditure responsibilities, Albania stands as an example of a difficult implementation process, typical of European countries in transition, where political and bureaucratic issues interweave with a difficult social situation on the ground. In Albania this is aggravated by the fact that the initiative for further specifying responsibilities and powers has essentially been left to the decisions of the line ministries, an approach that may not augur well because of the obvious vested interests involved.

27. The main issues in the assignment of responsibilities identified by the report include the following: (i) lack of clarity and specificity in the assignment of responsibilities; (ii) de facto insufficient expenditure autonomy for local governments; (iii) inefficient delivery of local public services; (iv) inconsistent separation in the assignment of responsibilities for capital expenditures; and (v) substantial disparities in per capita expenditures across local self-governing units.

28. The lack of clarity in the assignment of responsibilities for specific competences (to both the regions and the municipalities and communes), especially with respect to shared functions, may lead to concurrent authority, with duplication or under-provision of essential services. Confusion regarding powers may become an excuse for unfunded mandates and may serve as a perverse incentive for local governments to trigger a bailout which may soon turn into a source of soft budget constraints. As long as the specification of competences is not properly defined, distortions will tend to build up and the service delivery system will become increasingly
inefficient, further complicating the implementation of the Government’s decentralization agenda.

29. The insufficient de facto autonomy of local governments with regard to local expenditure (because of the excessive ascendency and power of Prefects and central regulating agencies, which are supported by the central authorities) has in practice limited the ability of local administrations to prioritize resource allocation in accordance with the citizens’ interest.

30. The inefficient delivery of local public services has recently been aggravated by two main factors. The first of these factors is the weak prioritization of resource allocation, revealed by an inadequate mix of factor inputs at the local level, reflected in the low O&M/wage expenditure ratio, which may indicate insufficient complementary resources per local public worker (including training and equipment). Low maintenance expenditures for existing equipment and facilities have led to inefficiencies, to the high cost of local service provision, and to the too rapid deterioration of the capital stock. The other factor is the intense migratory movements, mainly from small rural communities in the north and the south toward larger urban centers in the middle of the country that have exacerbated the structural imbalances of the territorial administration, which comprises, on the one hand, fragmented administrative units operating with high fixed costs and, at times, “idle” capacity, and, on the other hand, a few bloated urban centers with overcrowded infrastructures and social service facilities.

31. The inconsistent separation in the assignment of responsibilities of capital expenditures (investment and maintenance) has led to sub-optimal spending on the maintenance of facilities and equipment, since it represents a perverse incentive policy which tends to lead to more rapid depletion of the capital stock than would otherwise occur, including in the social sectors.

32. The substantial disparities in per capita expenditures across local self-governing units may increase with the decentralization of tax revenues on a derivation basis, thereby threatening equity principles, and, in the medium and long terms, may jeopardize the country’s social and political stability, colliding with the EU cohesion objectives.

33. Conflicts between emerging sectoral strategies and the Government’s decentralization agenda may indicate a disconnect and a lack of central coordination, which would tend to create confusion and uncertainty in local planning and budgeting, and would run the risk of alienating the local authorities. A disconnect also seems to persist between the decentralization strategy and the privatization policy (including utility services). In the matter of this disconnect, a clear policy sequencing (i.e., whether privatization of public assets would precede or follow decentralization, and under what conditions) may still need to be established.

34. In parallel to the required institutional and capacity building arrangements referred to in the previous section, the Government might consider addressing the above issues by:

35. **Effecting the implementation of exclusive functions** by clarifying specified functions and competences, defining the unconditional financing sources, and accelerating transfers of public properties to local governments. This could be achieved by: (i) establishing explicit implementation programs to complete the shifting of responsibilities (either to Regional Councils
or to municipalities and communes), including civil defense, urban planning, land management, housing, protection of the local environment, and utilities (e.g., water and sewerage); and (ii) resolving the pending issue on the assignment of responsibilities for capital expenditures (where currently the central government is basically responsible for capital investment while local governments are responsible for O&M) by establishing a long-term program to phase in local government responsibilities for local investment and, to the extent possible, to open this opportunity to private sector participation as well.

36. **Defining specific competences on shared functions** for local governments in accordance with Law # 8652/2000. This is critically urgent in order to resolve the pending inconsistencies in the legislation and to avoid increasing inefficiency and disruptions in social service delivery (including education, health, and the environment). In addition, *cost measurement criteria, national service standards, and funding sources for shared functions* should be agreed upon, in congruence with the national strategies for the respective sectors and in consultation with local governments. In this regard, a feasible, binding timeline for the transfer of assigned responsibilities to local governments, including capital expenditures, should be approved and implementation should begin soon. Moreover, the Government may consider whether some specific competences of “veterinary services” (e.g., animal disease control, agricultural research, and rural extension services) and “health care” (e.g., the campaign to combat contagious diseases, HIV) should be re-assigned from *shared* to *delegated* competences, in accordance with the argument that the benefit area is actually the entire national territory.

37. **Reviewing and re-assigning delegated functions** by considering (i) amending the organic law by re-assigning those functions of evident national benefit area, such as veterinary services, some national health care services, and social assistance to the poor (i.e., *ndihma economike*), from the *shared* to the *delegated* category (see previous paragraph); and (ii) defining the specific competences of local governments in education and health (including operations and maintenance of facilities) and re-assigning them from (the currently interim) *delegated* functions to *shared* functions definitively, as authorized by the organic law.

