MOVING FORWARD ON THE MUNICIPAL DEBT MANAGEMENT IN NORTH MACEDONIA

POLICY PAPER

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INTRODUCTORY NOTE

The Ministry of Finance of the Republic of North Macedonia is requesting technical assistance under the the Strengthening Resource Mobilization Activity (SRMA) Project of United States Agency for International Development (USAID), to help design policy recommendations regarding managing LGs indebtedness based on researched international experience and current status, which, if not addressed, would result in disruption in LGs finance and debt management.

The working paper is developed by SRMA Project funded by USAID and implemented by Cardno Emerging Markets USA Ltd. This Policy Paper is aimed at several purposes:

- To provide comparative analysis of local debt regulation and management systems in different countries, and uncover similarities and differences and provide some general observations on the development of the subject matter in other countries;
- To examine the overall debt management situation in North Macedonia and the identified current key problems (a pool of eight municipalities);
- To propose a framework of solutions to the key identified problems by providing urgent and medium-term recommendations on LGs debt regulatory policy and
- To propose debt management tools that can be transferred and impended in North Macedonia based on the before identified problems and solutions.

The study and comparative analysis were completed for seven countries (Slovenia, Bulgaria, Croatia, Poland, Hungary, Denmark and Greece), and also the paper is providing brief information on some other countries.

The report was prepared in a very short time based on the urgent request of the Ministry of Finance, and it completely fulfilles the set goals.

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1 INITIAL ASSESSMENT OF CURRENT MUNICIPAL DEBT REGULATORY FRAMEWORK AND MANAGEMENT IN NORTH MACEDONIA

1.1 Regulatory limits set out for total municipal government debt and debt service in accordance with legal framework in North Macedonia

Law on financing of the LSGU, (Local Self-Government units) in articles 19, 20 is determining the limits for debt generation as following:

Short-term borrowing - the municipality can borrow short-term with a loan that will repay within 12 months from the date of concluding the borrowing agreement. In case of short-term borrowing, the total debt of the municipality made on the basis of short-term borrowing and short-term loan from the Central Budget of the Republic of North Macedonia during the fiscal year cannot exceed 30% of the realized total revenues of the current municipal operating budget in the previous fiscal year[1].

Long-term borrowing - the total annual debt repayment (principal, interest and other expenses) made on the basis of long-term borrowing and long-term borrowing from the Central Budget may not exceed 30% of total municipal operating budget revenues in the previous fiscal year.

Regarding the total amount of the debt, including all issued guarantees, the Law on finansisng LSGU (article 19) states that "Municipality's outstanding debt **cannot exceed the amount of total revenues of the current municipal operating budget in the previous year**[2].The municipality can make long-term loans for the following reasons:

- Financing of capital projects and investments
- Re-financing od debts created by the loans for capital projects and investments
- Liabilities based on activated government securities
- Liabilities based on loans
- Disaster risk insurance and remediation of the disaster consequences"

The municipalities can also generate debt with issuing securities in accordance with the legal framework.

1.2 Who approves municipal borrowing?

The municipalities can make domestic and foreign loans only with the prior consent of the Government of the Republic of North Macedonia, determined on the basis of the opinion from the Ministry of Finance. The loan procedure is initiated by the municipalities with the consent of the Ministry of Finance, but only on basis of a previously made decision of the municipal council.

Article 19 and 20 (in the Law on financing LSGU) and definitions for short and long-term borrowing. More details - https://finance.gov.mk/files/u6/4_05_2011.pdf

[2]Article 20 (in the Law on financing LSGU) https://finance.gov.mk/wp-content/uploads/2009/02/4_05_2011.pdf

The decision by the council is valid only if the agreement for loan or issuing a guarantee is concluded in the fiscal year in which it was adopted.

Procedure for long-term loan - The municipal council approves the long-term loan, after a previously held public hearing in the municipality. The subject of the public hearing is the description and elaboration of the project and the conditions for its financing. Municipalities have an obligation to use the funds provided by long-term borrowing for the purpose for which they are approved.

Issuance of guarantees by the municipalities - public enterprises and trade companies that are fully or predominantly owned by the municipality or established by the municipality can be indebted only after a previously issued guarantee by the municipal council for which the council makes a decision. The mayor of the municipality is obliged to inform the Ministry of Finance for each issued guarantee.

1.3 Are there any provisions for local defaults/insolvency?

The most important provisions and procedures related to local defaults / insolvency are elaborated in the Law on Financing of LSGUs in Articles 39-43. However, these articles in the law have never been activated (no procedure is initiated) and no financial instability is ever declared for any of the municipalities in North Macedonia. This indicates possible issues in the implementation of the current legislation, given that many municipalities in the past met some of the conditions to declare their financial instability - especially since, with certain fluctuations, the number of municipalities with blocked accounts ranges from 10-20, in the last 5 years.

The state audit law clearly confirms the known situation and captures the whole framework of the current practice[3]:

- In none of the municipalities that met the conditions for financial instability, the Law on Financing of LSGUs has been acted upon, because a financial instability has never been declared and the necessary activities have not been undertaken.
- The decision-determined finances, necessary for performing of the activity of the municipalities – the one which are exempted from execution, adopted by the Presidents of the Basic Courts (locally competent) are in amounts that do not enable collection according to the executive orders by which the municipal accounts are blocked.
- The municipalities that have met the conditions for financial instability, despite this situation have started new capital projects and have new employments and promotions to the existing ones. There is also a phenomenon of paying liabilities to suppliers with calculations (cessions and compensations).
- Some of the municipalities that used loans from the budget of the Republic of Northern Macedonia hav made their payments, but most of the municipalities did not repay the loaned funds, although the deadline had passed.

[3] file:///C:/Users/user/Desktop/SRMA%20-%20USAID/54_RU_Prezemanje_obvrski_finansiska_nestabilnost_ELS_2017.pdf

1.4 How is" financial instability" defined in the Macedonian Legislation?

Financial instability of a municipality occurs if (Law on financing LSGU**,** Article 39):

- The municipality account has been blocked for more than six months or
- in a period of six months, continuously every month, the total amount of due unpaid liabilities, in a more than 60 days period, exceeds 80% of the realized revenues from the basic budget of the municipality in the previous year.

The mayor of the municipality is obliged to make a decision to declare financial instability no later than five days from the occurrence of one of the reasons listed above (this has never happened before).

The Mayor informs the Municipal Council, the Ministry of Finance, the Ministry of Local Self-Government and the Association of the Units of Local Self-Government of the Republic of North Macedonia within three days from the day of the decision of declaring the financial instability.

Process of coordination about the strategy for overcoming municipality financial instability

The Ministry of Finance after receiving the notification for financial instability or difficulty (within five days) in the municipality forms a coordination body consisting of five members, as follows: the president and one member are from the Ministry of Finance, one member from the Ministry of Local Self-Government and two members from Association of the Units of Local Self-Government of the Republic of Macedonia.

The mayor is obliged to participate in the work of the Coordination Body and to submit all information, documentation and reports necessary for the work of the Coordination Body. Also, the mayor shall submit a draft plan of measures for overcoming the financial instability to the Coordination Body within 15 days after the establishment of the Coordination Body. The Coordinating Body gives an opinion to the Mayor on the draft-plan of measures for overcoming the financial instability, while the Mayor is obliged to act on the opinion of the Coordinating Body.

The municipality mayor, from the day of occurrence of the reasons for financial instability cannot (Law on financing of LSGU, Article 41):

- start financing new capital projects and investments,
- initiate a public procurement procedure that can increase the financial obligations;
- propose the establishment of public enterprises and local public institutions;
- start a procedure for new employments and promotions of the existing employees;
- make a decision for selection of the most favorable bidder for all initiated procedures for public acquisitions.

Overcoming financial instability

The financial instability is considered overcome if the account of the municipality is unblocked and the total amount of due unpaid liabilities, over 60 days, does not exceed 80% of the realized revenues from the previous year's basic budget of the municipality. After the fulfilment of the conditions for overcoming of the financial instability, the mayor of the municipality, makes a decision for termination of the municipality's financial instability, and informs the Municipal Council and other institutions about the termination of the financial instability as soon as possible.

In order to overcome the situation of temporary shortage of funds, ie time mismatch of revenues and other incomes with the expenditures and other outflows, ***the municipality may be granted a short-term loan without interest from the Central Budget of the Republic of North Macedonia***, with an obligation to repay it by the end of the fiscal year in which the loan was approved (Law on financing LSGU, Article 43-a). The loan has to be approved by the Government of the Republic of Macedonia with a decision, at the proposal of the Minister of Finance, upon a previously submitted written request from the municipality. The Minister of Finance defines closely the procedure of acting upon approval and repayment of the loan. If the municipality does not return the funds or part of the funds by the end of the current fiscal year, the interest on the unreturned funds from the beginning of the next fiscal year starts to be calculated in the amount of 2% per year until the final payment.

Long-term loan from the Budget of the Republic of Macedonia (Law on financing LSGU, Article 43-b) - if financial instability cannot be overcomed by approving a short-term loan, ***the municipality may be granted a long-term loan without interest from the Central budget of the Republic of North Macedonia with an obligation to return it up to ten years from the date of approval.*** The long-term loan has to be approved by the Government of the Republic of North Macedonia with a decision, at the proposal of the Minister of Finance upon a previously submitted written request from the municipality. The Decision determines the amount, deadline and dynamics of repayment of the approved long-term loan. The Minister of Finance defines the procedure of acting upon approval and repayment of the long-term loan[4]. **If the municipality does not repay the annual annuity, in accordance with the decision, on the overdue and unpaid annuities, interest starts to be calculated in the amount of 2% per year until the final payment.**

1.5 Procedures and standards - Are there certain procedures and standard forms, as well as published approval standards?

As a consequence of the virtually non-existent application of the legislation related to the management of the LSGU's debt, liabilities or financial instability, the standard procedures for it are still underdeveloped. The only procedure regarding this is the rulebook about the way of acting upon approval and repayment of short-term and long-term loans to the municipalities, the municipalities in the City of Skopje and the City of Skopje from the Central Budget of the Republic of Macedonia[5]. This ***rulebook contains a description of the elements that should be included in the request submitted to the Ministry of Finance and a brief elaboration of the procedure.***

Another legislation of exceptional importance for the recording of liabilities (the main debt generator of the municipalities in the long run) is the **Law on Reporting and Recording of Liabilities**. This law regulates the reporting and recording of undertaken and overdue liabilities and overdue and unpaid liabilities, in order to ensure and maintain transparency and accountability and strengthen accountability in the disposal of public funds. The reporting and recording of liabilities is done through the Electronic System for Reporting and Recording liabilities (ESPEO)[6]. The Ministry of Finance establishes, manages and maintains ESPEO. This law

[4] https://finance.gov.mk/wp-content/uploads/2009/02/tinite_od_Centralen_budzet_Sl_vesnik_28_2010.pdf

[5] https://finance.gov.mk/wp-content/uploads/2009/02/tinite_od_Centralen_budzet_Sl_vesnik_28_2010.pdf

[6] https://finance.gov.mk/wp-content/uploads/2009/02/ZPEO.pdf

is especially important for fiscal transparency and accountability of public entities - we will mention it briefly in the reporting section.

