

# *Impact of fiscal decentralization on local economic development*

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The Case of Lezha Region (2002-2014)

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PLANNING AND LOCAL GOVERNANCE PROJECT (PLGP) IN ALBANIA

## **Abstract**

*Many reforms have been undertaken in local governance after the collapse of the totalitarian, centrist and bureaucratic regimes in Central and Eastern Europe. Albania has demonstrated that decentralization is a major development tool. More than two decades of decentralization activities have revealed that the decentralization process has brought about changes in the operation of institutions and delivery of services, even though this change has taken place gradually. Fiscal decentralization is one of the three dimensions that characterize the decentralization process. Local finance issues are an everyday topic in countries in transition and should be addressed by means of an approach that favors consolidation of local autonomy. Local governments in Albania have lacked, and continue to lack, the fiscal capacity to deliver on the promise of decentralization to improve public services and to promote and nurture local economic development. Decentralization can promote economic development and improve citizens' welfare and living standards when service delivery and the quality of the decisions over how public resources are deployed are improved, but local governments remain hampered by inadequate transfers from the central government and from restraints imposed on various revenue-generating options. However, inadequate financial instruments, especially those of intergovernmental transfers, have affected regional disparities. In this paper, through comparative analysis, analyzing a part of the Region (Qark) of Lezha's LGUs, economic development indicators, will approve the need for reform of these LGUs' financial instruments in order to narrow the gap of regional disparities in Albania.*

**Key words:** *economic development, fiscal decentralization, regional disparities, conditional transfers*

## 1. Introduction

Decentralization and globalization have been policy issues in many European and developing countries since the '80s ('The World Bank Premnotes, 2001; BiZa, 1980). When dealing with these key concepts on issues of decentralization and economic development, one cannot avoid comparative definitions of these concepts.

There are many definitions on decentralization; they match with the principles on which they build and on the objectives for which they were designed. The most inclusive definition on decentralization is provided by the UNDP (1997)<sup>1</sup>, which reads as follows:

"...Decentralization, or decentralizing governance, refers to the restructuring or reorganization of authority so that there is a system of co-responsibility between institutions of governance at the central, regional and local levels according to the principle of subsidiarity, thus increasing the overall quality and effectiveness of the system of governance, while increasing the authority and capacities of sub-national levels....Decentralization could also be expected to contribute to key elements of good governance, such as increasing people's opportunities for participation in economic, social and political decisions; assisting in developing people's capacities; and enhancing government responsiveness, transparency and accountability." (UNDP, 1997:4)

Its need stems from the lack of motivation, from the check of balance and ensuring the allocation of decision-making power, and provision of development structures. The following definition is comprehensive in terms of this concept. It clearly shows that one of the reasons is the liberation of forces, creation of synergies and development.

"...Not only has the over-concentration of business and political power been a problem in holding back worldwide economic development, it has also helped foster corruption and dictatorship. In that respect, the single most important form of checks and balances in any society is the dispersal, or fragmentation, of political power. Without question, the creation of strong regional and local governments is critical to that development." (UNDP, 1996:11)

<sup>1</sup> After the review and consultation of literature, it was generally found appropriate to incorporate quotes from the United Nations Development Program, because this organization's activities utilize an approach of development projects and programs. This focus suits well with the purpose of this study, as it correlates decentralization and local economic development. In addition, unlike definitions of other independent researchers and experts or banking institutions, such as the World Bank or International Monetary Fund, the United Nations employs a more balanced approach from the social viewpoint.

Fiscal decentralization is firstly linked with the creation of possibilities to fund supported or the so-called "subsidized" functions.

"...The establishment of effective and transparent financial management is at the core of any effort to reform the public sector. ...To be genuinely supportive of a decentralization process, the basic characteristics of a system for decentralized financial management should include: (a) transparency of allocation (b) predictability of the amounts available to local institutions and (c) local autonomy of decision making on resource utilization. In contrast with the widespread practice of ad hoc grants driven by politics, the allocation of resources should be based on transparent formulas. Also, unlike the typical unpredictability of most central-to-local transfer mechanisms prevailing in developing countries, the process should provide local institutions with an up-front indication of how much money will be available in the next multiyear planning cycle.." (DDSMS, UNDP, 1996:p.48)

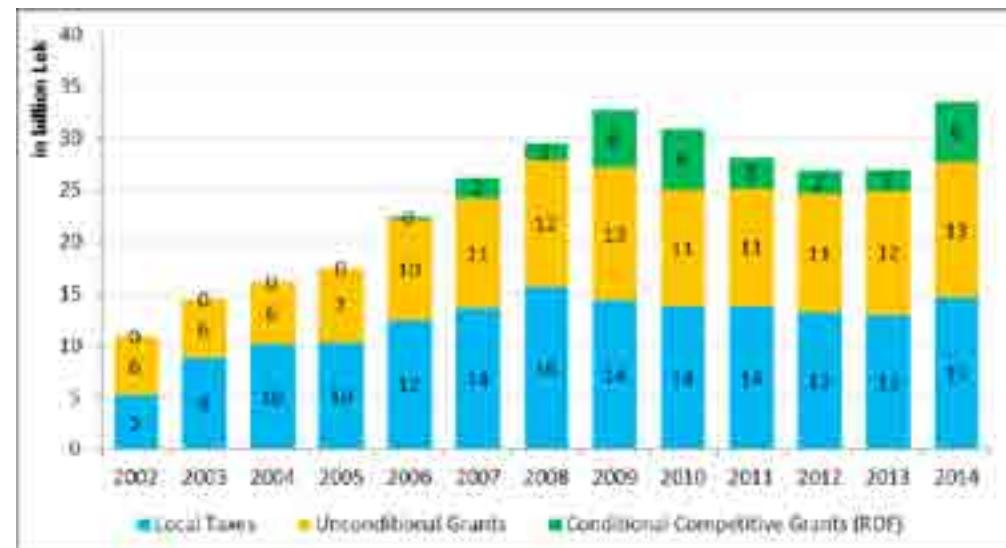
Why the constituent elements of decentralization as presented above are not the only definitions, they all converge in several shared points, which help to enhance implementation of the principle of subsidy and increase effectiveness and efficiency of public services and more. In order to narrow the regional gaps in terms of development indicators, funds have been projected, including Regional Development Fund (RDF)<sup>2</sup>. This measure makes sense in supporting economic development processes and in the implementation of the constitutional principles of equality and proportionality. Yet, these instruments of governmental transfers have two elements that cause problems to the local economic development. Thus, rather than supporting this development, they affect the business climate, reduce local revenues and chances of employment, and decrease the GDP per capita. Firstly, an annual increase of the Competitive (Conditional) Grant or of the Regional Development Fund in ratio to the total revenues of the local government units impairs or reduces the fiscal autonomy. Secondly, investments in rich communities enlarge the regional differences and disparities of development. These two elements - impact of reduction of fiscal autonomy and lack of RDF – are quite visible in a comparative analysis for the Region of Lezha.

<sup>2</sup> Regional Development Fund (RDF) is a development instrument and a competitive financial mechanism that supports national policy of regional and local development, to ensure implementation of policy objectives of territorial cohesion, to have regions with balanced, competitive development, and sustainable, economic, social, and environmental development. The Regional Development Fund is administered through collegial decision-making of the Committee of Regional Development headed by the Prime Minister.