38. **Assigning capital expenditure responsibilities consistently** by envisaging a medium- to long-term strategy of gradually transferring to the local governments the responsibilities for capital investment and maintenance on exclusive and shared functions. Although in the short term the Government may still have to provide substantial capital transfers and loans to the weaker local governments, the proposed medium- to long-term strategy would not only help the system converge to a more efficient allocation of capital expenditures (thereby minimizing the waste of scarce resources) but would also be consistent macroeconomically, since it would alleviate pressures on the state budget by tapping resources for essential local capital investments (including infrastructure reconstruction and expansion) from alternative financing sources.

39. **Assigning meaningful responsibilities to the regions while addressing the fragmentation problem of the communes and municipalities** by identifying and shifting functions whose expanded benefit areas can increase efficiency in service delivery. In this regard, some of the problems associated with economies of scale and externalities at the local

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6 The assurance of fiscal transparency and hard budget constraints is critical for such an approach to work well. Albania may still need considerable reforms in the financial sector for the necessary conditions to be in place.
level could probably be solved at the regional level, or by voluntary associations of municipalities/communes, service outsourcing, and the direct participation of the private sector. Probably some education competences (e.g., secondary and vocational education), some health care competences (e.g., primary health care, including ambulance services and regional hospitals), some civil security competences (e.g., firefighting), transportation and telecommunications (e.g., intercity transport services and regulations), and utilities (e.g., water supply, irrigation, solid waste collection and management) may fall into this category of services. Although the Government may consider delegating some of these functions and competences to the regions and introducing incentives for the municipalities and communities to do the same (or to associate, or outsource), caution should be exercised to avoid inter-jurisdictional conflicts regarding power, unfunded mandates, and soft budget constraints.

40. **Increasing efficiency of public service delivery** by implementing structural reforms that would account for an increase in the O&M/wage ratio and would resolve the regional imbalances provoked by the migratory movements of recent years. In this regard, the Government may consider the following:

a. Extending the civil service reform to cover local administrations, and better prioritizing local resources during the budget formulation phase (including adopting a cautious use of expenditure “norms” to avoid maintaining local oversized or idle institutions).

b. Carrying out sectoral and administrative reforms to rationalize the existing facilities, infrastructures, and personnel. These reforms would, on the one hand, probably require the closing of many idle facilities in the depressed areas of the country and the re-deployment of (de-concentrated) personnel across jurisdictions. On the other hand, they would also require increased investments in the immigration areas in order to alleviate the excessive pressure on the insufficient local infrastructures.

41. **Strengthening coordination between sectoral and decentralization strategies** by empowering the GED and the proposed NFDI with enforceable monitoring and control instruments to ensure policy consistency at the formulation and implementation phases, respectively. Strengthening coordination in policy formulation is essential to avoid the current disconnect between the emerging sectoral strategies and the Government’s decentralization agenda. A tight follow-up approach should be maintained to guarantee that a consistent and comprehensive decentralization strategy is implemented in congruence with the central and line ministries, without alienating the local governments and the private sector in the process.

**VI—REVENUE AUTONOMY AND ACCOUNTABILITY**

42. In fiscally decentralized systems, revenue autonomy—apart from expenditure autonomy—provided by meaningful and predictable own sources of revenues is a prerequisite incentive mechanism for local accountability. Citizens can easily associate the costs with the benefits of the public services they demand and with the local authorities that are responsible for taking decisions. In addition, an adequate degree of revenue autonomy provides local authorities
with the necessary instruments to reduce fiscal vertical imbalances, by predicting, forecasting and planning their budgetary priorities accordingly.

43. The system of revenue assignment in Albania is experiencing a major overhaul, which started with the introduction of new local tax, charges and fees legislation in December 2002. This fiscal reform is aimed at strengthening the local tax regime and developing a sound revenue base for local governments. It represents a rupture with the past local government financing structure, which was characterized by an extreme degree of centralization in fiscal decision-making. The fiscal reform package of December 2002 reorganized the assignment of revenue sources by redefining some previously national taxes as local taxes (property tax on buildings and land, small business tax, vehicle registration tax), creating new local taxes and fees (property transaction tax, simplified profit tax, temporary tax), reclassifying and rationalizing the previously existing fees, and eliminating the existing local turnover tax (on restaurants, discos, hotels, and cafés and bars).

44. The new legal configuration of the tax assignment in Albania as of January 2003 goes around state non-shared taxes, national shared taxes, and local taxes, fees and charges. State non-shared taxes include the value added tax (VAT), customs duties, the solidarity tax, and a set of non-shared national fees; all policy decisions on rates and bases, proceeds appropriation, and tax administration are entirely reserved to the central authorities. The law on local government (Arts. 15 and 17) introduced for the first time in Albania the category of national shared taxes, which includes the personal income tax (PIT) and the profit tax (corporate income tax-CIT), although to date no tax has been shared with the local governments, under the argument that this would add considerably to the revenue disparities among jurisdictions.

45. Local own taxes are levied on properties (including buildings and agricultural land), property transactions, turnover of local small businesses—the Local Small Business Tax (LSBT) and the Simplified Profit Tax (SPT)—vehicle registration, hotel services, business signs, construction, use of public space, and some temporary activities. Local fees and charges are authorized mainly on business registration, solid waste services, advertisements, slaughterhouses, new residence registration, car parking, and hunting and fishing. To date, with the exception of the larger urban centers (e.g., Tirana, Durres, Elbasan), local taxes, fees and charges have been characterized as ineffective fiscal instruments, since they constitute a myriad of small rates, which are complicated to administer (some of them costing more to collect than their tax yield) and which have low compliance rates owing to the economic conditions of the local population and/or the perceived low capacity of local enforcement mechanisms.