1.6 Current requirments/fiscal rules and procedures imposed by the central government concerning fiscal discipline on local level

There are no specific requirements or rules for LGs to prepare an annual balanced budget plan; there are no constraints on fiscal choices by LGs to guarantee that fiscal/budget outcomes remain predictable and robust; there are no rules on deficit targets, aside from the narrative recommendations; currently, there are no maximum expenditure rules. There are only narrative recommendations such as*:*

- The Law on Financing of LSGUs (Article 26) contains a recommendation for temporary use - "The funds from the municipal budget can be used only for the purposes and in the amounts determined in the budget";
- The Law on Budgets in Article 14 states that - The basis for budget preparation are the strategic priorities of the Government of the Republic of North Macedonia, the Fiscal Strategy, the proposed strategic plans of budget users and budget policy, as well as the priorities of the municipalities. The mayor is responsible for preparing the municipal budget and submitting it to the municipal council";
- Also in the Law on Budgets in Article 3 there are narrative recommendations: "The main goal in preparing and executing of the budget is the macroeconomic stability and sustainable and stable national economic development" as well as the principles according to which the Budget should be prepared such as: Budget balance, which implies total revenues and inflows to cover the approved funds with the budget; Economy, Transparency, Specificity, Efficiency, Secure financial management, etc.

The only fiscal rule that exists and confirm positive resuts that could be achieved, refers to the process of preparing/planning LSGU budgets.

The low level of efficiency in the planning and realization of the revenues and expenditures of the LSGU in the past period was the reason for the introduction of additional measures in order to increase the level of efficiency in the management of public resources. For this purpose, the Ministry of Finance took the initiative and adopted the Law on Amendments to the Law on Financing of Local Self-Government Units, which was adopted by the Assembly of the Republic of North Macedonia at its session held on November 13, 2018. With this amendment to the Law on Financing of LSGUs in Article 22 after paragraph (1), 4 new paragraphs were added, which read:

"The own revenues of the basic budget of the municipality can be planned with an increase of up to 10% of the average revenues in the last three years, according to data from the treasury records. As an exception to paragraph (2) of this Article, the municipality may exceed the maximum amount of planned own revenues of the basic budget only if it has provided confirmation of transfer of funds from an appropriate institution or in case of changes related to the amount and type of own revenues of the basic budget, determined by law."

The amendments to the law introduced a direct systemic mechanism that affects the process of planning the budgets of LSGUs, and especially their feasibility and reality. The above is especially important given that the continuous low realization of the planned revenues enabled the LSGUs to create unrealistic obligations that can further significantly affect the increase of debts and the normal functioning of the municipalities.

After adoption of the amendments to the Law on Municipal Financing and limiting the increase of the planned amounts in the budgets by 10%:

- As many as 43 LSGUs in 2019 planned fewer revenues in the basic budget and in the total budget compared to 2018;
- As many as 27 LSGUs in 2019 planned more revenues in basic in total budget compared to 2018;
- Only 11 LSGUs remained on occasion at a similar level of planned and realized revenues.

Some corrections in the planned budgets of the municipalities differed by 50-70% from the planned budgets in previous years. As a result of this fiscal rule, the basic (own) budget of the LSGU on the revenue side in 2019 had a realization of 77.5% of the planned, while in 2018 this realization was only 60.1% (17 percentage points difference). While the basic budget of the LSGU on the expenditure side in 2019 has a realization of 75% of the planned, in 2018 this realization was only 57.5% (almost 20 points difference). It will be elaborated further below in the section on planning efficiency.

Although the effects of the introduced change (a fiscal rule introduced by the Ministry of Finance) had an evident impact on both the planning and the actual realization of the revenue and expenditure side, at the request of some municipalities it was relaxed and expanded. The Ministry of Finance took again the initiative, by amending the Law on Financing of LSGUs, which was adopted by the Assembly of the Republic of North Macedonia at the session held on November 20, 2019. With this amendment to the Law on Financing of LSGUs in Article 22 after paragraph (2), the percentage "10%" is replaced with the percentage "30%". This provided a wider space for the municipalities in planning their revenues and expenditures, but at the same time again increases the risk of reduced efficiency in the realization of both the revenue and the expenditure side, as data showed.

However, this loosening and re-leaving space for the municipalities to plan their budgets based on wishes, and not on real possibilities, was further expanded during the pandemics and in the year of the upcoming local elections. By supplementing the Law on Financing of LSGUs at the proposal of a group of Assembly representatives, on 6.4.2021, the amount of 30%, increased to 50%. More precisely, there was a change in the Article 22-a, about the Budget of the municipality for 2021. As an exception to Article 22 paragraph (2) of this law, the own revenues from the basic budget of the municipality can be planned with an increase of up to 50% of the average income in the last three years, according to the data from the treasury records[7].

These changes in the only fiscal rule that has shown significant results, open the dilemma for the readiness of the central and local government to survive such rigid restrictions on various fiscal variables (revenues, expenditures and deficits) that in the near future will be necessary to be introduced in order to establish fiscal discipline.

[7] https://finance.gov.mk/wp-content/uploads/2021/04/%D0%97%D0%B0%D0%BA%D0%BE%D0%BD-%D0%B7%D0%B0-%D1%84%D0%B8%D0%BD%D0%B0%D0%BD%D1%81%D0%B8%D1%80%D0%B0%D1%9A%D0%B5-%D0%BD%D0%B0-%D0%95%D0%9B%D0%A1-%D0%B1%D1%80.77-%D0%BE%D0%B4-2021.pdf

1.7. Assessment of the budget execution reporting requirements and monitoring tools in place.

Key periodic reports that allow monitoring of budget execution[8]:

- Monthly report on the municipal budget user for the reporting period (cumulative) until the month for which the report is submitted;
- Monthly report on overdue liabilities of the municipal budget user;
- Quarterly report on the execution of the municipal budget (cumulative) until the quarter for which the report is submitted (K1);
- Quarterly report (K2) for overdue liabilities of the municipality (cumulatively) until the quarter to which the report refers;
- Quarterly report on municipal loans (K3);
- Annual account of the municipal budget - after the end of the fiscal year, the Municipal Council adopts an annual account of the municipal budget. The annual account contains all the elements contained in the municipal budget expressed as planned and realized revenues and expenditures for all municipal budget users.

Particularly important for the management of liabilities and debts is the **Law on Reporting and Recording of Liabilities[9]** (adopted on April 11, 2018) which regulates the reporting and recording of overdue liabilities and overdue and unpaid liabilities, in order to secure and maintain transparency and accountability and strengthen the accountability in the disposal of public funds. It applies to almost all public entities, including municipalities. This legislation has made serious progress in the monitoring and transparency of all public institutions, including the general ones, having in mind that they have obligations for reporting and recording the obligations performed through the Electronic System for reporting and recording the obligations (ESPEO). The Ministry of Finance establishes, manages and maintains ESPEO. This provided the Ministry of Finance with a tool for collecting, recording and publishing the reported data by the entities for the undertaken, overdue and overdue, and unpaid liabilities of the entities, which is one of the main generators of financial instability and debts by all public institutions, especially municipalities.

It should be emphasized that before the introduction of this mandatory way of recording liabilities, the municipalities submitted a K2 report mentioned above, on the basis of which the Ministry of Finance has recorded the liabilities of the municipalities. The State Audit Office and **several other analyzes established that very often such reports submitted by the municipalities did not correspond to reality, which limited the role of the ministry as a monitor and controller.** The State Audit Office in December 2017 stated that "there is a difference between the data on short-term liabilities to suppliers and long-term liabilities on various grounds with the data expressed in the Balance Sheet and data submitted by municipalities in quarterly reports to the Ministry of Finance".

[8] https://finance.gov.mk/wp-content/uploads/2009/02/Pravilnik_za_izvestaite_juli_2010.pdf

[9] https://finance.gov.mk/wp-content/uploads/2009/02/ZPEO.pdf

With the introduction of ESPEO (in the part of execution of the budgets of the municipalities it is the Treasury), the Ministry of Finance has an insight on a monthly basis - because the entities (municipalities) are obliged on a monthly basis through ESPEO to report the liabilities for the previous month, no later than the 10th of the following month. The municipalities also have access to this system as users. The Ministry of Finance publishes public reports from this system on a quarterly basis on its website. However, *it must be emphasized that another part of the municipalities are significantly late or do not regularly report their obligations to ESPEO*.

It is of additionall importance that apart from this way of monitoring liabilities, the municipal debts, additional tools, the in-depth analysis of certain indicators related to the financial stability of municipalities and their challenges, liabilities and debt management capacity, is not done on systematic basis. ***Therefore, in this regard, there is a need for continuous periodic evaluation of the fiscal health of the municipalities, based on the collected data, which will warn in time of the fiscal risks faced by certain municipalities, and will improve transparency with their public disclosure.***

Finally, we should mention that *the fiscal transparency prescribed by the existing legislation is still very modest* (the expected changes, above all the Law on Budgets, need to change more things in this direction). Only for the fiscal transparency in the existing Law on Budgets (Article 54) it is stated that "The Budget of the Republic of North Macedonia and the final account of the Budget of the Republic of Macedonia are published in the "Official Gazette of the Republic of Macedonia". The municipal budget and the final account of the municipal budget are published in the official gazette of the municipality.

This case is ***similar to the legally imposed audit obligations*** *(internal and external)*. The Law on Budgets (Article 55) states "Budget users and user units are obliged to maintain accounting and perform internal audit in accordance with the law". While the Law on Financing of LSGUs (Article 38) only states "The State Audit Office conducts regular annual audits of all financial statements of the municipality, in accordance with the Law on State Audit". In this regard, we must state that there are municipalities that have never been subject to state audit, and also more than 1/3 of the municipalities do not have their own internal auditors / audit department. This is additionally the cause of some of the problems that arise in the context of public financial management and the generation of liabilities and debts.

BOX 1: Barriers and Challenges to Efficient Municipal Debt Management in North Macedonia

- Barriers and serious gaps in the implementation of the current legislation for local defaults/insolvency, given that none of the municipalities that met the conditions for financial instability are met, the Law on Financing of LSGUs has been acted upon, because a financial instability has never been declared and the necessary activities have not been undertaken.
- Lack of mechanisms for automatically (by central or local governments) declaring local financial defaults/insolvency without the possibility this situation to be neglect based on discretion or political will.
- Needs for improving/strengthening legislation in part concerning prescribed conditions for declaring financial instability - need for more specific and comprehensive criteria/indicators.