## 2. Local Governance Financial Instruments

Local revenues in Albania are mainly composed of: i) own revenues; and ii) inter-governmental transfers, which are divided in a) unconditional grant; and, b) conditional grant. Graph 1 presents the structure of revenues.

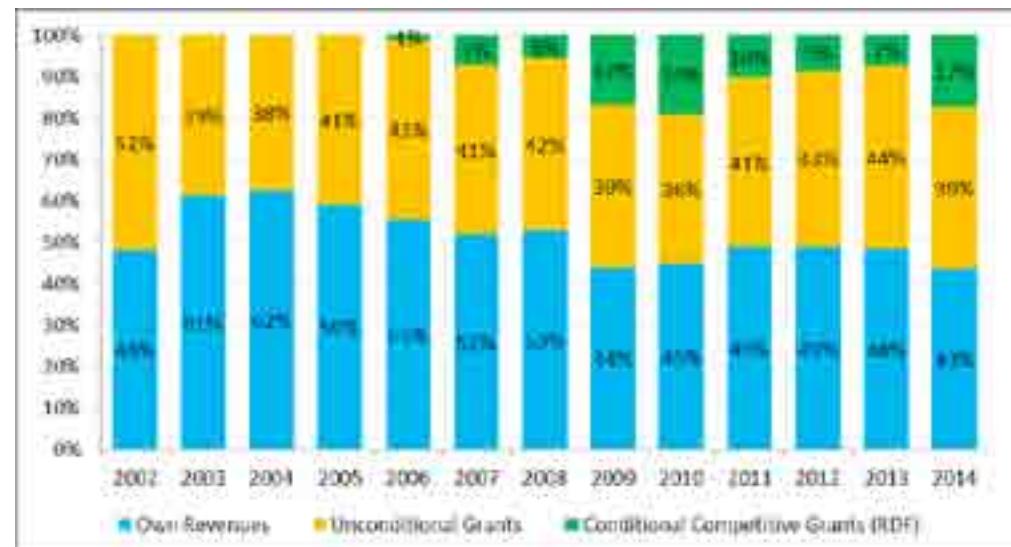
**GRAPH 1:** Basic composition of local revenues by region in billion Albanian Leks (ALL)



Source: PLGP/USAID

It can be easily observed that over the last few years there has been an increasing trend of funding for local governance in total (after year 2013), even though this is due to an increase of the Conditional Grant or the Regional Development Fund.<sup>3</sup> While in absolute values it represents an increase of local revenues, this situation relatively harms the local fiscal autonomy. A presentation of this situation is given in the following graphic as a percentage of the type of funding in ratio to the total.

**GRAPH 2:** Basic composition of local revenues (by region) in percentage



Source: PLGP/USAID

It is very hard in developing countries to accurately define the funding amount that local government units need to deliver services stipulated by law. This occurs for several reasons, but the most significant one is that in many countries we have little data on service costs, and even less data on costs per unit by reasonable service standards. (WB, 2004)

This makes it highly difficult to determine the amount of money required. Therefore, local budgets are guided by fixed demands for expenditures. We can set ideas and base indicators in our comparative analysis.<sup>4</sup> (PLGP/USAID, 2015).

### Fiscal Indicators of LGUs of the Region of Lezha (2002-2014)

Prior to implementation of the territorial-administrative reform, the Region of Lezha had 16 local government units. It is a region with no major administrative center; its rural LGUs have had no agricultural activity.

The fiscal indicators of these local government units are related with three major elements of their revenues: own revenues, unconditional grants, and conditional grants (RDF).

A comparative analysis is conducted by grouping the local government units by district, which after the territorial-administrative reform in 2014 became independent LGUs. It is also worthwhile to analyze progress over the years in terms of local expenditures. According to this table and the related illustrative graph, the

<sup>3</sup> The Regional Development Fund and the Albanian Development Fund according GoA are designed to serve as instruments that promote urban and rural development in the framework of broader policies of regional development. Investments at local level will be incorporated in strategic programs of regional development that guarantee economic and social cohesion among various regions and areas of the country

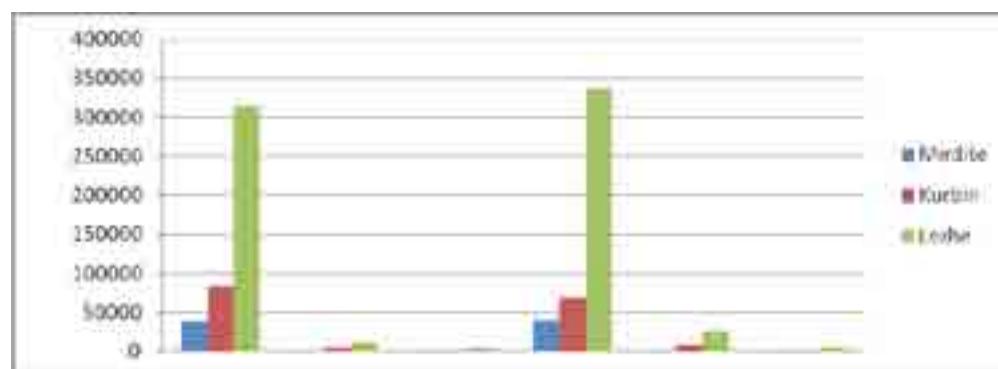
<sup>4</sup> Indeed, many of these difficulties are still persistent in developed countries. Cf. J. Kim and J. Lotz, Measuring Local Government Needs, Korean Institute of Public Finances and Danish Ministry of Social Welfare, 2007 (PLGP/USAID)

specific share of local revenues in years 2011 and 2014, regardless of the LGUs within the region (in which 1/3 are municipalities), is in the center of the region.

Own revenues and those from the infrastructure impact tax (or building tax) are concentrated in Lezha. Table 1 below provides the main indicators of year 2011 and 2014 of own revenues of Lezha's LGUs and the two most important components that make up own revenues – property tax and tax on agricultural land. This table shows the dynamics in the last four years and the movement of the elements of own revenues in three districts of the Region of Lezha.

**TABLE 1:** Own revenues, tax on building/agricultural land (Region of Lezha)

Districts	Own revenues 2011	Property tax 2011	Agriculture B land 2011	Own revenues 2014	Building tax 2014	Agriculture B land 2014
Mirdita	38,983.33	646.45	210.37	39,542.68	1,632.88	62.95
Kurbin	84,638.72	4,747.2	249.64	69173.12	8,096.96	907.71
Lezha	314362.83	11129.46	5343.44	336270.98	25891.9	5852.91



The theory of transfers states that transfers base their equalization on how communities are taxed. In the unconditional transfer, if a community has a high tax performance, then the transfers are small. The opposite applies for poor communities. (Prud'home, R. 2001).