46. Currently, in regard to tax assignment, the Government of Albania faces the following main issues: (i) local revenue autonomy is low; (ii) the 2002 fiscal reforms introduced new pitfalls; (iii) decisions on sharing national taxes are still pending; (iv) the legal provisions for the use of local fees and service charges are inappropriate; (v) property value assessment is still inadequate; (vi) local capacity in tax administration is weak; and (vii) the disparities in per capita revenues across municipalities and communes are significant.

47. Local revenue autonomy in Albania remains low even after the introduction, with the 2002 fiscal reform, of the LSBT, the SPT, the Agricultural Land Tax (ALT), and the vehicle
registration tax. Relative to its European comparators, local government in Albania lags behind quantitatively, and cannot decide on bases and rates for the SPT and the vehicle registration tax. Moreover, the Regional Councils remain without any fiscal power of their own.

48. The pitfalls introduced by the 2002 fiscal reform may entail a non-buoyant local tax system for local governments, since (i) the tax liability of the newly assigned local taxes is not ad valorem based; (ii) the indicative LSBT fixed quota scale and the SPT rate are still centrally determined; and (iii) although the entire tax yield is local government’s, the LSBT and SPT taxpayers are subjected to two separate tax administrations, and this implies a perverse incentive for the collection of the local tax.

49. Allegedly because it would increase horizontal disparities, a broad-based national tax-sharing scheme has not as yet been implemented, which leaves room for an unpredictable “gap-filling” negotiation of transfers and grants. This approach to complementing the financing of local budgets is highly inefficient from the economic perspective of resource allocation, and has been subjected to all forms of political and bureaucratic influences.

50. Albania makes inadequate use of fees and service charges, owing to an inappropriate legal provision in the local government law (Art. 33) which requires a three-fifths majority of Local Council votes for the approval of decisions on local taxes and fees. This rule renders a fiscal system that is inflexible, and which tends to be particularly problematic for the near future with the transfer of the “water and sewerage supply” responsibilities to the local governments. This is an important matter because Albania does not yet have clear tariff policies for the utility services, which, while providing affordable services to the poor, would allow the utility companies to recover costs (and to stop accumulating arrears) and the consumers to minimize waste. Clearer utility tariff policies could help rationalize the use of resources, increase efficiency, ensure a sustainable supply of public services, and reduce the vertical fiscal imbalances and pressures to raise revenue from general taxes.

51. Property value assessment is also inadequate, owing to the underdeveloped real estate market, insufficient parameters for differentiating property valuation, lack of a reliable cadastral system of properties, and potential loopholes (allowed by the tax exemption mechanisms) in the property tax legislation. These inadequacies may depress the local tax base and the effectiveness of the property taxes as potentially the most relevant source of local revenues.

52. The local capacity for administering taxes, fees, and service charges is variable in Albania. While the larger urban centers seem reasonably equipped to take on more responsibilities for administering their own revenues, the smallest municipalities and the communes may have difficulties in performing this function in the short run. On the one hand, the General Tax Department (GTD) has argued that, apart from the lack of a minimum required scale of operations, not all local governments have the infrastructure and technical expertise to satisfactorily administer the assigned local taxes (in particular, the LSBT). On the other hand, the local governments have contended that the GTD has usually been more concerned with

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7 On October 30, 2003 the CoM approved a draft amendment to the Law on Local Self-Government altering this provision. The new draft proposes a simple majority vote (50 percent plus one vote). By early-December 2003 this was still pending approval by the Parliament.
collecting the larger national taxes (CIT, PIT, and VAT) and only marginally pursues the collection of local taxes.

53. Finally, the already large disparities in per capita local revenues between and across municipalities and communes will tend to increase in the near future, since the 2002 fiscal reform’s emphasis is on the allocation of tax yields on a derivation basis. While the reform encourages local tax efforts in rich communities, the poor communities tend to be left behind for lack of tax capacity.

54. To address the above challenges of increasing local revenue autonomy, the Government may wish to consider adopting the following three major lines of action:

55. **Boosting fiscal efficiency and accountability** as a major goal of the Government’s decentralization strategy by:
   a. Improving local revenue autonomy and fostering a buoyant local tax base, by examining the feasibility of assigning to the local governments on a residence basis (either municipalities/communes or regions, selectively) a proportional PIT surcharge piggybacking on the national progressive PIT rate. This would give local authorities a tool to efficiently exploit their tax bases and reduce vertical imbalances.
   b. Setting up a legally pre-determined, broad-based national tax-sharing mechanism as a proportion of (some) national taxes, to be distributed according to a formula-based equalization scheme. This measure would put in place a predictable revenue mechanism for the local governments while removing any political or bureaucratic influence on the determination of the overall size of the pool of transfers/grants.
   c. Consolidating the small business turnover taxes (the LSBT and the SPT) to simplify tax administration and restore a buoyant revenue base for the local governments. This would remove the actual and potential inefficiencies of the current turnover and profit taxes.
   d. Rationalizing the use of fees and service charges by removing the “nuisance” charges and fees; spelling out sectoral strategies and tariff policies for utilities separated from social policies; replacing the three-fifths voting requirement rule for decisions on local taxes, charges and fees by a simple majority rule; and considering the introduction of some buoyant and equitable sources of local revenues, such as levies on some public utilities, on vehicle property transfers, or on driver’s licenses. These are sine qua non measures if Albania is to have in place a reasonably rational system of fees and service charges.