- Need for a more flexible and transparent system of financing the municipalities that temporarily fall into financial instability.
- Need to develop detailed standards, procedures and processes for detecting, managing and supporting different types of municipalities that have financial instability difficulties.
- Lack of mechanisms concerning fiscal discipline of most of the municipalities that used loans from the budget of the Republic of North Macedonia that did not repay the loaned funds, although the deadline had passed.
- Gaps in regulation and implementation as well as lack of monitoring tools by Ministry of Finance regarding municipalities that met the conditions for financial instability, and despite this situation have started new capital projects and have new employments.
- Given the level of fiscal discipline between municipalities there is a significant need to introduce additional fiscal rules restrictions - for example - specific requirements to prepare an annual balanced budget plan; rules on deficit targets; maximum expenditure rules etc.
- Frequent changes and easing in the only fiscal rule (which has shown significant results) regarding the limitation in the planning of municipal budgets, open the dilemma for the readiness of the central and local government to survive such rigid restrictions on various fiscal variables (revenues, expenditures and deficits) that in the near future will be necessary to be introduced in order to establish fiscal discipline.
- Fiscal transparency and accountability prescribed by the existing legislation is still very modest/declarative and not concrete enough (the expected changes, above all the Law on Budgets, need to change more things in this direction).
- Strong need for strengthening legislation (as well as implementation) regarding imposed audit obligations (internal and external), which is too general and non-binding. In this regard, a serious problem is the capacity of the State Audit Office and the capacity of internal auditors in the municipalities.

2 INTERNATIONAL EXPERIENCE IN IMPLEMENTING MUNICIPAL DEBT RELIEF ASSISTANCE AND DEBT MANAGEMENT

2.1 Summary

In the context of decentralisation, fiscal rules that constrain LGs budgeting are seen as a key policy instrument for ensuring fiscal discipline and thus overall macroeconomic stability, fiscal rules are also used as a tool to coordinate deficit and debt levels across levels of government. Local debt regulation and management differ among countries. This Section intends to compare current regulatory systems, uncover similarities and differences and provide some general observations on the development of the subject matter in other countries. The study and comparative analysis were completed for nine countries (Bulgaria, Croatia, Bosnia and Herzegovina, Slovenia, Lithuania, Hungary, Poland, Denmark and Greece), and brief information is also provided on some other countries. Countries were selected based on a combination of quantitative and qualitative factors (e.g. how other EU countries deal with fiscal rules and debt constraints for LGs, resemblance or dissimilarity to Noth Macedonia). Given that North Macedonia is a relatively small country (2.083 million inhabitants in 2020) with only one layer of local government, large federal and quasi-federal countries are excluded from the study. Another criterion used is recent reforms in local finance regulations regarding LGs borrowing. It was also interesting to choose neighbouring countries outside the EU. The selected group of countries can be viewed as an interesting benchmark as it illustrates good practices and helps to understand how fiscal and debt sustainability can be ensured.

The section aims to give an overview of the different practices of fiscal rules subnational governments across the abovementioned countries. **The main findings are the following:**

- **All countries have put in place at least two fiscal rules for LGs** (balanced budget rule, solvency, debt controls rules, expenditure limits), and two-thirds of the countries have three types of rules in place. The stringency of each of these rules depends on the exact formulation of the rule and how it is calculated (please refer to Box 2 below). Countries also defer in terms of different constraints on the fiscal behaviour and choices of their local governments.
- **Borrowing constraints are the most commonly used fiscal rule, followed by budget balance objectives.** Expenditure limits are not widely used and they usually limit the only certain type of expenditures (for example personnel expenditure). Those fiscal rules for LG are often imposed by the central governments.
- The principles for fiscal rules, details on the targets and allocation of ceilings across levels of government are set in the country legislations.
- **Most countries have passed legislation establishing the principles, details and constraints on LGs debt.** In the majority of cases, the limitations apply to the maximum amount local governments can borrow (the debt ceiling), the debt service ratio (in general expressed as a share of SNG revenues), the type of borrowing allowed (generally, restricting borrowing abroad), or types of expenditures that can be financed with the long-term debt (in general, capital expenditure).
- **Most countries define LGs debt as total gross local government debt, which is the sum of all accumulated liabilities for loans and issued guarantees (for utility companies' borrowings) and arrears.**
- A few countries **provide central government guarantees to individual LGs loans (Croatia).**
- **Remove Insufficient transparency criteria** – for example, municipalities may perform some of their activities through separate legal entities or institutions. The employment of such institutions enables the municipalities to circumvent the constraints imposed on them to curb their deficit and indebtedness, and the debts thus generated

can remain hidden from the central government[10]. It is noted that most counties have in place stricter regulations regarding the indebtedness of municipal enterprises.

- **Resolved major vertical Imbalances** - one of the reasons for excessive indebtedness was so-called vertical imbalance (i.e., differences between subnational expenditure and revenue autonomy). For example, in the absence of sufficient autonomous income, conflict easily builds up between the central government and the local municipalities. Most of the benchmark countries implemented reforms regarding vertical imbalances. In other words, the tightening constraint is passed on to municipalities by curbing their revenues[11].

- **Soft budget constraints and moral hazard allow LGs to over-spend and build up debt in** the expectation that upper-tier government will increase transfers to them or bail them out in the event of financial difficulty. It appears that the system in NM as it currently functions creates incentives for soft budget constraints (a number of a bailout of LGs in recent years, however, many LGs today have built-in large outstanding debt). It can be said that to the extent that a local government can push financing of local services on to another level of government it will promote a softer constraint. To resolve this the central government can pursue putting in place stricter/ hard budget constraints and monitoring mechanisms.

- Some countries (most recently Bulgaria, Serbia, Croatia) have **performed reforms to resolve the structural mismatch between LGs spending obligations and allocation of revenues** to ensure sufficient funding for LGs responsibilities, and as such further prevent building up of LGs debts. Monitoring mechanisms such as early warning tools can be one useful way to prevent structural deficits and further unmanageable accumulation of LGs debt.

- **Proper assignment of expenditure responsibilities to LGs results in reducing operating arrays at the local level**. The study identified that in the past LGs in some countries (Bulgaria, Lithuania, Hungary) accumulated a material stock of operating arrears (committed expenditures not being paid) including tasks related to social protection, education, and health. The size of arrears at the local government level can reflect in part an imbalance between mandated expenditures at local levels and the capacity of local government to finance such expenditures. It can be said that building- up arrears reflect the squeezing of deficits through the system – from the central government to local governments onward to companies, wage earners and etc. Arrears represent a form of borrowing (without interest) from other parts of the economy. Indeed, with the use of mutual offsets, localities have a positive incentive to build up arrears that can later be offset against revenues owed by the centre. Such transactions tend to reinforce soft budget constraints rather than discourage them.

[10] Spanish municipal businesses could have a heavy impact on municipalities' compliance with the financial regulations since the businesses in municipal ownership are capable of converting the budget deficit into an off-budget item, thus making the local government fiscal situation unhealthy.

[11] In Spain after the 2008 global financial crisis, a considerable budget deficit was built up and serious sovereign debt sustainability problems were encountered and followed by a significant budgetary adjustment. The subnational sector's central incomes dropped, but this was not followed by a drastic cut in expenditures. As a result, numerous regions found themselves on the verge of insolvency within three years.

- The fiscal rules on **Budget balance objectives often target only current balances**, for realised budgets, are set on an annual basis. The possibility to carry over budget deficits to be offset in subsequent budgeting years is rare.
- In many EU countries sub-national **long-term borrowing is authorised by municipal councils at the recommendation of the chief executive, with a requirement for national or provincial approval of such borrowing**. Short-term borrowing may be authorised either by council resolution in each instance or by a general resolution that the chief executive may borrow up to specified limits.
- In all of the studied countries, **Ministries of Finance, Ministries of Interior and Independent Fiscal Institutions are responsible for monitoring compliance with fiscal rules**, identifying LGs facing fiscal and financial difficulties, and imposing corrective measures.
- All of the studied countries have established systems for **quarterly budget and debt reporting and monitoring. Countries[12] are required to provide regular and promptly publish reliable,** transparent and quality fiscal data to allow proper and well-timed monitoring of the fiscal situation in the particular Member State of EU.
- **Enforcement mechanisms in place** – include cutting specific types of grants, imposing sanctions, corrective measures, replacing LGs officials and even forcing municipal consolidations.
- Different **mechanisms are used to deal with emergencies or unplanned crisis** /shocks (the COVID-19 crisis) including rainy day funds, unallocated budget lines for emergencies, Central Government's support, **bailout envelopes for local governments** badly hit by Covid-19 pandemic crises – funding from the federal and provincial governments to help shore up their finances in the wake of the pandemic-related shutdown. The funding is to help local governments in providing needed health and social services as well as cover some of the 2020 fiscal operating deficit. (international examples include but are not limited to Croatia, Bulgaria).
- **Some countries have formal insolvency and bailout mechanisms in place**. These mechanisms impose costs to bailed out LGs to reduce the risk of moral hazard while ensuring fiscal sustainability of the LGs

Given the scope and time limitations of this study, below are provided greater details on five of the most important aforementioned measures including LGs debt regulations, monitoring and enforcement mechanisms, insolvency and default, budget balance rule, and bailouts.

[12] Regular publication of cash-based fiscal data - European Union adopted Directive 2011/85/EU, which lays down detailed rules concerning the budgetary frameworks of the Member States. The Member States are obliged to regularly publish cash-based fiscal data (i.e., on a cash accounting basis, which means that in a certain fiscal year all revenues and expenditures received and paid from 1 January to 31 December of the current year are included) for the general government and all sub-sectors of the general government. They are also obliged to publish a detailed reconciliation table showing the methodology of transition between cash-based data and data based on the ESA standard (the European system of national and regional accounts). The Member States must also present relevant information on contingent liabilities (government guarantees, non-performing loans and liabilities stemming from the operation of public corporations) and information on the participation of general government in the capital of private and public corporations.

2.2 LGs Debt Regulations

Definition of LGs Debt: there are some commonly used definitions for sub-national debt and this study can adopt the definition and the structure used by OECD, „subnational debt stock is made up of "financial debt" (mainly loans and debt securities resulting from borrowing) and "non-financial debt" i.e. the sum of other accounts payable (arrears, suppliers debt, etc.) and pension liabilities (insurance pensions and standardised guarantees) ".