The Unconditional Grant to LGUs of the Region of Lezha has experienced both an increasing trend since 2002 and noticeable fluctuations as shown in Graph 3, which provides data on the dynamics of revenues during 2002-2014. This grant reached its lowest level in 2009 and the highest peak in 2012. The Unconditional Grant is allocated by means of a formula and LGUs have complete discretion over it provided that a share of this grant goes for investments and salaries.<sup>5</sup> Table 2

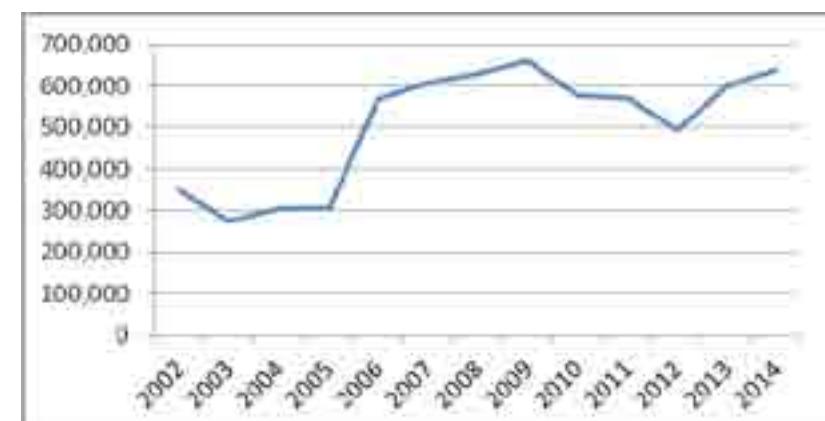
shows how this formula has not changed until 2012. In fact, the formula underwent modifications in year 2014.

**TABLE 2:** Changes in the rules governing THE ALLOCATION of the unconditional grant in 2002–2012

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Fixed amount	3.5%	3.5%	4%	0	0	0	0	0	0	0	0
Population	62.5%	62.5%	62.5%	73%	70%	70%	70%	70%	70%	70%	70%
Surface of communes	4%	4%	9%	12%	15%	15%	15%	15%	15%	15%	15%
Urban services	20.5%	20.5%	18%	15%	15%	15%	15%	15%	15%	15%	15%
Urban services Tirana	9.5%	9.5%	6.5%	0	0	0	0	0	0	0	0
Equalization	-	35%	35%	35%	30%	25%	25%	25%	25%	25%	25%
Further adjustments	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

While the grant formula for the period under consideration, starting from year 2005, has not changed, significant fluctuations have been noticed in the own revenues of the local government unit in the previous year, and the amount of funds to be allocated in the system has changed. The formula foresees a variable that in case an LGU performs poorly in terms of its own revenues, it can be compensated with the unconditional grant. As shown in Graph 4, "Own revenues in Year 2011", revenues have increased when compared with year 2010. Therefore, the unconditional grant for year 2012 has decreased.

**GRAPH 3.** Unconditional grant for LGUs of the Region of Lezha in thousand ALL during 2002-2014



Source: Ministry of Finance, own calculations

<sup>5</sup> This value varies by the grant formula and budgetary conditions imposed by the local governance.

**GRAPH 4:** Own revenues of the LGUs of the Region of Lezha in thousand ALL during 2002-2014



Source: Ministry of Finance, own calculations

According to Prud'home, benefits from decentralization are disproportionate or in opposite relation with the economic development, particularly in poor countries, where tax rates are low and tax collection or tax revenues are two to three times lower than in rich countries. This leads to problems given that some expenditures are the same for both groups of countries. (Prud'home, R. 2001). How will this problem for poor communities be possible to equalize? One way is the equalization part of the unconditional grant formula, whereas the other relates with the conditional transfers or grants.

The Conditional Grant, or the governmental competitive transfer, also known as Regional Development Fund, is the most controversial instrument in the last years. Competitive grants constitute another instrument of the equalization in the Albanian system, though at least in theory these grants are supposed to be allocated less on the basis of the relative wealth of jurisdictions than on how well they have prepared their grant applications and on the relative importance of their investment priorities to the needs of the country as a whole. This fund was later called the Regional Development Fund that sought to decrease the regional development imbalances.

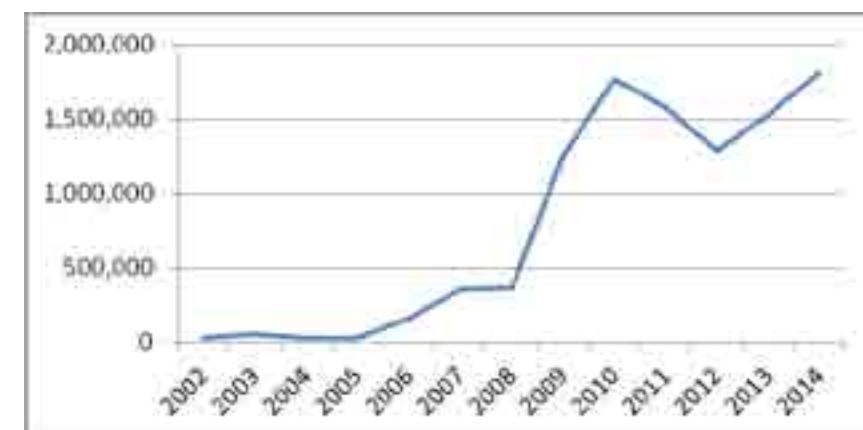
As shown in Graph 5, in year 2009 a criterion to narrow the regional disparities was introduced in the conditional grant. By this time, this grant decreased for Lezha, while the GDP per capita for this region is the lowest in Albania, with the exception of Dibra and Kukes.

An increase of conditional grants in ratio to the total transfer has led to more dependence on central government and has decreased the rate of fiscal autonomy.

The criterion and procedures of these grants are not transparent. (USAID/PLGP, 2012, p. 73)

Local government units have no discretion to change the destination or intention of this type of funding for the local governance. This fund is composed of monies for investments of ministries as per their related sector, for which local government units compete to win funding for their projects.

**GRAPH 5:** Conditional grant in the Region of Lezha in thousand ALL during 2002-2014



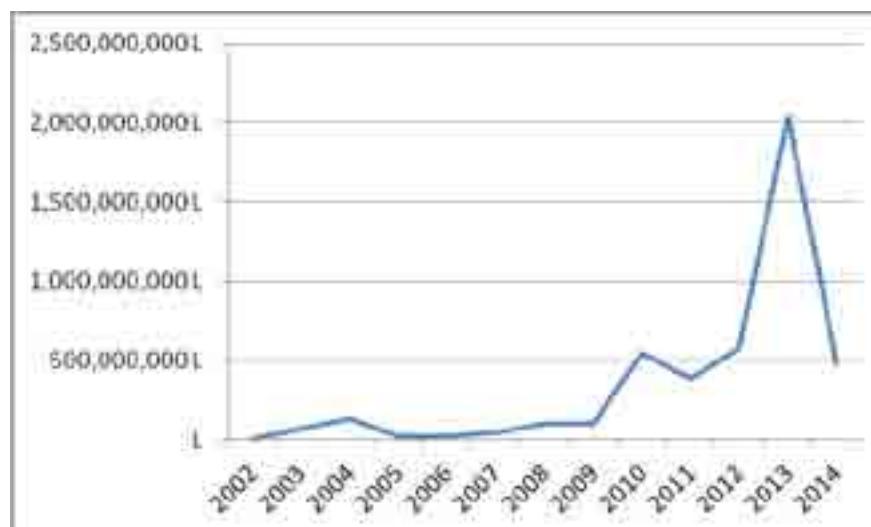
Source: Ministry of Finance, own calculations

The above graphical presentation shows that some progress has been achieved starting from year 2002. Local revenues have increased significantly as an absolute value; likewise, the unconditional grant has followed suit at similar pace.