56. **Maximizing local own revenue collection** to provide local authorities with the necessary means to discharge their responsibilities by:
   a. Improving the system of property value assessment with the adoption of an ad valorem market assessment system as a strategic direction for the medium and long terms. To this end, steps should be taken immediately in order to find proper financing, build capacity, and pilot the main cities. Meanwhile, the Government should resolve the two main weaknesses related to the current valuation system: (a) bringing the eligibility criteria for granting exemptions for the poor strictly in line with the criteria applicable for social assistance; and (b) upgrading cross-reference information among the four...
main components of property tax administration (identification of properties, record keeping, assessment and collection).

b. upgrading the capacity for local tax administration in general, including the equipment and training of local government staff. This is the case for the LSBT during the two-year transition period, and the property tax, where the Ministry of Local Government and Decentralization (MoLGD)—in collaboration with the Department of Public Administration (DOPA), the GTD, and the Association of Municipalities, Communes and Regions—should put in place as soon as possible a national capacity building program supported by the state.

57. **Improving the fairness of the fiscal system** by compensating for the horizontal disparities, which have been exacerbated by the recent creation of the new own taxes, fees and service charges on a derivation basis. The utilization of fiscal equalization mechanisms (see Chapter 4 of the report), which are already partially in place (e.g., the “unconditional grants”), should be completed, adjusted and strengthened accordingly over time to compensate for the limited revenue capacity of the poorest jurisdictions. This is an unequivocal policy direction to sustain social stability in Albania in line with the EU cohesion principle.

### VII—FISCAL IMBALANCES AND THE SYSTEM OF TRANSFERS

58. Decentralization in Albania, as in many other countries, has tended to lead to vertical and horizontal fiscal imbalances.\(^8\) This phenomenon tends to be an inevitable outcome which may arise from efficiency reasons (for example, from economies of scale in tax administration that require the centralization of certain taxes, vis-à-vis local preferences and costs in service delivery that recommend subsidiarity in expenditure decision-making) and/or out of differential economic conditions across jurisdictions (for example, a distinct distribution of economic resources across jurisdictions vis-à-vis the distribution of social needs, that will affect tax capacity and expenditure patterns asymmetrically).

59. Following international best practices, Albania has shown remarkable progress in designing and implementing transfer/grants mechanisms to compensate for these fiscal imbalances and externalities. Since the early 1990s, these mechanisms have evolved from an almost exclusively earmarked system of conditional grants (where local governments essentially performed the role of agents for the central government in the delivery of local public services) towards a mixed system of “conditional” and “unconditional” transfers—the latter was preceded (between 1999 and 2001) by a “block grant” system, used to allocate (non-labor) operations and maintenance expenditures in the health, education, public works, and culture sectors.\(^9\) The “conditional grants” mechanism still keeps its old features of being non-transparent, being

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\(^8\) Vertical fiscal imbalances result from a mismatch between expenditure responsibilities and revenue-raising powers at different levels of government. Horizontal fiscal imbalances result from a divergence in expenditure needs and the respective tax capacity across jurisdictions at the same government level (regions or municipalities/communes).

\(^9\) Personnel costs and capital expenditures are still covered by “conditional” grants financed by line ministries’ budgets.
unpredictable and depending basically on the bargaining powers of local authorities and the line ministries. The “unconditional grants” mechanism was initiated with a provisional formula for distribution based on differential local needs and is still evolving towards a true equalization transfer. Nevertheless, the size of the unconditional grant is neither transparent nor predictable: rather, it is an ad hoc amount resulting from purely bureaucratic and political bargaining without any technical rationale behind it.

60. Notwithstanding the recent progress in decentralization, it is important to observe that: (i) decision making is still mostly retained by the center (with about one-quarter of total public expenditures de-concentrated), which has required a corresponding substantial amount of transfers from the center on a conditional basis;\(^{10}\) and (ii) local governments are still highly “transfer-dependent” (87 percent as projected for 2003), and will continue to be so in the near future.

61. Apart from the considerable fiscal imbalances, the most critical issues pertaining to intergovernmental grants in Albania include: (i) the lack of any rationale for the size of the unconditional transfer pool; (ii) the excessive complexity (and incompleteness) of the current formula for the distribution of the unconditional grants; and (iii) the lack of transparency in the determination and allocation of conditional grants.

62. In fact, there are still no rational criteria for the annual determination of the size of the unconditional pool of resources to be transferred (i.e., the general purpose transfer pool), which tends to be non-transparent and unpredictable, and does not differ much from the old inefficient vertical “gap-fill” negotiated approach. This approach has been highly vulnerable to political and bureaucratic influences. It has generated perverse incentives for soft budget constraints, by allowing for endless, costly and open negotiations, that permanently engage most of the influential central and local executive and legislative authorities.

63. Despite the commendable effort by the Government to put in place a pre-established rule to discipline the distribution of unconditional transfers, the formula used to date is too complex (although unsatisfactory as an equalization mechanism) to be administered centrally and understood by the main beneficiaries. The formula still deals with too many compensation funds (the general, the regional, the municipal/communal) which depend on too many conditions. The factors affecting the general purpose component and the equalization factor are still poorly specified in the formula, and a convincing rationale is needed for the structure of coefficients that weights the factors.