As per OECD data and reports, the subnational government debt was at 28.5% of GDP and amounted to 23.2% of total public debt in 2018. Subnational government outstanding debt is very unevenly distributed among OECD countries. *LGs debt is particularly low in unitary countries such as Bulgaria, Greece, Hungary, Ireland, Slovenia, both in terms of GDP and weight in total public debt.* (retrieved from: https://www.oecd-ilibrary.org/). The level of subnational debt is expected to increase further in 2021 and 2022, as the COVID-19 crisis has put pressure on subnational government finances through higher expenditure and reduced revenues.

Most central governments in Europe have made an effort to regulate LGs debt and borrowing as they recognized that market discipline was insufficient due to information problems (the informational asymmetries and the absence of transparency). *For example, Hungary introduced tight debt limits to avoid repetition of the LGs debt crisis in the 1990s, when large municipalities had to be bailed out repeatedly and the national government absorbed their subnational debt*. Most Eastern European countries allow local borrowing for capital investment purposes as well as for liquidity (short-term) but have set out an explicit regulation in place to control the debt and prior approval from the Ministers of finance.

Overall, based on the conducted study and comparative analysis, the author has found that legislation and regulations on LG debt are typically focused on four rules:

- ***The use of the debt proceeds***. Most countries follow the „golden rule" that municipalities can borrow long term or issue bonds to finance only capital expenditures for investment projects, and not current expenditures.

- ***Debt Controls on***

  – ***the debt stock or on debt service ratio*** - place limits on the amount of aggregate debt as a percentage of annual revenues and the debt service ratio should be limited to a certain percentage of revenues (please refer to the table below).

  – ***the issuance of municipal guarantees*** - apply to the issuance of guarantees by local governments and types of collateral that may be offered to a lender. Municipal guarantees are justifiable only in support of essential public service projects but should not be used for supporting commercial or revenue-generating investments and should be subject to approval by the municipal council and also subject to a public hearing procedure.

  – ***LGs revenue to secure debt*** - apply to the type of revenue that may or may not be used for debt servicing – some countries allow pledging certain own revenue as a pledge.

- ***Sources of debt financing***, in general, no foreign loans are allowed unless hedging in place approved by the MoF of the respective country.

- ***In case of default***. Insolvency and default procedure in place describing who pays or when revenues can be intercepted to pay the debt, must be specified.

The use of the debt proceeds

Most of the examined countries place limitations on the use of debt by local governments, with a distinction usually made between short- and long-term debt. Short term debt is defined as debt which is payable within a year and long-term debt is debt with a maturity of more than 12 months.

- Short-term borrowing - In some cases, depending on the municipality's size, level of service responsibility and local policies, it may make sense to borrow in the short-term to help provide sufficient working capital to allow municipal managers reasonable operational flexibility and is subject to the constraint that **municipalities settle their account by the end of the current fiscal year by legislation**. **However, it is important to ensure that short term debt does not become an indirect way of financing operational deficits over time, which is problematic from the point of view of prudent fiscal management.** Municipalities should be allowed to bridge cash flow in anticipation of specific and realistic future revenue/income streams to be realised within the fiscal year, should be allowed to bridge capital requirements in anticipation of specific and realistic grants to be received or long-term debt to be issued within the fiscal year.
- Long term debt - in most countries' municipalities may take on long-term to finance "capital expenditure which has been budgeted for and approved by council." It is recommended that in no event, should long term debt be used to finance current account budget deficits. Municipalities may take on long-term debt to finance infrastructure and other capital assets.

Debt controls

Box 2 LGs Debt Controls in selected countries

Slovenia: LGs borrowing rights are regulated by the Public Finance Act (1999) and the Financing of Municipalities Act (2006). The possibilities of borrowing for municipalities are limited by strict rules. Municipalities are allowed to borrow domestically for liquidity purposes up to a ceiling of 5% of the budget of the previous year. **Municipalities can borrow to finance certain types of investment projects** ("Golden Rule"), such as housing, water networks, and sewerage **upon prior consent from the Ministry of Finance**. Municipalities are not allowed to issue bonds but they can guarantee loans to indirect budgetary users (legal entities that provide public services). **LGs indebtedness levels may not exceed 8% of the revenue generated by the municipality in the year before the year of borrowing.** Municipalities incur debt mainly to finance schools and electricity-related

Denmark. Municipal borrowing (loans and bonds) is subject to the supervision and approval of the central government. In general, municipalities can only borrow for capital expenditure for certain utility services only. Municipalities are also allowed to borrow to meet their short-term needs with permission from central government. Automatic permission is granted for fee-based borrowing for public utilities. KommuneKredit, a local government bank established in March 1898, and governed by Act No. 383 dated 3 May 2006 on the Credit Institution for Local and Regional Authorities in Denmark. Under the supervision of the Ministry of Economic Affairs and the Interior, it provides lending and finance leases to Danish municipalities and regions. Currently, all municipalities and regions are projects. Until 2018, there were no special laws or guidance in the event of a municipality's insolvency.

Bulgaria. Long-term borrowing is authorised only for investment projects ("golden rule"), refinancing of existing debt, ensuring payments required for municipal guarantees, and municipal public-private partnerships projects.

The 2014 Public Finance Act clarified the legal requirements regarding municipal debt and municipal guarantees. **Municipalities' annual debt payments must be lower than 15% of the annual average sum of own revenues and of the block equalising grant for the last three years**. LGs can take out loans from the „Fund for Local Authorities and Governments in Bulgaria -FLAG", which provides long-term and short-term funding to Bulgarian municipalities (or groups of municipalities) to implement projects funded by EU programmes. **Local authorities may also borrow through interest-free loans from the central budget and financial leasing.**

Lithuania: LGs debt is regulated by the annual Budget Law. Long-term borrowing is restricted to financing investments, and the issuance of municipal bonds on capital markets is not authorised. Short-term loans are allowed to finance investment projects, cover temporary income shortfalls, or provide guarantees for loans to companies controlled by the municipalities.

Limits to local government borrowing are set annually by the government via the Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets. It has decreased from 70% to 60% of projected revenue in 2018, except for Vilnius city which has a higher ceiling;

Net borrowing limit (debt to revenue limit): the Annual budget law also sets a limit for the total annual net municipal borrowing as a share of the approved total municipal revenues (excluding state-specific grants).

members of KommuneKredit, which hold 90% of subnational government loans in the country.

Poland: Limits on local governments' debt service should not exceed a three-year average sum of operating surpluses and proceeds from privatising public assets. Moreover, LGs debt must not exceed 60% of GDP. As a result, the level of LGs outstanding debt as a share of GDP and public debt has decreased over the last years.

Hungary: The Cardinal Local Government Law, forbids any operating deficit, and stipulates that LGs are responsible for their own financial management. However, there is no national stability pact agreement between the central and local levels. Following the 2013 reform, the total debt of Hungarian local governments accumulated from 2002 to 2008 was taken over by the central government and consolidated in full between 2011 and 2014. It was done progressively in three stages based on the size of SNGs. The ratio of debt to be taken over was determined on the basis of the number of inhabitants in a particular municipality and the taxation power measured by the local business tax.

Greece: Borrowing is authorised to finance investment projects ("golden rule") and to refinance existing debt under better conditions. The law 4111/2013 introduced additional fiscal rules limiting debt: interest payments for a given year cannot exceed 20% of ordinary annual revenues and total debt must remain under 60% of total annual revenues. It also requires that SNG receive the approval of the Minister of Finance to access any kind of loans. A debt-brake was introduced for the few municipalities facing over-indebtedness problems, which have to join a "Special Economic Recovery Program".

Bosna and Herzegovina: - according to the 2010 Law on Debt, Borrowing

These limits vary every year and are, therefore, difficult to predict;

Guarantee limit: the amount of municipal guarantees to municipally-owned enterprises cannot exceed 10% of the budgeted municipal revenues (also excluding state-specific grants). The Ministry of Finance must be informed when local governments take out loans or conduct guarantee operations.

A pilot project started in 2018 for the creation of a Local Development Fund is ongoing. It enables municipalities to have more favourable credit conditions.

Serbia: Under the Public Debt Law, local government bodies are allowed to borrow if they obtain the approval of central government authorities. Loans and bonds can be contracted both in the domestic and foreign markets. While local governments can borrow to finance liquidity resulting from a fiscal imbalance, ***liquidity borrowing should not exceed 5% of actual recurring revenues from the previous year***; moreover, the total borrowed amount must be repaid before the end of the budget year and it cannot be refinanced or renewed at the end of the budget year. The local government cannot borrow long term, except for the financing or refinancing of capital investments that are included in an approved local government budget. ***Outstanding long-term borrowing for capital investment expenditure cannot be higher than 50% of the revenues that were government collected in the previous year***. ***The amount of principal and interest on all outstanding long-term debt due in a future fiscal year cannot exceed 15% of revenues generated*** by local governments in the previous year.

and Guarantees, municipalities and cities can contract long-term debt if their debt service payment in a given year does not exceed 10% of the previous year's revenues. In specific cases, municipalities and cities need permission from the Federal Ministry of Finance to borrow. In RS, municipalities and towns can borrow to finance capital investment expenditures by up to 10% of the actual revenues generated in the previous fiscal year. A municipality's total borrowing obligations cannot exceed 20% of the actual revenue generated.

Croatia: Counties and local governments can borrow to finance capital investment (golden rule), with previous approval by the central government. In addition, **there are two main prudential rules: a general limit on the aggregate borrowing of all LGs (2.3% of current revenues of the previous year) and an individual limit (20% of current revenues of the previous year). These percentages are determined annually by the Act on the State Budget Execution.** These limits do not include municipal utility companies and/or guarantees issued by local governments, which is why local government units have 'hidden debt'.

Source: OECD 2019

It is worth noting that some local governments may circumvent borrowing limits if management systems (monitoring and reporting fiscal systems) are not rigorous and local governments may assume that will not be caught for a while. For example, in some countries, there were cases of local governments taking commercial and failed to register them in the official budget documents. Some local governments extended loans to their public entities and when they become due the entities were not in a position to pay back the loans. This practice is often harmful.

Controls on revenue to secure debt

Types of debt or debt instruments that municipalities may issue can be best approached by examining the kinds of security that may be given by municipal borrowers. Trends in countries with established municipal debt markets show that the parties are exploring ways of enhancing a creditor's security by contract. Pledges of particular physical assets, receivables, and particular revenue streams have all been used (in Bulgaria to pledge certain revenue). ***It will be necessary, as part of the new amendments to the legislation that governs municipal borrowing, to spell out in greater detail what powers municipalities have to pledge security to collateralize debt***. In addition to the conventional "full faith and credit" (general obligation) provisions, this may include special security arrangements including the pledging of assets, of local tax and tariff revenue streams, of intergovernmental grants or transfers, and tax and tariff level covenants; However, certain limits should apply. For example, municipalities should not be permitted to pledge assets deemed essential to the maintenance of public health and safety.