A more dynamic trend is observed after year 2008, by which time there is a very significant increase. (See Graph 5.) This boost of ministries' spending at local level on matters pertaining to shared functions of LGUs and to own functions seems to have occurred by the time a moderate decrease of own revenues and unconditional grant of LGUs have taken place. (Shih Graphs 3-4).

According to this comparative analysis, this shows that the spending at local level has increased; that line ministries have increased their expenditures on annual basis (particularly after year 2008) in the Region of Lezha; and, that own revenues (from local taxes and fees) have also dropped after year 2008. After year 2012, an increasing trend of own revenues in the Region of Lezha can be easily seen, as shown in Graph 6. By this time, funding from the Regional Development Fund for the Region of Lezha also shrank.

**GRAPH 6.** Investments of the Regional Development Fund in the Region of Lezha during 2002-2014



Source: Regional Development Fund

The Conditional Grant or the Regional Development Fund implies direct conditional transfers for expenditures, capital investment of line ministries based on projects submitted by local governance. A variety of reports of international and donor organizations that have supported these processes, such as USAID, UNDP, SCD, etc., consider the criteria of allocation of these funds to be politically biased and non-transparent. Recently, there is a trend to increase the pool of the conditional grant in ratio to the unconditional one. This trend runs counter to the principle of local autonomy and its consolidation. (PLGP/USAID 2012:15).

### 3. What Is the Impact of Fiscal Decentralization Policies on Local Economic Development Indicators? Case of Lezha (2002-2014)

#### *Why Lezha as a Study Sample?*

At first, we have to point out that the timespan of this study belongs to a different territorial organization than the current one. Since this study cover a pre-territorial-administrative reform period, its discussions apply to that period. If we seek to analyze the LGUs of the Region of Lezha, initially we need to rationalize why we chose Lezha?

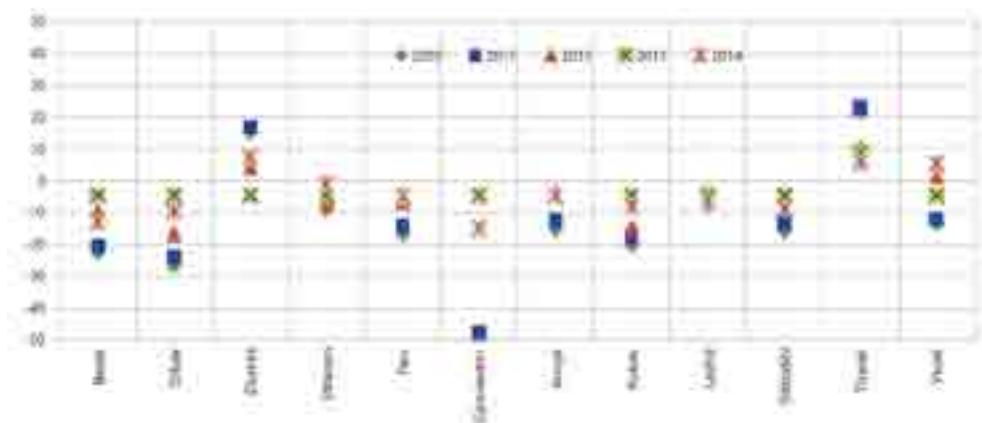
The Region of Lezha is composed of 5 municipalities and 16 communes, which have 9 towns and 170 villages, with a total population of 134,027 residents.

Surveys and statistics indicate that the Region of Lezha reveals a more sustainable picture of some base indicators that impact the increase of development indicators, which have not fluctuated during this period when compared with other regions of the country.

- Change of population and density of population
- Migration
- Political stability

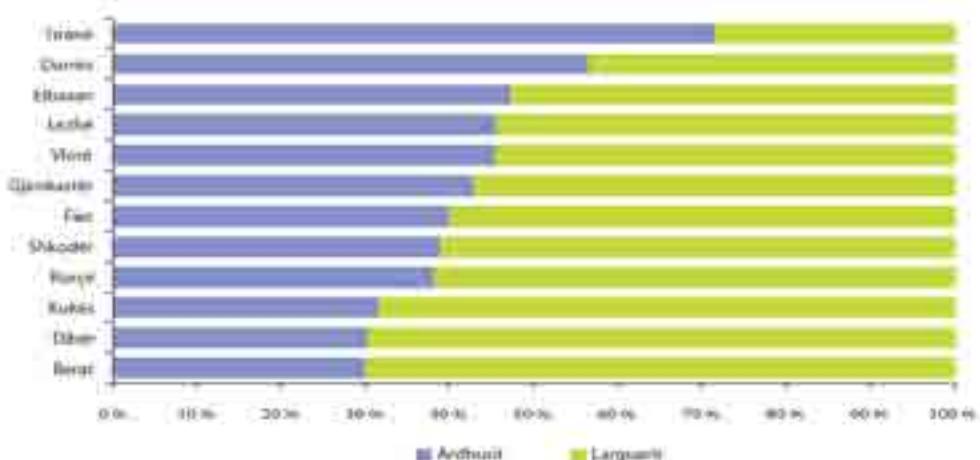
Change of population. When speaking about demography, similar to other regions in the country, the Region of Lezha has experienced significant internal migration of its population, with people leaving the rural areas and settling in urban centers and then leaving urban centers in pursuit of a better life in other cities with higher economic potentials. Regardless of this, the Region of Lezha has had a modest decrease of its population when compared with the demographic dynamics of other regions during 2002-2014. Graph 7 provides a graphical presentation of this phenomenon. It clearly shows that Lezha is almost constant in terms of its natural change and gross rate of change of population.

**GRAPH 7:** Regional demographic changes of the Region of Lezha during 2010-2014



Source: INSTAT/Regional Statistical Yearbook 2015

Migration. In addition, the Region of Lezha represents a more balanced division between the settlers and migrants. Thus, Lezha has an almost perfect balance between the newcomers and those who left the region, with a slight percentage favoring those that left their home in search for a better life in other places outside the region. See Graph 8.

**GRAPH 8.** Migration of the Region of Lezha during 2010-2014

Source: INSTAT/ Regional Statistical Yearbook 2015

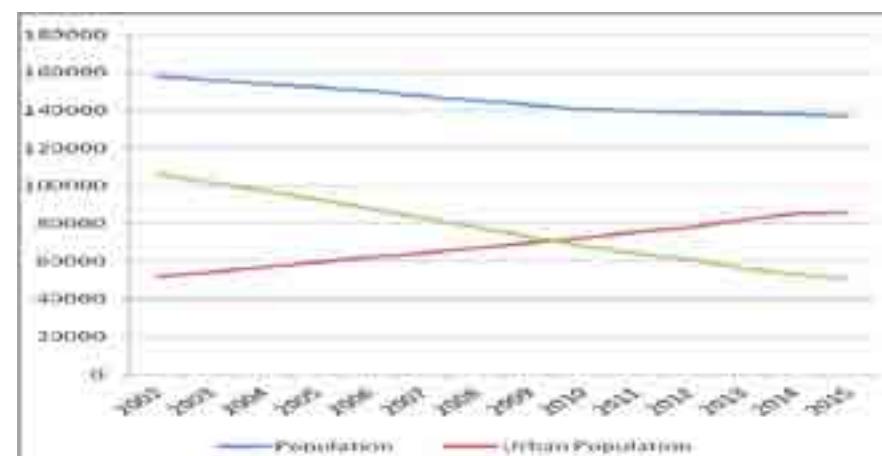
The following table provides a clear view of the migration from rural areas to urban centers with stabilized figures in the recent years, which imposed a balance between the rural and urban areas.