64. Conditional grants for the operations and maintenance of existing institutions are basically allocated on a historical basis, while the few fund allocations for investment have mainly been the result of political influence. There is considerable imbalance in the size of the conditional grants vis-à-vis the size of the unconditional transfers, which tends to negatively affect the expenditure autonomy of local governments. There is a lack of criteria and of

\(^{10}\) Conditional grants to the local governments are essentially earmarked for: (i) wages and social benefits and investments in education, health, and social assistance; (ii) certain subsidies and delegated functions (including food, accommodation, and the transportation of teachers and students); and (iii) capital grants for investment in reconstruction of local infrastructure and public works.
competition for the allocation of conditional recurrent grants, which has simply followed an incremental approach. Reliable monitoring and evaluation systems on local public service delivery are absent, which rules out any possibility of verifying the effectiveness of policy implementation. And, there are no clear national standards for local public services set up as yet, which renders meaningless any monitoring and evaluation system on local government performance regarding service delivery.

65. The effectiveness and efficiency of the system of transfers in Albania could be improved in several ways, including the following:

66. **Pre-determining the current financing level of the pool of unconditional transfers** as a fixed percentage of national shared taxes. This percentage could eventually be adjusted later on, whenever the attribution of responsibilities/competences is considered complete. This would simultaneously resolve the problem of determining the size of the unconditional (equalization) transfer fund (in an objective, transparent manner) and of the pending decision on sharing national taxes (without increasing revenue disparities). This would be a simple automatic mechanism, linking the shared-tax scheme with the transfer system, and rendering both of them transparent, predictable and immune to bureaucratic and political influences.

67. **Improving the current distribution formula for unconditional grants** by emphasizing and simplifying the equalization component, which could simply be computed by the inverse of the local per capita revenue capacity (or any meaningful proxy, properly weighted).

68. **Improving the distribution of conditional grants** by: (i) moving the system towards a more balanced allocation of resources between conditional and unconditional transfers, in order to increase autonomy and allocative efficiency; (ii) setting national standards for public service delivery that can be monitored and evaluated through independent and reliable indicators of performance; (iii) improving the equity and efficiency of conditional recurrent expenditure grants by allocating grants through a targeted capitation basis and through “block grants;” and (iv) increasing the transparency and efficiency of conditional capital grants through the use of explicit rules for project selection.

**VIII—TOWARDS A ROAD MAP FOR REFORMS**

69. For the Government’s reform implementation agenda to move forward, it should focus on putting in place the feasible institutional arrangements and incentive mechanisms that can establish a sound accountability framework for public service delivery at the local level, while effecting efficiency and preserving macroeconomic stability. Albeit desirable in the long term, a reform of the territorial-administrative division of the country is not a necessary condition to proceed with the implementation of the decentralization strategy.

70. Although fragmentation of local administrative units continues as a hurdle for decentralization, there are various possible ways to circumvent this problem without disrupt social and political stability. Besides strengthening institutions and capacity building, and
assigning responsibilities asymmetrically, the Government should facilitate and promote incentives for the local government units to pool their resources together and jointly deliver services, including by voluntarily merging, temporary associations and agreements, or outsourcing on a contractual basis.

71. The local accountability framework can be assured, first, by a gradual increase in local revenue autonomy and authority to perform (discretion) and, second, by upgrading the fiscal reporting system. In this regard, the fiscal imbalances and the risk of unfunded mandates, as well as the problems of implementing a law on local government financing should be resolved sooner than later.

72. Policy consistency and policy sequencing should be addressed at the beginning of the decentralization implementation. Consistency between the decentralization strategy, sector strategies and the macroeconomic framework have to be determined as soon as possible, and monitored on a permanent basis. Policy sequencing should essentially be guided by the principle that financing should follow responsibility, otherwise neither local accountability nor macroeconomic stability can be assured. This means that for the Albanian decentralization strategy to move forward: (a) specific competences, especially on shared functions, have to be assigned soon; (b) the badly needed law on the financing structure of the local government (which includes local own taxes/fees/service charges, shared-taxes, transfers, and access to borrowing) can only be formulated and implemented after a clear assignment of responsibilities; and (c) the role of the Regions has to be defined more clearly.

73. Finally, a feasible agenda for specific reform implementation (Road Map) has to be defined in order to set expectations, mobilize stakeholders cooperation, and gather general support for the decentralization strategy. The following road map stems from the analysis and options/recommendations in the report:

74. A. Immediate Measures (to be implemented in the next three months)

i **Shifting the paradigm of central institutions** away from micromanaging local public service delivery and refocusing its efforts toward setting up standards and regulations, and monitoring results and policy evaluation.

ii **Re-assigning the responsibility for expenditures with a national benefit area from “shared” to “delegated” functions** (e.g., contagious diseases, HIV, ndihma economike), and the responsibilities for education and health O&M from “delegated” back to “shared”, with clear specification of competences.

iii **Reassuring consistency between sectoral strategies and the Government’s decentralization strategy** (on both policy formulation

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11 For details see the main text of the report and also “Matrix of Options/ Recommendations”. Consistent with the NSSED 2004-6
12 The preparation of this action plan can be significantly facilitated by the technical assistance (on the “strengthening of policy formulation, coordination and performance-management mechanisms”) to be provided under the Civil Servant Component of the World Bank’s Public Administration Reform Project.
B. Short-Term Measures (to be implemented in the next year)

i  **Strengthening governance institutions (I),** by enacting a new local budget law (or amending the Organic Budget Law accordingly), upgrading the fiscal reporting system, and implementing effective capacity building programs.

ii  **Strengthening downstream coordination of decentralization implementation,** by setting up the independent NFDI and ensuring that it will be complementary to the GED and NCD.

iii  **Effecting the implementation of exclusive functions,** by: (a) establishing programs to complete the transfer of exclusive responsibilities to local authorities; and (b) explicitly addressing the issues on the assignment of capital expenditures (including maintenance and investment).

iv  **Defining local governments’ specific competences, service standards, cost measurement criteria, and funding in regard to shared functions,** and starting implementation soon.

v  **Rationalizing the use of local fees and service charges** by: (a) removing “nuisance” charges and fees; (b) separating utility tariffs policy from social policies; (c) reviewing the voting requirement for Local Council fiscal decisions; and (d) considering the introduction of new buoyant and equitable sources of local revenues.

vi  **Completing and simplifying the current distribution formula for unconditional grants** by considering the equalization component as the inverse of the local per capita revenue capacity (properly weighted).

vii  **Improving the distribution of conditional grants** by a better balance with the unconditional transfers, setting national standards service delivery, targeting on a capitation basis and using “block grants,” and adopting explicit rules, competition and project selection criteria for the allocation of conditional capital grants.