2.3 Monitoring and Enforcement Mechanisms for LGs

Fiscal rules, in particular budget balance and debt rules, can be imposed by higher levels of government, self-imposed by a level of government itself, negotiated across levels of government and fiscal "pacts" (Austria). For regional/provincial/state governments, fiscal rules are generally self-imposed. For LGs as most of the time, fiscal rules are imposed by higher levels of government.

- **The statutory base for budget balance and debt rules for LGs** – in most of our benchmark countries (Bulgaria, Denmark, Hungary, Poland) ordinary legislations stipulate precise regulations of these fiscal rules and the actual target for the different level of governance. It is important to consider the statutory base for the limits of the fiscal rules and their flexibility in case of a need to reform these rules. In Slovenia, while the Constitution defines a balanced budget rule for the general government, details on how this rule translates for the LGs are given in ordinary legislation. The strongest statutory fiscal rules are those set in the constitution or constitutional laws, but they are very difficult to reform. (In Lithuania the balanced budget rule for LGs is set in the Constitutional Law on the Implementation of the Treaty while borrowing limits are set in ordinary law). Constitutional requirements strongly reduce the capacity of central government to address unpredicted economic crises. Based on the observation, it can be concluded that **many EU countries only have the fiscal rules for LGs set in ordinary legislation.**

- **Responsibility for monitoring compliance with fiscal rules** – in most of the studied countries the Ministry of Finance and the Ministry of Interior have direct responsibility for monitoring LGs compliance with fiscal rules including debt controls. The Ministry of Finance conducts supervision over the performance of municipalities and in-year monitoring of municipal debt levels and the adherence to borrowing limits by assessing quarterly submitted financial statements and or conclusions from the National Audit Offices. In many countries, the scrutiny and monitoring of municipal-owned enterprises' debt levels are quite weak (Lithuania). Most of the selected countries require some form of central government control over sub-central debt, and in most cases, the responsible ministry giving its approval.

Box 3: Reforms in Monitoring Mechanism in Hungary

In 2010, LGs levels of debt were very high and debt service was putting a heavy burden on municipalities. This high debt stock was partially caused by the under-financing of municipal tasks, and the municipalities' disproportionate task service obligations. At that time the new government in power set as a priority to deal with this situation and undertook an important reform which included taking over the debt of the council local governments and the Municipality of Budapest, as well as putting in place a system of "task-based finance" and new regulations and rules on municipal debt transactions (the Act CXCIV of 2011 on the economic stability of Hungary -Stability Act). Some of the introduced monitoring mechanisms included that:

- Municipalities must get prior approval from Cabinet for new debt transactions. The Cabinet can reject approval for debit transactions not related to improving the delivery of municipalities' tasks and obligations;
- Debt service should not exceed 50% of the annual own revenues of the municipality in any year during the maturity of the transaction. Before requesting approval for borrowing, municipalities must assess their local taxes, to prove that they cannot use other sources of income than debt to finance the needed transaction.

Box 4: Public Register of LGs debt in Bulgaria

According to the Municipal Debt Act, a central municipal debt register is maintained by the Local Government Financing Directorate at the Ministry of Finance which shows individual records for each local government. The municipality is required to submit information to the register of the Ministry of Finance on a montly basis.

The register of the municipality is divided into the following subregisters:

1. subregister of the emitted municipal securities;
2. subregister of the loans, provided to the municipality;
3. subregister of the issued municipal guaranties.

The following circumstances shall be entered in the register:

- the decisions of the Municipal Council under Art. 17, Para. 1 and Art. 40, Para. 4;
- the term of the debt, amendments of the term, depreciation scheme of the debt;
- delay of the debt servicing longer than 30 days.

Table 1: Monitoring Institutions

Ministry of Finance/Treasury	Ministry of Interior	Independent fiscal institution	Other
Bulgaria	Denmark	Slovenia	Poland: Regional Accounting Chambers
Greece			

Ministry of Finance/Treasury	Ministry of Interior	Independent fiscal institution	Other
Hungary			
Lithuania		Independent Fiscal Institution (IFI) monitors ex-ante and ex-post compliance of municipalities with fiscal rules.	
Croatia			

- **Enforcement mechanisms and procedures –** these may include financial sanctions and corrective measures, – an example of a corrective measure in case of breaking the fiscal rules, the subject LG loses the possibility to receive certain grants from the Central Government (for example in Lithuania LGs in breach lose the possibility to receive CG "non-returnable subsidies" for the co-financing of projects from the EU Structural Funds; in Denmark, the central government can reduce transfers to LGs in case breaches to the fiscal rule are not compensated in the following year. Denmark has some sort of "evaluation/administration" mechanism for LGs facing financial difficulties, where the central government can directly intervene in LGs' decisions, temporarily replace their administration). Some of the examined countries have put in place early warning and response indicators to identify LGs in financial difficulties (Denmark), or take measures towards revenue structure and expenditure responsibilities of LGs to ensure sufficient funding for the mandatory tasks.

  Another procedure is to offset (compensate) the breach of the fiscal rule in future budgets (Hungary, Bulgaria).

  Portugal is an example of an early-warning system for debt accumulation, and different types of adjustment or restructuring plans for over-indebted municipalities. Municipal Resolution Fund (FAM) was created to assist distressed municipalities https://www.fundodeapoiomunicipal.gov.pt/proposta-de-pam.

  Some countries have weaker enforcement tools, such as not granting permission for new borrowing, or ineligibility to specific types of central government support. In Lithuania, breaching FRs is subject to "moral sanction" (i.e. the LG must submit to the Ministry of Finance a letter explaining the reasons for the infringement), and will not be eligible to a co-financing grant from CG for EU structural funds.

- Some countries like Bulgaria, Lithuania have been developing a tool for LGs assessment management, which also aims at identifying LGs assets liabilities for municipalities. Current liabilities from LGs property are monitored, but there is no information on the long-term property associated liabilities of municipalities and the risks and costs associated with these. For example, many LGs lack proper information re: the kind and age of municipal properties, and when renovation (i.e. increased spending) will be necessary. Such a tool was created for municipalities in Bulgaria to consolidate information about their assets (property) liabilities and forecast costs. LGs and the Ministry better plan funding needs including borrowing. (In Lithuania such tools are applied in the Kaunas district municipality).

2.4 Balance Budget Rule

The budget balance rules are effective policy tools as they are linked to better budgetary performance such as generating budgetary higher surpluses or lower budget deficits. A major criticism of budget balance rules is that budget balance rules defined in nominal terms is the correct assessment of the cyclical position of the economy. This fiscal rule applies most of the time to individual LGs. The most commonly used rule is that only the current budget needs to be balanced. Most countries require that the realised budgets are balanced, but differ on the treatment of realised deficits. For example, some countries do not require deficit to be compensated in the following year, but only require LGs to take corrective actions to avoid further deficits in the future (Hungary, Poland, Slovenia and Lithuania), while other countries require them to compensate realised deficits by offsetting surpluses during the next budget. For example, in Lithuania, in case of ex-post non-compliance with the balanced budget rule, municipalities must submit to the Ministry of Finance a written explanation of the breach. The municipality, at its own discretion, can decide upon the corrective measures for the next year such as raising local tax rates and/or reducing certain expenditures. These measures apply only to the year following the year where the budget deviation was registered.

2.5 Insolvency and Default Mechanisms

Sub-national governments and public companies or public-private partnerships can become subject to an insolvency procedure. For example, in Hungary, local governments are subject to such insolvency laws. In general, the Insolvency framework for LGs provides rules to resolve unsustainable borrowing in an orderly way and define how to proceed when a sub-national entity has gone bankrupt. Insolvency frameworks serve to promote a fiscal recovery of highly indebted governments. Some countries do not have formal municipal insolvency framework (Lithuania, Bulgaria, Poland, Slovenia). Denmark and Netherlands have ex-ante mechanisms in place to make sure municipal defaults cannot happen. In this framework, the lenders can appoint a receiver to collect the property tax in case of LG default.

In general, there are three different kinds of insolvency frameworks depending on the role of the courts, higher-level governments or other authorities in the procedure.

1. The court has decision-making authority in the whole insolvency process. For example, in Hungary, the court decides whether a municipality is eligible for filing for insolvency, gives consent to the crisis budget and appoints a trustee who leads and supervises the bankruptcy and reorganisation process.
2. Higher-level governments determine the status of LG being bankrupt, carry out the debt restructuring procedure and take control of sub-national finances.
3. In hybrid insolvency systems, both the court and the administration are involved in the debt restructuring process. The elaboration of the restructuring plan, as well as fiscal adjustment, is left to the municipality itself (Bulgaria).

Box 5 Hungarian Subnational Borrowing Framework: Ex-Ante Regulations

Hungary has one of the few insolvency systems in the world where municipal insolvency can lead to a court-supervised "bankruptcy and reorganization" process that is led by an independent receiver or trustee. The Municipal Debt Adjustment Law regulates the insolvency procedure for municipalities, and it covers only municipalities, while all corporate entities regardless of ownership and type (limited liability, share companies, for-profit, or nonprofit) fall under the jurisdiction of corporate bankruptcy law. The Law extends the obligations of providing public services to the municipality itself if the company (private or public) that provides a particular municipal service such as water or public transportation goes through bankruptcy proceedings under the commercial code.

The Hungarian Municipal Debt Adjustment Law specifies a procedure consisting of seven major phases:

1. Initiation of debt adjustment procedure, 2. Court review of the petition,

3.Creating a debt adjustment committee, 4. Adoption of budget developed for a financial crisis,

5. Formulating the financial reorganization plan and the proposed agreement, 6. Debt agreement negotiations, and 7. Asset liquidation if no agreement is reached.

Box 6 Criteria for triggering the assessment mechanism in Bulgaria

Criteria set in the Public Finance Act:

Municipalities with financial difficulties are municipalities for which a minimum three of the following conditions are present:

1. fiscal rules provided regarding debt limitations are not complied with;
2. the existing at the end of the year debts for municipality budget expenses exceed 15 per cent of the average annual amount of the accounted expenses for the last 4 years;
3. the existing at the end of the year undertaken engagements for municipality budget expenses exceed 50 per cent of the average annual amount of the accounted expenses for the last 4 years;
4. the existing at the end of the year outstanding debts under municipality budget exceed 5 per cent of the accounted municipality expenses for the last year;
5. the budget balance of municipality budget in the last three years is a negative value for every one of the three years;
6. the average collectability rate of the property tax and of the motor vehicles tax is under the average collectability of both taxes for all municipalities, accounted for the last year.