**TABLE 3.** Dynamics of demography of the Region of Lezha

LEZHA	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Demography	156,266	154,193	152,360	150,094	147,583	145,240	142,872	140,755	139,734	138,992	138,349	138,214
Urban	54,344	56,879	59,469	62,049	64,614	67,212	69,830	72,522	75,259	78,054	81,777	85,347
Rural	101,922	97,314	92,891	88,045	82,969	78,028	73,042	68,233	64,475	60,938	56,572	52,867

Source: INSTAT

Unlike other regions, the Region of Lezha does not have a major administrative center that dominates the entire region. In fact, the region houses five municipalities (Lezha, Laç, Rrëshen, Rubik, and Mamurras). The largest municipalities are Lezha (regional center) and Laç, whose population differs by no fewer than 1,000 residents. This statistical model shows that the region has a highly centric development model with regard to development terms.

**GRAPH 9:** Demographic dynamics of the Region of Lezha

Source: INSTAT, Own calculations

Political stability. According to the data of the Central Election Commission and the Institute of Statistics, the terms in the office for the Region of Lezha have been won by various political parties and on a rotation basis producing a balance of political mandate between the left wing and right wing parties for the period under consideration. The regional center (the Municipality of Lezha), or the largest town where the most political activity is carried out, was managed by the Socialist Party (SP) in 2002, then under the leadership of Socialist Movement for Integration (SMI) in 2007, and under a SP+SMI coalition in 2011. In addition, during the said period, the central government was run by the Socialist Party in 2002, Democratic Party (DP) in 2005, and DP+SMI in 2009 until 2013. SP regained power in 2013. Table 5 provides some details. Change of coalitions within the period of the office terms during 2011-2013 affected the balance of numbers of mandates, particularly at the regional level. It was necessary to point this out, because various reports of international partner organizations have emphasized that funds are allocated on political preferences. This finding would, indeed, render the study of our hypothesis difficult and unreliable and would, therefore, make our conclusions invalid.

**TABLE 5:** A comparison of Regional Development Fund grants to LGUs by political affiliation

	Socialist Party	Democratic Party
Number of LGUs in each year of the 4-year term in the office	13 out of 26 LGUs (50%)	25 out of 33 LGUs (76%)
Total amount of grants		
2006	741,347	1,075,506

2007	1,266,275	1,343,739
2008	351,303	571,790
2009	496,982	1,271,132
Average grant per year		
2006	28,513	32,591
2007	48,702	40,719
2008	13,511	17,327
2009	19,114	38,519

Source: PLGP/USAID

#### 4. Natural Resources and Access to Infrastructure Network

The Region of Lezha lies in a very good geographical location and features many natural resources. A combination of mountains, plains, and seaside lay bare a great variety of opportunities for the establishment of a sundry of economic profiles. An analysis of these potentials reveals that the Region of Lezha experienced the country's greatest growth (by 28.1%) of population during the 1989–2002. (UNDP/2005:11)

The region is home to a coastal tourist area of 11,000 hectares, with a seacoast line of 38 km long and 3 km wide. The coastline starts in Velipoja in North and ends in the Cape of Rodon in South. There are many places and locations appropriate for the construction of tourist resorts or ports.

The part that represents the region's economic engine is located in the crossroad of the major communication axes among North and Central Albania and Kosovo. Shengjin, its only port, is only 8 km far from the center of the region's administrative unit. Roads have been constructed recently that not only have shortened the distance and reduced commute time but have helped to boost cooperation and trade, increase of tourist visitorship, development of economy, etc.

Very important elements for local economic development include the road network, railways, power supply infrastructure, the Port of Shengjin, and air runways (in case the Airport of Gjadri becomes operational), water supply system, and regular urban transport service. (UNDP/2005:11) Yet, Lezha ranks among the regions with the lowest GDP per capita at national scale, irrespective of its location (between the regions of Tirana and Shkodra), its status as an administrative center with very good access to railroad infrastructure, to sea, natural resources and good climate, educational and cultural networks in place, and specialized healthcare network. Lezha occupies the 10<sup>th</sup> place out of 12 regarding the GDP per capita, at a rate of 327,000 ALL per capita (in 2013), leaving behind only the regions of Kukes and Dibra.

#### 5. GDP of the Region of Lezha

Over the many years, Lezha has featured an almost trajectory in terms of GDP. The following table shows how this region's GDP has fluctuated in the 13 years taken under this study. During this period, this region has "maintained" the same place in comparison with other regions. It occupied the last places of this table, together with other northern regions, such as Kukes and Dibra, even though its comparative advantages and positions are better than those of these regions.

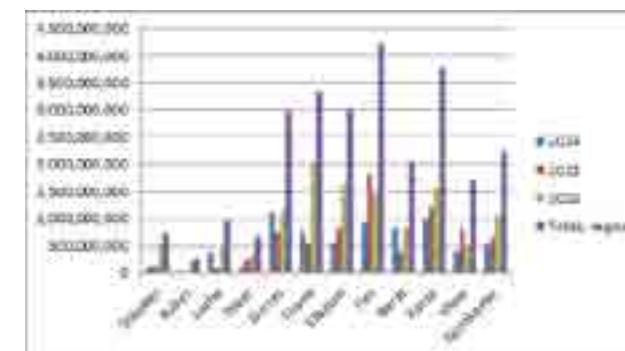
**TABLE 6:** GDP per capita in the Region of Lezha (in thousand ALL per capita)

Region of Lezha	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
GDP per capita	177.2	188	217.1	238.6	260	282	298.3	294.3	289.5	294.3	327.3	303	311

Source: INSTAT, Own calculations

These elements –rich natural resources, access to major transport infrastructure– and the lowest economic indicators at national level (GDP) constitute some of the reasons for selecting the Region of Lezha as a case study. According to the USAID Planning and Local Governance Project, UNDP, OSCE, and CoE, the central government allocates funds from the Unconditional Grant, Conditional Grant or Regional Development Fund on preferential basis (as shown in Table 5). This situation occurs to this very day. (See Graph 10.)

**GRAPH 10.** Allocation of grants of rural development by the Ministry of Urban Development by region in 2014, 2015, and 2016 in thousand ALL



Source: Ministry of Urban Development, own calculations

What we see in the conditional transfers is the opposite to what is taught by the theory of alleviation of harmful effects of decentralization. The specific or conditional transfers through the Regional Development Fund go usually to relatively rich communities. (See Table 4 and Graph 10.)

Given the above and taking into account these reports as well as a simple reading of political mandates, we believe that the selection of the Region of Lezha as a study case will help to draw clear results that are politically unbiased and uninfluenced.