C. Medium-Term Measures (to be implemented in the next two years)

i  **Defining and implementing the role of the regions,** by: (a) determining specific Region’s competences in accordance with the subsidiarity principle, considering economies of scale and scope, and externalities; and (b) addressing the pending issues of direct versus indirect election for Regional Councils, the “de facto” new role of Prefects, a meaningful degree of fiscal autonomy for the Regional Councils, the compilation of statistical data in conformity with EU NUTS, and the proper evaluation of the consistency of existing semi-autonomous agencies [e.g., TRHA] with the decentralization strategy.

ii  **Strengthening governance institutions (II)** by: (a) empowering local authorities and managers with clear responsibilities and making them
personally accountable for policy results; and (b) designing and implementing a Law on Local Government Finance, which regulates all governmental relations, including tax sharing and access to borrowing.

iii  **Increasing the efficiency of public service delivery (I)** by restructuring, re-mapping and re-deploying facilities and personnel across jurisdictions from the depressed areas to the immigration areas.

iv  **Boosting local fiscal efficiency and accountability**, by considering: (a) the introduction a local surcharge proportional PIT; (b) implementing tax-sharing mechanism as a financing source for the pool of equalization transfers; and (c) consolidating the LSBT and the SPT.

v  **Effecting the unconditional fiscal grants as an objective instrument to correct for fiscal imbalances and inequities** by pre-determining the size of the transfer pool as a percentage of national shared-taxes and its distribution as a function of needs and capacity indicators (formula based).

D.  **Long-Term Measures** (to be implemented when the necessary conditions are in place)

i  **Overcoming the challenges of administrative fragmentation** by: (a) attributing asymmetric responsibilities to local self-government units (according to capacity to deliver); and (b) articulating incentive instruments for voluntary amalgamation/association/merger).

ii  **Strengthening the role of the private sector** (including NGOs and civil society) in the financing and provision of local public services.

iii  **Assigning capital expenditure responsibilities** (both maintenance and investment) to local governments gradually, while increasing local autonomy and access to capital market.

iv  **Maximizing own local tax collection** by improving the system of property identification, record keeping, value assessment, and upgrading the local capacity for tax administration.
# ANNEX

## Albania: Decentralization in Transition

### Matrix of Main Issues and Options/Recommendations

<table>
<thead>
<tr>
<th>Areas</th>
<th>Main Issues</th>
<th>Options/Recommendations</th>
<th>Timing</th>
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| I – Reform of the Administrative Structure | 1. The fragmentation of local self-governing units (especially communes), has weakened implementation capacity (both administrative and technical), and may adversely affect the already precarious quality of and access to local public services, which has served as a valid excuse for delays in the implementation of the decentralization agenda.  
2. The still undefined role of the regions, and the interactions among the prefectures with the regions, municipalities, and communes, which can create conflicting authorities, duplications, and inefficiencies, or can cause under-provision of essential local public services.  
3. The pre-1998 Constitution/pre-2000 local self-government law paradigm under which the central government and donors still operate, may end up obstructing, instead of assisting, the implementation of the decentralization agenda.  
4. The weak governance of current | Boosting credibility of the government’s decentralization strategy by keeping up the momentum of its reform implementation agenda to consolidate the multilevel administrative structure. | Long-term |
| | | 1. Overcoming the challenges of administrative fragmentation by: (i) assigning responsibilities to local governments asymmetrically; (ii) articulating incentive instruments (including direct technical support, training, and financial/ fiscal) so that eligible jurisdictions could easily realize that amalgamation/association could increase efficiency and make them better-off permanently, besides improving their chances to access EU concessions later on.  
2. Defining the role of the regions aiming at greater efficiency and accountability by: (i) examining the advantages/disadvantages of indirectly elected Regional Councils; (ii) de facto submitting the role of the Prefects according to the new Law # 8927/2002; (iii) attributing Regional Councils with a commensurate degree of fiscal autonomy; (iv) considering adapting compilation of statistical information in conformity with EU NUTS | Medium-term |