For municipalities with financial difficulties, a financial recovery procedure shall be opened for the achievement of financial sustainability and stability of municipal finances.

- The procedure of municipality financial recovery is opened for a period from one to three years. In the financial recovery procedure, local community interests shall be taken into account. The Ministry of Finance carries out monitoring of municipality for assessment of the parameters under Art. 130a. of Public Finance Act.

- In case of identified existence of three and more of the conditions, the Minister of Finance issues methodological directions and instruction on the application of financial recovery plan, which has to be published on the Internet site of the Ministry of Finance.
- Every quarter on the Internet page of the Ministry of Finance information from the reported by the municipalities data about their financial situation shall be reported.

2.6 Central Governments bailouts

With respect to bailout expectations the study shows the following broad cases:

- Central governments may be more willing to bail out smaller regions as costs are lower. For example, the two German local states that bailed out in the 1990s were the smallest ones in the West German federation and, in Italy, smaller municipalities and regions seem to have a higher willingness to request bailouts.
- Another hypothesis is "two sensitive to fail" where the key factor is not the size of the population but the extent to which local governments provide key public services such as education, health and social services in this region.
- Too financially weak to be able to recover where a large vertical imbalance exists (Hungary). For example, central governments may feel obliged to bail out regions that strongly depend on Central Governments transfer as such regions may not have enough revenue capacity to raise necessary resources by themselves. Although regions with large fiscal imbalances tend to be subject to borrowing restrictions (Eichengreen and von Hagen, 1996), this does not prevent bailouts, and
- The limited capacity of the central government to discipline an individual local government can lead to bail out.

Some of our benchmark countries experienced in the past central government's bail outs such as Hungary, Denmark and Greece. For example, In Denmark, a few municipalities need to be bailed out, and the total amount spent on bailouts was modest. After being bailed out, municipalities tend to improve their financial situation fairly rapidly, without the need for new bailouts later on. The bailout system does not appear to give municipalities a strong incentive to misbehave. Bailouts may be beneficial if financial distress is caused by factors truly outside the control of subnational administrators. In that case, timely bailouts may be cost-effective and avoid unacceptable damage to public service provision. Moreover, the explicit bailout guarantee enables Dutch municipalities to borrow cheaply.

For greater details on the above issues, please refer to Annex 2 Countries Case Studies where the topical issues of LGs debt and overall fiscal rules are discussed in more details. Recent official documents and reports from OECD, World Bank, EU Council of local governments, etc have been used. Each country report follows the same outline and gives answers to the following key questions 1) Most recent years level of government debt and subnational debt, and as a % of the country GDP, 2) Has the central government-imposed restrictions on local governments debt and borrowings? If so, what are those restrictions, which legislation includes these restrictions, and what are the relevant sections or clauses? 3) Is there authorization in legislation to approve borrowings and loan guarantees on behalf of the local governments assigned to the local assembly (or similar body), the governor, the executive council? If so, which legislation provides authorization, and what are the relevant sections or clauses? 4) Is there clear authorization in legislation to undertake debt-related transactions and to issue loan guarantees on behalf of the local governments? 5) Are there requirements for mandatory reporting to the local assembly or similar body covering debt management and, where applicable, issued loan guarantees? and 6) Has there been any instance in the past five years in which local governments were bailout or were in an insolvency procedure?

Below is presented a brief summary of key lessons re: LGs debt for the benchmark countries

Key lessons from Slovenia

- **The balanced budget rule in place-** Slovenia adopted a Constitutional Act in 2013 by which there is a commitment to a balanced budget (that the income and expenditure of the state budget will be balanced in the medium term without incurring debt or that income must exceed expenditure).
- **Decentralization in place,** LGs have sound revenue autonomy and it is slightly higher than the EU average (61% versus 53% in 2018), the dependency on central government transfers is lower than the EU average (39% versus 48% in 2018).
- **The strict fiscal rule regarding borrowing and debt limits**– LGs can borrow domestically for liquidity purposes up to a ceiling of 5% of the budget of the previous year. Borrowing for investment purposes is subject to specific authorisation by the Ministry of Finance. LGs are not allowed to issue bonds, but they can guarantee loans to certain public entities that provide public services. The total annual ceiling for the repayment of loans principles and interest, financial leasing, trade credits and contingent liabilities is set at 8% of the revenues of the previous year.

Key lessons from Bulgaria

- Municipal Debt is highly regulated with a sound legal framework in place- restrictions on the total debt stock, debt service capacity, use of debt, terms of debt, etc.
- Well defined criteria for triggering the assessment mechanism of LGs in Bulgaria.
- Defaults are not allowed by law.
- Existence of a Public Debt Register managed by MoF ensuring a sound high level of transparency and reporting mechanisms.
- The government can provide interest-free loans to LGs in financial distress upon approval of financial recovery plans for the subject LGs.
- The Local Governments are closely monitored and supervised by the Ministry of Finance.
- Sound reporting mechanisms for LGs in place, the predictability of monitoring indicators.
- Moderate tax autonomy of LGs.

- Equalisation system in place.
- Clear vertical coordination mechanism, with one department in the Ministry of Finance responsible for all financial issues related to LGs.
- FLAG - a financial institution specialised in municipal lending and a municipal guarantee institution to pool funding needs and risks and access international markets. Creating such institutions would require a high level of capacity and coordination from municipalities, which may be lacking in North Macedonia.

Key take away from Croatia

- LGs have access to debt markets (loans and municipal bonds) under the very strict conditions imposed by the State Law Budget. Every long term loan engaged in by LGs needs to be approved by the Ministry of Finance.
- The Government gives guarantees to provide protection in case an LG cannot repay its long term debt. For this reason, before taking on long term debt, the LGs must receive the guarantee of the Government.
- Debt controls in place- the total debt service of an individual LG cannot exceed 20% of budget revenues from the previous year.
- In case of non-compliance with the legal framework (violation of borrowing limits, issuing guarantees without the Ministry of Finance's approval, borrowing for current expenditure funding, etc.) the Budget Law provides financial sanctions.
- Secondary legislation in form of a bylaw on LGs borrowing and issuing guarantees is implemented to ensure compliance with the provisions of the primary legislation.

Key lessons from Denmark

- LGs in Denmark are subject to a structurally balanced budget rule (zero structural deficit), and borrowing is forbidden, except in some specific cases (e.g., LG public utilities, homes for elderly people, etc.) with prior approval from the Ministry of Interior.
- Strong revenue base with an unlimited right to levy taxes on income and property.
- Strong fiscal monitoring - strong and tightly enforced fiscal discipline procedures in place. There are two main fiscal discipline mechanisms for LGs in Denmark: 1) If the annual collective limits of the economic agreement are breached, the central government withhold grants to LGs. Municipalities must keep their budget's current account balance positive over the year; and 2) Breaching this provision triggers a fiscal discipline procedure where municipalities in economic distress can be put "under

administration”. This procedure is triggered automatically and is highly predictable with limited CG discretion.

- A strong role of LGs association in vertical coordination - the local government association (LGDK).
- KommuneKredit funding – is a specialised publicly owned non-for-profit financial institution providing loans to Danish regions, municipalities, municipal-owned enterprises and companies undertaking regional or municipal tasks. Risk management has a high priority. It issues bonds on national and international markets and lends to its clients with only a small administrative margin. Legally, KommuneKredit is a voluntary membership association. Nonetheless, all Danish municipalities and regions are members.

Key lessons from Hungary

- LGs are allowed to borrow from financial institutions or directly from the market. No golden rule exists; operational deficits can be financed by borrowing or disinvestment (sales of assets).
- The undertaking of new long term financial liabilities is subject to authorisation by the central government.
- Debt controls in place- debt redemption would not exceed 50% of own revenues in any given year during the maturity of the loan contract.
- Well designed default procedure in place.

Key take aways from Greece

- LGs have moderate revenue autonomy which results in a slightly higher fiscal imbalance and transfer dependency than the EU average.
- LGs debt levels are limited, given limited autonomy.
- LGs have the right to issue bonds, but this has not yet been exercised.
- Some local authorities have been bailed out by the state.

3 NORTH MACEDONIA MUNICIPAL DEBT: PROBLEMS AND SOLUTIONS

This section is organised into three parts where the first two examine the overall debt management situation in North Macedonia and the identified current key problems (a pool of seven municipalities), after that the authors of the report propose a framework of solutions to the key identified problems by adopting two approaches complementing each other. At the end are discussed debt management tools that can be transferred and impended in NM based on the prior identified problems and solutions.

3.1 Overall Situation

The information given by the MoF Office in May 2021 shows that subnational debts comprise of three main categories: The debts to be repaid by local governments, the debts guaranteed by local governments, and the debts that may be relieved by local governments. North Macedonia municipal debt has accumulated over the last 15 years. At present, most local government debt risk is generally controllable. However, some municipal debts pose certain risks.

North Macedonia total local debt amounted to 0,1% of GDP[1], so can be concluded that the risk of NM sub government debt is controllable generally, while the risk of government debts mainly lies in [1] See more details - https://javendolg.open.finance.gov.mk/ .

Several local governments. Although, with all due and unpaid liabilities and all other long-term liabilities of the municipalities taken into account, this amount is significantly higher. In terms of the growth of municipal debts, after March 2020, the growth of local government debt continues mainly as a result of COVID-19 pandemic crisis.

Box 7 North Macedonia Central Government Bail-out

The overall municipal debt in the last 10 years was also steadily increasing, with the general liabilities increasing drastically which deems municipalities unable to service their debt independently. The State Audit Office has repeatedly stressed that municipalities do not respect the Law on Financial discipline and do not pay their obligations timely to their suppliers. In 2008, total municipal debt was about 50 million euros, in 2012 it was 55 million euros, in 2016 it was 82 million euros and in 2018 jumped to 97 million euros.

Long term borrowing is largely confined to the City of Skopje and a few other large cities: Kumanovo, Strumica, Shtip, Tetovo, Ohrid. Bailouts have happened before, with the latest in September 2018 when the Central Government decided to pay off arrears of municipalities up to 3 billion MKD, if municipalities reach an agreement with their creditors, and the total debt was reduced by 12% between September 2018 and March 2019.

Namely, following the local elections in October 2017, newly elected mayors requested from the Central Government for support in resolving the inherited large municipal debt. The municipalities have accumulated arrears of 4.6 billion MKD (74,796,747.00 EUR) of municipal debt and 2.5 billion MKD (40,650,406.50 EUR) of public enterprise debts in 2017[13] over a period of 7 years, causing many bank accounts of the municipalities to be blocked. The arrears have accumulated for a number of reasons, including launch of infrastructure projects without having adequate funding.