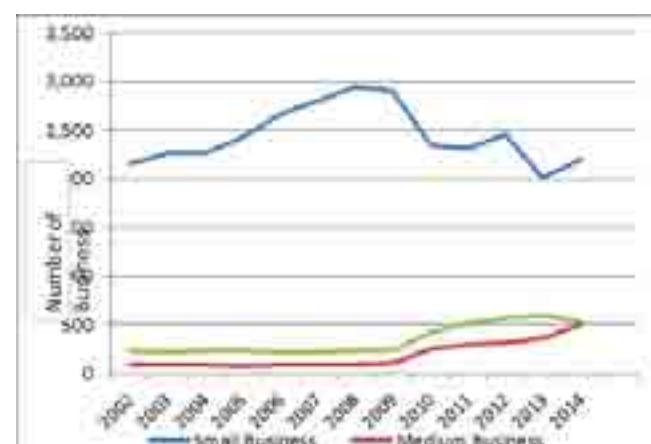
## 6. Base Economic Indicators and Situation of the Region of Lezha

The structure of economic operators in the Region of Lezha is dominated by small businesses. In this sense, there is a strong correlation with the local governance, which produces an impact on business development by providing infrastructure, capital improvements, public service, and local regulatory framework.

In addition to the local governance, central government contributes to the business climate improvement by making direct investments that support national policies with particular focus on regional policies, for which a considerable share of local investments is intended for them.

Likewise, INSTAT tables and reports on increase of enterprises and their dynamics over these years reveal a positive trend. This shows that small businesses have developed (as shown in Graph 11) and can be clearly proven by the structure of business operators in the region.

**GRAPH 11:** Non-agriculture enterprises in the Region of Lezha



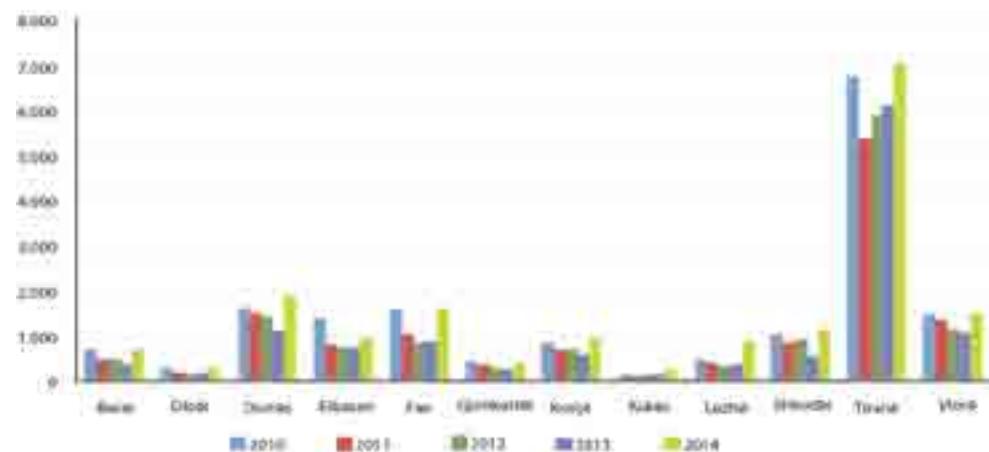
Source: Regional Tax Directorate; Own calculations.

Graph 11 shows fluctuations of the number of non-agriculture businesses/enterprises, mainly small businesses. This is due to fiscal policies implemented by central government and not simply as a result of the economic climate.

According to INSTAT, employment in the non-agriculture sector has increased. (INSTAT, 2015) This fact indicates a positive trend, mainly in urban centers, when comparing these data with those of the demographic movements from rural areas to urban areas. Indeed, it can be emphasized that business supply in urban areas is closer to local authorities and its need for services, infrastructure investments, capital investment plan, and support with regulatory framework and strategic planning.

This approach applies to all regions and is probably a result of the fight against informal businesses undertaken by tax authorities in year 2014. Tax inspections forced many enterprises to classify from small business to large business and change their registration with the tax authorities. (See Graph 11.)

**GRAPH 12:** New businesses by region



Source: INSTAT

Graph 12 shows that the dynamics is almost the same for all regions of Albania, with decreases in years 2011, 2012, and 2013, and an increase in year 2014. The slightest increase applies to the regions of Dibra, Kukesi, and Lezha, which, as stated earlier in this analysis, have benefited the least from inter-governmental transfers in the subsequent years, producing more regional disparities among regions. (See Graph 10.)

**TABLE 7.** Employment in non-agriculture private sector

Qarku	2010	2011	2012	2013	2014
Shqipëria	241.836	256.387	268.690	290.763	318.571
Berat	6.609	6.853	7.827	8.275	8.828
Dibër	4.305	3.578	3.634	3.293	4.190
Durrës	23.166	31.614	33.600	36.823	38.000
Elbasan	13.426	15.299	13.685	13.845	13.996
Fier	16.754	16.097	16.159	16.424	17.671
Gjirokastër	5.715	5.335	3.500	4.030	4.936
Korçë	12.351	12.422	12.790	12.650	12.685
Kukës	1.826	2.055	1.968	2.076	2.040
Lezhë	7.906	8.078	8.515	8.541	9.256
Shkodër	13.457	13.727	13.665	13.762	13.882
Tiranë	119.428	124.389	135.341	153.014	173.360
Vlorë	16.801	17.024	17.928	18.034	19.732

Source: National Employment Service

Table 7 shows that employment increased significantly in the last year as a result of the fight against informality. The situation has, however, been constant in the previous years, divided in two segments (2009-2010 and 2011-2013). This indicator is closely linked with the work of the local government units. While, according to INSTAT, 87% of businesses are small and medium-sized businesses, employment is by all means linked with the success of these businesses. This is where local government units come in handy; they are a factor of significant impact on the creation of adequate business climate and promotion of new business development.

The structure of these local government units by region and economic activity is given in the following table (Table 8), which shows that 3,241 out of 3,887 businesses operate in the area of services. About 84.6% of the businesses operating in the Region of Lezha run their activities in the area of services.

**TABLE 8.** Local government units by region/economic activity and specific share in percentage by economic activity in total