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13 Immediate = to be implemented in the next three months  
Short-term = to be implemented during the next year  
Medium-term = to be implemented during the next two years  
Long-term = to be implemented when the necessary conditions are in place
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<td><strong>institutions</strong>, which can jeopardize transparency and accountability in a fiscally decentralized system.</td>
<td><strong>Strategic Direction of Reforms</strong></td>
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<td>5. The poor coordination of decentralization implementation, which has left local authorities alienated from and unconvinced of a clear, common understanding of the decisions taken, and of their role and responsibilities in the process, essential to successful policy implementation on the ground.</td>
<td><strong>Specific Policy Actions</strong></td>
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<td>(v) considering the evaluation of current and prospective regional semi-autonomous agencies (e.g., TRHA) for consistency and proper coordination with the decentralization reforms.</td>
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<td>3. <strong>Shifting the paradigm of central government institutions</strong> away from micromanaging local service delivery and, instead, focusing towards policy formulation, setting up standards and regulation, monitoring, controlling and evaluation. This refocus of central institution responsibilities should be facilitated by the ongoing technical assistance supported by the World Bank Public Administration Reform Project.</td>
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<td>4. <strong>Strengthening governance institutions and building capacity</strong>, by:</td>
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<td>(i) reviewing the Organic Budget Law and making budgetary procedures and processes uniform at every government levels;</td>
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<td>(ii) upgrading the fiscal reporting system, by regularly disseminating local budget, strengthening internal and external controls, and a more systematic auditing by the Supreme Audit Authority;</td>
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<td>(iii) empowering local authorities and managers with clear responsibilities and making them personally accountable for results before the law and the local voters;</td>
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<td>(iv) designing and implementing a Law on Local Government Finance, which clearly regulates all intergovernmental relations, including tax sharing and access to borrowing; and</td>
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<td>(v) adopting a national training program for local government staff</td>
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### Areas

#### Main Issues

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| IIA -- Assignment of Responsibilities | 1. A still unclear assignment of responsibilities especially with respect to shared functions, which may lead to concurrent authority, duplication, or under-provision of essential local public services.  
2. Insufficient de facto local expenditure autonomy which has constrained local administrations' ability to prioritize resource allocation.  
3. An inefficient delivery of local public services, compounded by two cumulative factors: (i) too low O&M/wage expenditure ratio; (ii) demographic movements which exacerbate structural imbalances between stagnating jurisdictions with “idle,” deteriorating capacity, and a few bloated urban centers with overcrowded service infrastructures.  
4. An inconsistent separation in the assignment of responsibilities for capital expenditures (between investment and maintenance) which tends to lead to sub-optimal maintenance expenditure and too rapid depletion | **Strategic Direction of Reforms**  
Assigning specific responsibilities to local self-government units asymmetrically, on the basis of pre-established objective criteria of eligibility. Empowering local managers and authorities with enough incentives and autonomy, and making them accountable to policy outcomes through enforceable meaningful legal penalties. | Short-term |

| | | **Specific Policy Actions** | |
| | | 1. **Effecting the implementation of exclusive functions** by (i) establishing explicit implementation programs to complete the transfer of exclusive responsibilities—including civil defense, urban planning, land management, housing, protection of the local environment, and utilities (e.g., water and sewerage); and (ii) addressing the pending issue on the assignment of responsibilities for capital investment.  
2. **Defining specific competences on shared functions** for local governments and setting up national criteria, service standards and funding sources, and starting a scheduled implementation soon.  
3. **Reviewing the assignment of shared and delegated functions** and considering (i) amending the Organic Law by re-assigning those functions of evident national benefit areas, such as veterinary services, some national health care services (e.g., campaign to combat contagious diseases, HIV), and social development activities; (ii) building a consensus on governance arrangements and responsibilities (e.g., increased role of autonomous institutions, strategies for active participation in decision-making by small municipalities, etc.) | Long-term |