Following a Government proposal, the Law on Reporting and Recording of the Commitments of All Beneficiaries of Public Funds[14] was adopted in April 2018. This Law regulates the reporting and recording of the commitments that have been undertaken but are not due, and of due but unpaid liabilities, in order to ensure and maintain the transparency and accountability in using public funds. The Law pertains both to the

[13] https://finance.gov.mk/mk/node/6972

[14] Official Gazette of the Republic of Macedonia No. 64 from 11.4.2018

municipalities and the City of Skopje, as well as to public enterprises and institutions established by the municipalities and the City of Skopje. The list of largest debtors includes the municipalities of Ohrid, Tetovo, Karposh, Bitola, Struga, Kumanovo, as well as rural municipalities whose debt compared to the large municipalities does not seem large, but seriously endangers the functions of small and low-capacity municipalities. The reporting and recording of the commitments (liabilities) is done on a monthly basis through the Electronic System (ESPEO).[15]

Once debt was meticulously recorded, in the fall 2018, the Government proposed adoption of the Law on Financial Support to the Local Self-government Units and the beneficiaries established by the local self-government units for funding of due unpaid liabilities[16], and this Law was adopted. According to this Law, the Government used 3 billion MKD (50 million EUR) as earmarked funds for repayment of 51% of the debt of the municipalities as of September 2018. In order to ensure financial discipline, the Law on Financing of the Local Self-government Units[17] imposed a restriction on planning of municipal own revenues – they were required to plan up to 10% more from the average revenue generated in the last three years, according to treasury records. A municipality would be able to exceed the maximum amount of planned revenues only if it has obtained confirmation of transfer of funds. This clause changed again in December 2020, when by initiative in Parliament, this limit to exceed the planning was reverted to 30% and furthermore to 50%.

3.2 Current situation of selected eight LGs in North Macedonia

For this study, **8 municipalities** (Ohrid, Tetovo, Karposh, Kumanovo, Vrapciste, Pechcevo, Illinden, Veles) **were being analyzed, which represents a mix of cities that have been experiencing debt problems in the past and currently, as well as two municipalities that have potential for borrowings for capital expenditures.** The objective is to identify immediate problems associated with the LGs debt /obligations and their debt serving and repayment capacity based on the past 3 years financial performance (more details for analyses of each municipality in Annex 1).

Table II: A summary of the selected municipalities.

Name of LG	Size	Region	Population	Revenue per capita in 2020	Expenditure per capita in 2020
Ohrid	392 km^2	Southwest	55.749	17.664	17.290
Tetovo	262 km^2	Polog	86.580	17.446	17.250
Karposh	21 km^2	Skopje	59.666	13.754	13.556
Kumanovo	432 km^2	North-east	105.484	16.651	15.424
Vrapciste	157 km^2	Polog	25.399	13.176	13.121
Pechcevo	208 km^2	East	5.517	16.495	16.369
Ilinden	97 km^2	Skopje	15.894	17.905	16.165
Veles	518 km^2	Vardar	55.108	12.837	14.016

[15] ESPEO https://finance.gov.mk/mk/node/7317

[16] Official Gazette of the Republic of Macedonia No. 209 from 15.11.2018

[17] Official Gazette of the RN Macedonia No. 244 from 26.11.2019

Analysis of current liabilities and debt of the municipalities

70 out of 80 municipalities in North Macedonia reported due and unpaid liabilities on various grounds. The largest debtors are three municipalities, Tetovo, Ohrid and Karposh. The deterioration of the financial situation of the municipalities is not a new situation, rather a process that lasts for decades. According to documents provided by the Municipality of Ohrid, they have a lawsuit in a case for expropriation from 1980, for which the municipality now, after four decades, has to pay 415,000 euros.[1] Some municipalities, such as Kumanovo have managed to resolve their old debts. "After eight years under blockade, the municipality is now unblocked. In three years, more than seven million euros were returned and at the moment there are no cases with enforcement agents for forced collection "- said the mayor of Kumanovo, Maksim Dimitrievski[18]

Table III: Current unpaid liabilities of eight selected municipalities

	2018	2019	2020	2020/2018
Ohrid	969.760.484	449.397.004	427.583.256	44,09
Tetovo	692.487.508	443.830.481	603.763.801	87,19
Karposh	577.728.628	304.841.121	305.038.038	52,80
Kumanovo	144.236.792	70.921.755	24.444	0,02
Vrapchishte	131.876.565	N/A	N/A	N/A
Pehchevo	58.665.432	30.188.901	33.123.016	56,46
Ilinden	19.811.431	1.741.579	15.964.712	80,58
Veles	75.165.523	30.106.690	38.864.831	51,71

On table 1 and 2 the current unpaid liabilities can be seen for the eight selected municipalities in the last 3 years. In the last column, it can be noticed how is the situation with the current liabilities in comparison to 2018.

Table IV: Non-current liabilities of eight selected municipalities

	2018	2019	2020	2020/2018
Ohrid	31.729.244	25.130.516	0	N/A
Tetovo	0	0	0	N/A
Karposh	57.122.815	82.622.595	75.158.200	131,57
Kumanovo	46.293.088	53.875.139	8.965.447	19,37
Vrapchishte	11.000.000	0	0	N/A
Pehchevo	8.644.369	2.475.385	3.161.885	36,58
Ilinden	63.947.976	50.405.272	45.314.929	70,86
Veles	23.329.776	27.376.993	21.187.281	90,82

The key questions here to examine is if municipal debt levels can be explained by municipal's debt-service capacities, or are rather driven by moral hazard as municipalities accumulate overly large debt levels in expectation of being bailed out by the central government of North Macedonia. Municipal debt can create various externalities across levels of government (see e.g. Blöchliger, 2011, for a more detailed discussion). Given the current debt level of NM, a modest increase in debt by a large number of municipalities and government entities may significantly

[18] Schoop.mk

impact general government debt, thereby affecting budget balances and potentially interest rates on public debt. Second, financial problems of some, even small municipalities can have large repercussions on the functioning of markets for municipal borrowing leading to a rise in risk premia. Third, municipalities often own public enterprises whose debt is not accounted for in the national accounts but represents contingent liabilities and thus exacerbating risks. Also, in most small EU countries the central governments are held politically responsible for municipal debt, often taking on the form of bailout guarantees.

Box 8 The overall risks of subnational debts mainly arise from:

- There are **no regular statistics** and released detailed subnational debt data.
- There **are no well-defined governmental standards/indicators for the confirmation and measurement of subnational debts.**
- **The debt risk management system of the MoF is incomplete**. Fragmented financial management data including debt management data.
- **Lack of effective monitoring and early warning system** and response tools for the management of debt serving risks at local governments.
- **Limited administrative and institutional capacity of LG department in Ministry of Finance**.
- There is **no real punishment for local government that fails to report** to the MoF information re: outstanding debt, debt costs, due payments, etc.
- **Weak balanced budget and budget priority setting**.
- **Distorted budgeting process based – the significant gap between planned and realised budget revenue/expenditure items.**
- **Inadequate expenditure and cash forecasting**, and persistent operating cash shortfalls in some municipalities.
- **Municipalities highly dependent on central government transfers - with limited capacity to collect their revenues.**
- **There is no system for sanctioning/managing municipalities that, despite being once bail-out by the central government, again generate debts/liabilities.**
- **Weak public accountability and transparency regarding debt structure** – lack of sanctions and punishment.
- **Limited verification and monitoring of inaccurate reporting in municipal debt** and obligations. Still not monitored and sanctioned debt increase from inaccurate reporting.
- **Gaps in the current legislation and regulations including reporting and disclosure of information**.
- **Lack of political will (central/local level) for consistent implementation of current legislation - especially in the area of financial instability**.
- **Limited capacity of state audit and internal audit in municipalities.**

- **Weak debt management at a local level** – cost of borrowing, the purpose of borrowing, repayment plans and debt limitations, etc.
- **Weak coordination of central and local government in the field of fiscal decentralization** and fiscal sustainability of municipalities.

3.3 Proposed/Possible Solutions

The approach: The solutions are addressed with the use of a blend of two approaches including 1) clustering/grouping of municipalities based on a number of indicators (refer to the table below) and 2) solutions based on the urgency. Clustering of the municipalities is strongly recommended having in mind the differences in fiscal and human capacities of LGs. The objective of the first approach is to help MoF examine the level of LGs debt strength, and test whether smaller municipalities are more indebted and have higher current expenditure in comparison with larger municipalities concerning the level of the budget realized. Also helps us to determine whether the debt of municipalities is affected by their revenues, especially those revenues that are at least partially managed by municipalities.

The second approach outlines the possible recommendations in terms of timeframes: immediate and midterm time horizon.

3.3.1 Clustering and or grouping approach of municipalities in North Macedonia

The following approach can be suggested: **separate the entire sample of municipalities in North Macedonia, based on the effectiveness of financial management and financial health into three clusters/categories.** This approach provides in-depth observation of the current situation of the financial management capabilities of municipalities, and additionally it is crucial to extract the differences in specific characteristics between financially healthy and efficient and „unhealthy" or inefficient municipalities. For the separation of the sample into groups, cluster analysis was preferred.

This approach will help you to identify municipalities that are in permanent financial difficulty and require a differentiated approach by the central government.

Table V: A set of indicators that can be used

Variables/indicators	2017	2018	2019	2020
Compound annual growth rate (CAGR) of recurrent revenue				
CAGR of recurrent expenditures				
CAGR of own-source revenue				
CAGR of property tax				
Recurring Operating surplus				
Operating ratio				
Share of property tax in own source revenues				
Share of own-source of revenue in recurrent revenue				

Another set of indicators could be: 1) the own revenue-generating capacity of the municipality; 2) an operating budget surplus generating capacity of the municipality, 3) the flexibility in making expenditures (non-investment costs), and 4) capacity/ flexibility in investment spending.

Box 9 Clustering analysis - K-Means partitioning statistical method[19]

- This method predetermines the number of clusters into which the sample is divided. In this research, the number of clusters was set at three because (a) theoretically, dividing municipalities into unhealthy and inefficient, semi-healthy and healthy and efficient, and (b) this number is considered to be appropriate when the variables used for division are more than two. Cluster analysis is used to separate the sample in groups and this statistical tool is a widely used method in various scientific fields (Kinnear & Taylor, 1996). The aim is to explore the possibility of dividing the sample into clusters based on one or more characteristics (variables) (Kinnear & Taylor, 1996)
- As a measurement tool, the MoF could prepare a survey tool- a structured questionnaire to collect data. During the preparation of the questionnaire, a logical flow of questions can be used. The questions have to be designed in a way that gets the interest of the respondent, easy to understand and avoid confusion. You can carry on a pretesting period with a sample of 10 municipalities and then following the evaluation of observations made by participants in the pilot study, certain questions may be removed, recomposed, or added by the experts that initially prepared and tested the questionnaire. In the end, the questionnaire is used to collect data. In the questionnaire, there might be questions to examine issues like financial management and or budgeting, reporting tools that are currently used or can be used by municipalities.