Njësítë lokale sipas qerqeve dhe aktivitetit ekonomik Local units by prefectures and economic activity												
Dëshmi i rritjes së përgatitjeve e përdorura												
Kod i prefek- tureve	Qarri	Vlera të përgatitjeve e përdorura miliardë francë	Dëshmi për përgatitje e përdorura %/-rrazia									
Q1994												
Total	109.898	98.777	11,1%	16.909	42,7%	150.291	47,1%	6.406	16,2%	14.470	16,3%	99.119
Bashkia	8.680	233	-10%	1.680	10%	1.130	21%	100	10%	100	10%	100
Gjilan	2.222	119	-10%	310	10%	200	11%	100	10%	100	10%	100
Gostivar	18.260	5.011	-10%	1.117	11%	8.720	8,2%	100	1,0%	100	1,0%	100
Jabllanicë	9.990	5.775	-10%	975	11%	6.000	6,0%	300	1,0%	300	1,0%	300
Kukës	12.000	1.000	-10%	1.000	10%	8.000	8,0%	100	1,0%	100	1,0%	100
Lipljan	21.180	7.007	-10%	2.200	10%	1.600	15%	100	10%	100	10%	100
Mitrovicë	11.100	1.100	-10%	1.100	10%	8.000	7,3%	100	1,0%	100	1,0%	100
Pristina	19.890	1.233	-10%	8.000	10%	1.133	12,3%	100	1,0%	100	1,0%	100
Rushen	1.100	233	-10%	110	10%	100	10%	100	1,0%	100	1,0%	100
Tetovë	1.800	400	-10%	310	11%	1.300	11,1%	100	1,0%	100	1,0%	100
Zhupa	1.200	200	-10%	100	10%	1.000	10,0%	100	1,0%	100	1,0%	100
Zhupë	1.200	200	-10%	100	10%	1.000	10,0%	100	1,0%	100	1,0%	100
Total	123.998	10.007	10%	12.218	12,0%	46.027	16,0%	1.223	1,0%	1.647	1,0%	100.416
Q2005	109.898	103.773	610	16.909	149	6.406	16.2%	1.223	1,0%	1.647	1,0%	99.119
Total												
Rezultati Total	126	14,4	1,4	12,8	1,8	46,8	11,8	1,8	1,0	14,0	1,0	33,8
Bashkia	100	10,0	1,0	10,0	1,0	30,0	30,0	1,0	1,0	10,0	1,0	30,0
Gjilan	100	10,0	1,0	10,0	1,0	20,0	20,0	1,0	1,0	10,0	1,0	20,0
Gostivar	100	10,0	1,0	10,0	1,0	8,0	8,0	1,0	1,0	10,0	1,0	8,0
Jabllanicë	100	10,0	1,0	10,0	1,0	6,0	6,0	1,0	1,0	10,0	1,0	6,0
Kukës	100	10,0	1,0	10,0	1,0	4,0	4,0	1,0	1,0	10,0	1,0	4,0
Lipljan	100	10,0	1,0	10,0	1,0	3,0	3,0	1,0	1,0	10,0	1,0	3,0
Mitrovicë	100	10,0	1,0	10,0	1,0	2,0	2,0	1,0	1,0	10,0	1,0	2,0
Pristina	100	10,0	1,0	10,0	1,0	1,0	1,0	1,0	1,0	10,0	1,0	1,0
Rushen	100	10,0	1,0	10,0	1,0	1,0	1,0	1,0	1,0	10,0	1,0	1,0
Tetovë	100	10,0	1,0	10,0	1,0	1,0	1,0	1,0	1,0	10,0	1,0	1,0
Zhupa	100	10,0	1,0	10,0	1,0	1,0	1,0	1,0	1,0	10,0	1,0	1,0
Zhupë	100	10,0	1,0	10,0	1,0	1,0	1,0	1,0	1,0	10,0	1,0	1,0
Total	100	10,0	1,0	10,0	1,0	46,8	11,8	1,0	1,0	14,0	1,0	33,8
Rezultati Total	100	10,0	1,0	10,0	1,0	20,0	20,0	1,0	1,0	10,0	1,0	20,0
Bashkia	100	10,0	1,0	10,0	1,0	10,0	10,0	1,0	1,0	10,0	1,0	10,0
Gjilan	100	10,0	1,0	10,0	1,0	10,0	10,0	1,0	1,0	10,0	1,0	10,0
Gostivar	100	10,0	1,0	10,0	1,0	10,0	10,0	1,0	1,0	10,0	1,0	10,0
Jabllanicë	100	10,0	1,0	10,0	1,0	10,0	10,0	1,0	1,0	10,0	1,0	10,0
Kukës	100	10,0	1,0	10,0	1,0	10,0	10,0	1,0	1,0	10,0	1,0	10,0
Lipljan	100	10,0	1,0	10,0	1,0	10,0	10,0	1,0	1,0	10,0	1,0	10,0
Mitrovicë	100	10,0	1,0	10,0	1,0	10,0	10,0	1,0	1,0	10,0	1,0	10,0
Pristina	100	10,0	1,0	10,0	1,0	10,0	10,0	1,0	1,0	10,0	1,0	10,0
Rushen	100	10,0	1,0	10,0	1,0	10,0	10,0	1,0	1,0	10,0	1,0	10,0
Tetovë	100	10,0	1,0	10,0	1,0	10,0	10,0	1,0	1,0	10,0	1,0	10,0
Zhupa	100	10,0	1,0	10,0	1,0	10,0	10,0	1,0	1,0	10,0	1,0	10,0
Zhupë	100	10,0	1,0	10,0	1,0	10,0	10,0	1,0	1,0	10,0	1,0	10,0
Total	100	10,0	1,0	10,0	1,0	46,8	11,8	1,0	1,0	14,0	1,0	33,8
Rezultati Total	100	10,0	1,0	10,0	1,0	20,0	20,0	1,0	1,0	10,0	1,0	20,0

Source: INSTAT (2015)

## **7. An Analysis of Economic and Fiscal Indicators – LGUs of Region of Lezha (2002-2014)**

Taking into consideration what we presented and discussed above, we can say that the expenditures for local governance as a share of GDP varied from 1.8% in 2008 to 2.3% in 2014, which is the lowest in the Western Balkans, even though the unconditional grant doubled during 2002-2014, own revenues increased annually during this time, and irrespective of the lack of progress in 2008-2014 as well as dynamic increase of the conditional grant after year 2008. (Nalas, 2015)

Yet, has all this spending impacted the business growth, increase of revenues from businesses and generation of employment in the Region of Lezha? What are the factors of fiscal decentralization and what is their impact on increasing or improving local economic development indicators?

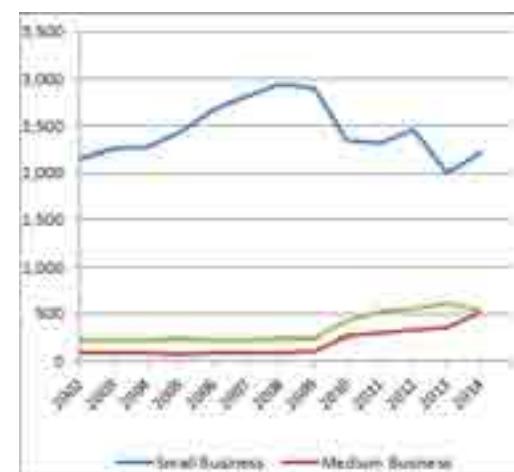
Graph 13 shows that the number of small business units has increased from 2002 until 2008, by which time local revenues started to shrink and the unconditional grant decreased. The number of small business fell at a significant rate. Regardless of an increase of expenditures and investments made by central government and the line ministries, mainly in infrastructure (Graphs 5 and 6), the number of small businesses decreased. We need to consider that the small and medium-sized businesses in the Region of Lezha occupy over 90% of the total of business entities in this region, as shown in the graphics provided earlier in this document.

The trend of the business numbers pursues coactively the trend of the graph of LGUs' Own Revenues. Therefore, 90% of the businesses of this region are correlatively linked with this indicator.

Expenditures of conditional grants and spending of the Regional Development Fund, as shown in Graphs 5 and 6, seem to have no impact on the business climate. Infrastructure is, by all means, important, but it requires decision-making autonomy so as to produce some impact on the typology of the economic operators, such as micro, small, and medium-sized businesses.