5. **Strengthening downstream monitoring and coordination** by setting up an independent “National Forum for Decentralization Implementation (NFDI)”, which include all stakeholders, to support GED and NCD in effecting the government’s decentralization agenda.  
6. **Considering the strengthening of the role of the private sector** (incl. NGOs and civil society), in financing and provision of local public services, aimed at rationalizing the use of services, reducing the waste of scarce resources, and ensuring the sustainability of the supply of local public services (including utilities) to the local population. | Short-term | Immediately |
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<td>of the capital stock.</td>
<td>assistance to the poor (i.e., <em>ndihma economike</em>) from <em>shared</em> to <em>delegated</em> categories; and (ii) defining the specific competencies of local governments on education and health (including O&amp;M of facilities) and re-assigning them from <em>delegated</em> back to <em>shared</em> functions, as authorized by the Organic Law.</td>
<td>Medium-term to long-term</td>
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<td>5. Substantial disparities in per capita expenditures across local self-governing units which may increase with decentralization of fiscal powers on a derivation basis.</td>
<td>4. Assigning capital expenditures consistently by the establishment of a medium- to long-term strategy to gradually attribute both maintenance and investment responsibilities (regarding exclusive functions and some shared functions) to local governments, and to operate transparent interim mechanisms of investment grants while increasing local revenue autonomy and regulating the municipal capital market.</td>
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<td>6. A conflict between emerging sectoral strategies and the government’s decentralization agenda, which shows a lack of central coordination, a disconnect between policy instruments, and unclear overall policy sequencing, creating confusion and uncertainty.</td>
<td>5. Assigning/delegating responsibilities to the regions while addressing the fragmentation problem of communes and municipalities by identifying services whose expanded benefit areas (by economies of scale and/or externalities) would increase delivery efficiency—including some competences in education, health care, civil security, transportation, telecommunications, and utilities.</td>
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<td>4. Assigning capital expenditures consistently by the establishment of a medium- to long-term strategy to gradually attribute both maintenance and investment responsibilities (regarding exclusive functions and some shared functions) to local governments, and to operate transparent interim mechanisms of investment grants while increasing local revenue autonomy and regulating the municipal capital market.</td>
<td>6. Increasing efficiency of public service delivery (to improve the O&amp;M/wage ratio) by restructuring, re-mapping, and re-deploying facilities and personnel across jurisdictions from the depressed areas to the immigration areas.</td>
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<td>7. Reviewing and assuring consistency between sectoral strategies and the government’s decentralization strategy (both on policy formulation and on the implementation agenda), including social sectors, local infrastructures, and the provision of utilities. This action should be reflected as</td>
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| III – Revenue Assignment and Revenue Autonomy | 1. Local revenue autonomy remains low even after the 2002 fiscal reform—quantitatively Albania lags far behind its European comparators, local governments do not decide on bases or rates of SPT and vehicle registration tax, and Regional Councils remain without any fiscal power of their own.  
2. Pitfalls in the 2002 fiscal reform may entail a non buoyant local tax system, since: (i) the tax liability of the newly assigned local taxes—SLBT, ALT, property tax on buildings, and vehicle registration tax—is not ad valorem based; (ii) the indicative SLBT fixed quota scale and the SPT rate are determined by the central government; and (iii) the excessively complex LSBT and SPT tax administration submits the taxpayers to two separate administrations and may embody perverse incentives for local tax collection.  
3. No broad-based national tax-sharing scheme has been implemented as yet—allegedly because the attribution of competences has not yet been completed and/or sharing PIT and CIT would increase horizontal disparities—leaving local revenue unpredictable and also leaving room for “gap-filling” types of negotiated transfer mechanisms.  
4. Inadequate use of local fees and service charges may result from an inappropriate legal provision (Law # 8652/2000, Art. 33) which requires a three-fifths majority of Local Council for the approval of local decisions on local taxes | Improving local government accountability, by promoting an efficient and fair assignment of revenues.  
1. Boosting local fiscal efficiency and accountability by enacting a Law on Local Government Financing—see Section I—above (that establishes criteria for costing responsibilities and access to sources of financing, i.e., own taxes/fees, national shared-taxes/transfers, and borrowing), besides:  
(i) improving local revenue autonomy and fostering a buoyant local tax base, by assigning a proportional PIT surcharge piggybacking on the national progressive rate to the local governments (either to municipalities/communes or regions);  
(ii) setting up a legally pre-determined, broad-based tax-sharing scheme, as a proportion of national taxes, to be distributed according to formula-based equalization mechanism;  
(iii) consolidating the small business turnover taxes (the LSBT and the SPT), to simplify tax administration, and restore a buoyant revenue base for the local governments; and  
(iv) rationalizing the use of local fees and service charges by removing the “nuisance” charges | one of the cross-cutting analysis in the next 2004-2006 MTEF.  
Short and Medium-term |
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| IV—Matching Resources with Responsibilities | and fees.  
5. **Inadequate property value assessment** due to an underdeveloped real estate market, insufficient parameters for differentiating property valuation, lack of a reliable cadastral system of properties, and potential loopholes in the property tax legislation—which may depress the local tax base.  
6. **Weakness in local tax administration capacity** particularly in small municipalities and communes.  
7. Disparities in per capita own revenues between and across municipalities and communes tend to increase for the near future owing to the 2002 fiscal reform’s emphasis on the allocation of local taxes on a derivation basis. | Using the transfer system as an effective instrument to compensate for fiscal imbalances and achieve national objectives in a transparent, congruent and efficient manner. | Medium- to Long-term |
| | 1. **Vertical and horizontal fiscal imbalances are significant in Albania** and, because of asymmetric distribution of needs and tax capacity across jurisdictions, these imbalances tend to increase with the decentralization of responsibilities and revenue autonomy.  
2. There still are no rational criteria for the annual determination of the size of the unconditional transfer pool, which tends to be non-transparent and unpredictable, generates perverse incentives for soft budget constraints and is a stimulus for inefficient, endless discussions.  
3. The present formula for allocation of unconditional transfers is too complex to be administered and understood by the main beneficiaries, especially in relation to the three compensation funds.  
4. Conditional grants for operations and fees; spelling out sectoral strategies and tariff policies for utilities separated from social policies; replacing the three-fifths voting requirement rule for decisions on local taxes, charges and fees by a simple majority rule; and considering the introduction of some buoyant and equitable sources of local revenues, such as levies on some public utilities, on vehicle property transfers, or on driver’s licenses. | 1. Pre-determining the current financing level of the unconditional grants as a fixed percentage of the national shared taxes—see Section I and III above—(whose percentage could eventually be adjusted whenever the attribution of responsibilities/competences is considered complete) to form the basis of the pool of transfers to be distributed according to objective formula (including an equalization component).  
2. **Improving the current distribution formula for unconditional grants** by emphasizing and simplifying the equalization component which could simply be computed by the inverse of the local per capita revenue capacity (properly weighted).  
3. **Improving the distribution of conditional grants** by: (i) moving towards a better | Medium-term |
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<td><em>maintenance of existing institutions are basically allocated on a historical basis, while the few fund allocations for investment have mainly been the result of political influence, with the following outstanding issues:</em> (i) considerable imbalance in the size of the conditional versus unconditional transfers; (ii) lack of clear national standards for public services to be achieved by local governments; (iii) lack of criteria and competition for the allocation of conditional recurrent grants (which follows an incremental approach); and (iv) the absence of reliable monitoring and evaluation systems, which rules out any possibility of verifying the effectiveness of policy implementation.</td>
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<td>balance between conditional and unconditional transfers, in order to increase autonomy and allocative efficiency; (ii) setting national standards for local public service delivery that can be monitored and evaluated through independent and reliable indicators of performance; (iii) improving equity and efficiency of recurrent expenditure grants by allocating conditional grants through well targeted capitation basis and using “block grants;” and (iv) increasing transparency and efficiency of conditional capital grants through competition and the use of explicit rules for project selection.</td>
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