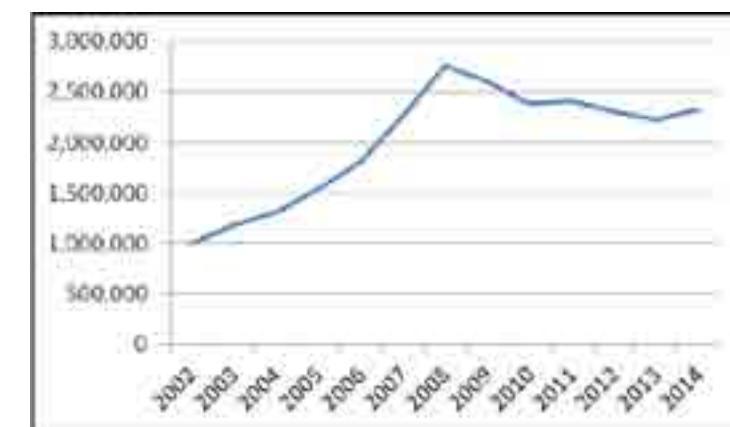
Graph 13 shows that revenues from businesses have slight fluctuations irrespective of the increase and decrease of the number of small business entities during 2002-2014. While the number of medium-sized and large business entities doubled after year 2008 in the Region of Lezha, revenues after this year dropped following the small businesses trend. This indicates that the economy in this region is closely linked with the small businesses. Also, the above graphs and a comparative analysis show that there is a correlation the own revenues and unconditional grants with the small business entities.

**GRAPH 13:** Total number of businesses in the Region of Lezha in 2002-2014



Source: Lezha Tax Directorate, own calculations

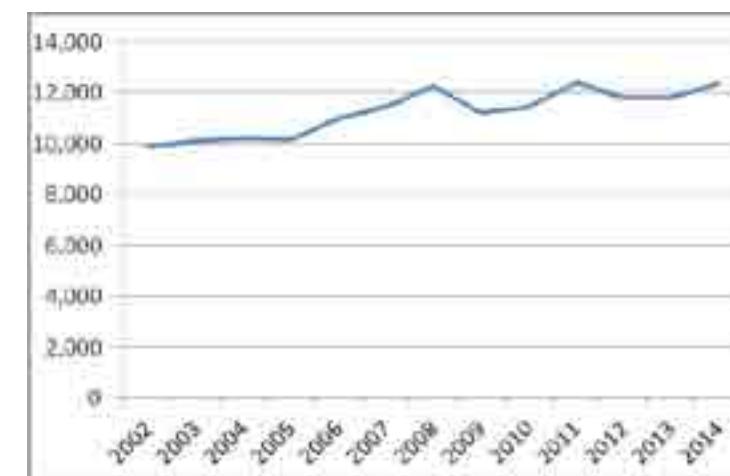
**GRAPH 14:** Business tax collection in the Region of Lezha in 2002-2014



Source: Lezha Tax Directorate, Own calculations

Employment figures in the Region of Lezha have followed the same trend with the increase of regional fiscal indicators, own revenues, and unconditional grant after year 2002 until 2008, their decrease after 2008 and a moderate increase after that year. Graph 15 shows that employment varied during 2008-2010 and 2011-2014. Its curbs indicate that regardless of an increase of the large business by 2.5 time since 2008, employment did not follow suit. This is another fact shedding light on the impact of the fiscal indicators, such as own revenues and unconditional grant, on local economic development.

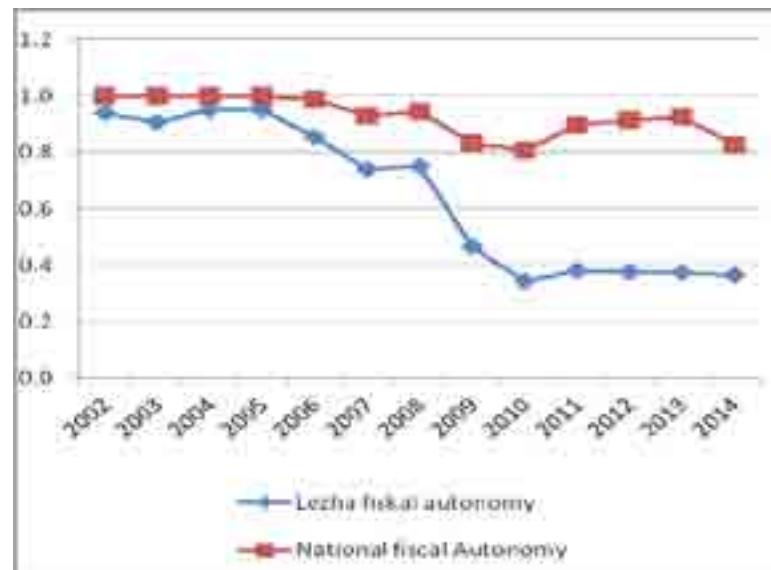
**FIGURE 15:** Employment in the Region of Lezha in 2002-2014



Source: Lezha Tax Directorate, Own calculations

The fiscal autonomy, as explained by Nakai and Sakata, is measured by the ratio of own expenditures/revenues to the total of expenditures/revenues. When examining the ratio of own revenues with total revenues and the ratio of own revenues including the unconditional grant (since LGUs have discretion on its spending) to the total of revenues, we see that the fiscal autonomy of the Region of Lezha's LGUs has decreased with the increase of funding and spending at regional level until year 2010 (by 13% and 34% when including the unconditional grant). After this year, the rate of fiscal autonomy has moved horizontally, i.e., there is a balance between the own revenues and unconditional grant on one hand and the Regional Development Fund (conditional grant) on the other.

**GRAPH 16:** Fiscal autonomy of the Region of Lezha compared with the national fiscal autonomy in 2002-2014



Source: Lezha Tax Directorate; Own calculations

To conclude, the above graph shows that the level of fiscal autonomy in the Region of Lezha is below the country's level of fiscal autonomy. The graph also indicates the close linkage between fiscal autonomy and the number of small business entities as a key indicator that affects local economic development.

## 8. Conclusions

Irrespective of the efforts and achievements in implementing the decentralization reforms with the aim of improving local services and creation of opportunities

for a sustainable local economic development, there are, again, aberrations in the allocation of inter-governmental transfers, which harm poor communities and aggravate regional disparities.

The case of the local government units of the Region of Lezha, which has development potentials but is among the regions with the lowest GDP per capita at country level, clearly shows that the negative effects of the decentralization are persistent. In the mid and long run, these effects will lead to abandonment of the region due to migration and emigration, as residents will pursue a better life elsewhere.

Given what was presented above, we conclude that unconditional and conditional transfers should undergo a reformation in order to assuage the overall and fiscal decentralization effects, particularly to address the trend of regional development disparities.

"The UNDP Integrated Support for Decentralization Project's recommendations include improving the criteria for project selection, maintaining the level of funding at a constant ratio to GDP or national investment budget, and distribution of funds based on regional priorities. These are sound recommendations and should be implemented." (PLGP/USAID 2012:15).

Increase of the unconditional grant pool by identifying incentives for LGUs or by establishing the costs per unit for public services is a requirement stipulated in the new Law on Local Self-Governance. Enhancement of the dialog between central government and local government units would mend this situation with the aim of improving the enforcement of the law so as to produce the desired effects on generation of employment. (Lindin, M. 2005)

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