The table below outlines suggested Groups of LGs in North Macedonia and respective Debt Management Solutions the MoF can adapt to each group. The objective here is to tailor its strategy/solutions in line with the characteristics and needs of each group.

Table VI: Caption

	Financially Weak Municipalities	Intermediate Financial Conditions	Relatively Strong Municipalities
LGs [total number or provide their names]			
Strategy/Solutions to be applied	• Restructuring plans* 20for the existing long-term debt and accrued liabilities or	• Interest-free government loans to support any current budget deficit due to COVID-19 crisis /to be paid back within the term of the MC/	• Interest free government loans to support any current budget deficit due to COVID-19 crisis /to

[19] K-Means partitioning statistical method – this method intends to classify and identify the data in the pool that have certain characteristics in common. Example: The Optimized K-Means Clustering Algorithms To Analyzed the Budget Revenue Expenditure in Padang;

[20] Note: *A option could be to consider restructuring the terms of existing debt payments, by extending the maturity to mitigate as long as 4 years and limiting debt service to no more than 15 per cent of real net revenue. If debt service obligations exceed the 15 per cent limit, the central government may consider providing interest-free loans to cover the excess, and the municipality would pay back the loan in 4 years. What needs to be achieved is the financial sustainability of those municipalities in the short term horizon to preserve economic stability. They also need to improve financial control and monitoring of the municipal debt to control financial risks.

	Financially Weak Municipalities	Intermediate Financial Conditions	Relatively Strong Municipalities
	• In case of „naturaly“ weak LGs- full government bailout support if restructuring is not feasible • Improved monitoring and reporting discipline at LGs level • Ask for and approve a multiyear financial recovery plan for each municipality • Enhance fiscal rules on municipal debt and municipal debt service • Introduce sanctions /penalties	• Assessment of municipal borrowing capacity for long term project-based borrowing • Matching government grants plus own financing or borrowing • Fiscal rules on municipal debt and municipal debt service • Improved monitoring and reporting discipline at LGs level • Sanctions/penalties	be paid back within the term of the MC/ • Introduce fiscal rules on municipal debt and municipal debt service • Commercial credit for investment projects • Issuance of municipal bonds for investment project

Note that there might be some movement among these 3 categories. **The MoF long term policy should aim at "graduating" as many local authorities as possible over time to stronger financial capacity and improved municipal creditworthiness where they can make greater use of market financing for capital investment.**

The assumptions are that municipalities that fall under Group **I** are in a situation where the dependence on central transfers is high, expenditure responsibilities are not allocated, and here borrowing restrictions can not easily have a corrective impact since these municipalities have limited access to the private credit market due to their week financial health and already large outstanding debt. These municipalities are unable to contribute their funds toward debt repayment and debt service and also towards the issuance of long-term debt for capital expenditures. In these localities, the government policy priority is first to establish a solid equalization scheme/grant that will enable a more sustainable fiscal position to these municipalities and to design financial recovery schemes that, once put in place, the local government can afford to maintain and operate in good standing and serve their obligations. It is recognized that this group of municipal capital expenditures, even for affordable infrastructure, will have to be financed largely through central government grants.

In Group 2 some municipalities will need some substantial subsidies from the government to make their projects financially feasible. The Government of North Macedonia discussed the possibility of introducing a formal matching-grant capital program similar to that found in some other countries. This strategy would lower the total cost of capital projects for municipalities while exposing them at the margin to the full market cost of capital and the private market's expectations about financial discipline in project design.

The LGs that fall in this cluster should be pushed to raise their revenues (better collection, revisit their revenue sources, etc.) and seek expenditure e

fficiency gains and also to take some measures in cutting some expenditures (the fiscal reform in Bulgaria could be an example). In Estonia- some municipalities freezed operating costs for a while allowing investment expenditure to grow. Italy, the central government sought efficiency gains by encouraging municipal cooperation: it proposed a financial reward conditional on the setting-up of a "regional unit for purchasing" responsible for tender procedures for the provision of goods and services.

Group 3 covers several local governments in significantly stronger financial condition, most of them belonging to the larger urban areas. They can generate an operating budget surplus and can afford to pay for most of their debt from their resources. Their local revenue streams can be leveraged with long term debt / via the credit market/ for individual projects or a broader local capital investment plan. Although the number of municipalities currently able to obtain and repay purely private-sector credit is small, they include some of the largest jurisdictions. A large proportion of the urban population also lives in these areas.

The exact nature of the MoF intervention is yet uncertain, but efforts need to be made to help those local governments that are naturally financial week and have inherited a large size of the debt. The value of central government intervention in the case of local authority financial emergencies has yet to be tested.

3.3.2 The second approach regarding solutions provides recommendations in terms of urgency (immediate and mid-term framework) as follows:

To consider nine urgent recommendations on LGs debt regulatory policy framework and management. The proposed below solutions are based on the above analysis, identified gaps in the current framework, key findings, and also lessons from the international experience.

1. The MoF of North Macedonia could set as a priority to put in place a formal ***Agenda*** for dealing with currently escalating municipal debt to eliminate any threats on North Macedonia economic development and social stability. The agenda could be a binding document approved by the parliament and developed based on *a multi-stakeholder participatory approach* from beginning to end. Adherence to a municipal debt agenda will signal that the central government is determined to maintain a sound financial position of LGs in North Macedonia.
2. A key element of the aforementioned agenda should be **to *revise or reform respective laws to introduce stricter debt controls regarding overall debt stock, debt service ratio, liquidity and to strengthen the transparency and accountability of the LGs***. Budgetary constraints for LGs' debt to a certain extent will motivate mayors to use their financial resources more efficiently. The reform should also put in place regulating mechanisms that will ensure the implementation of the subject legislation. Regulating mechanism for early warning system and Insolvency procedure. Another element is setting up appropriate sanctions, corrective measures to foster the enforcement of fiscal rules and other debt-related regulations (please refer to international experience of other countries).
3. Conduct external audit of all LGs with substantial payments in arrears as they represent untransparent and undesirable source of financing and as such the MoF should discourage LGs in North Macedonia to run up payment arrears and a case could be made for placing restrictions on the borrowing of local government via outstanding payment arrears, irrespective of the size of the debt. This would encourage local government to replace arrears with more transparent sources of funding and disincentivize the accumulation of new arrears by local government units with substantial capital investment programs that need to be funded by borrowing.
4. **Enhance monitoring and reporting system for budget performance and debt management.** Municipal debt monitoring needs in North Macedonia need to be addressed and improved in a way that municipal financial reports are generated and released on time. In the current environment, there is firstly a lack of clear information

on the real indebtedness of municipalities, the financial information provided by LGs is often incomplete. Unfortunately, most LGs may not have this reporting and monitoring mentality. Some of them may have been reluctant in the past to report in timely manner debt information to the MoF or their potential involvement in the municipal debt sector is modest enough that it does not justify, in their judgment, the creation of a specialized debt management capacity within their institution. The government can address this situation by implementing two solutions: a***) Require quarterly reporting and monitoring through an e-web-based electronic system,*** including data for liquidity *cash-flow information not normally reported by municipalities in the standard documents. All information obtained from individual local authorities should be analysed and published in a quarterly report/bulletin on the LGs performance according to the fiscal rule (this is the case in Bulgaria where MoF quarterly reports are uploaded on the website), and b) ***Create Public Debt Register*** - such a system will allow MoF to have an accurate, comprehensive and timely local government debt statistical system, internal reporting system and external disclosure system.

5. ***Resolve the structural deficit and vertical imbalances -*** a major effort to be made is to better define and delineate assignments of revenues and expenditure responsibilities between budgets. The reform shall also envisage greater use of general transfers.
6. ***Encourage municipalities to establish formal internal policies and procedures on the issuance of debt*** – LG debt management policy approved by the Municipal council.
7. ***Promote the need for active municipal creditworthiness analysis***. This will provide the debt market players and stakeholders with a better picture of LGs debt position; municipalities could consider conducting such analysis using a tool - Municipal Creditworthiness and Final Health Model (Bulgaria). As well as developing a Methodology for Munnicipal Financial Health (Bulgaria, Poland, Denmark).
8. ***Promote tools and procedures at LGs to assess long term and short-term property liabilities.***
9. ***Foster better horizontal coordination across institutions such as the MoF, Central Audits Office*** to eliminate barriers and develop adequate mechanisms for coordination, collaboration and resolving disputes across a level of governance (Danish example);

In the aspect of medium-term solutions (in the following two year):

1. *The MoF e-government debt management system/Register is established and functions* and jointly supervised by the central government, local authorities, and other institutional players.
2. *Expand municipal access to debt financing* – In the current situation, because of uncertainty about loan repayments and municipal creditworthiness, the domestic banking sector is not yet interested in lending to municipalities for investment projects. One reason could be that there is limited information flows and interest between municipalities and investors. The municipal credit market in North Macedonia is not yet established. Comparative international experience suggests that such a market is unlikely to start without some incentives or assistance from the Government.
3. *Build municipal capacity in capital investment planning and budgeting to produce marketable infrastructure finance packages*. Municipalities in North Macedonia have typically funded infrastructure investments in a "pay as you go" manner, accumulating sufficient revenues from asset sales or minimal transfers from the operating budget. This is hardly a sustainable strategy and it could never mobilize the volumes needed to fund the considerable infrastructure deficit. The established strategy in most developed and

transition countries has been to promote debt finance through access to the capital market or a specialized infrastructure finance institution. At present North Macedonia has little experience with capital market financing of municipal infrastructure and lacks a legal framework to regulate it.

4. *Deepen fiscal reform and revitalize the municipal financial funds.* The municipalities should make significant efforts to increase their tax coverage, including the introduction of a property database system to improve the efficiency of property tax collection. A methodology and a system for regular review of property valuation rates and taxes and/or fees will help them boost revenue generation and collection. *The technical assistance may include preparing a comprehensive financial management improvement plan that will contribute to the identification of revenue-improving actions and the establishment of the property identification and management system.*
5. *Establish a special purpose fund vehicle* for funding municipal investment projects.

3.4 Tools for Municipal Debt Management (Refer to Annex 3)

- **A set of Legislation for Municipal Debt adopted in Bulgaria.** The MoF of North Macedonia upon their discretion may decide to borrow some ideas from the enclosed acts. Bulgarian legislations in English including Municipal Debt Act and Public Finance Act.
- **An Excel-based multiyear model for assessing Municipal Creditworthiness and Debt Capacity including borrowing for investment projects.** The electronic model is an open based system, can be easily modified, and adjust to the needs of the municipalities). The model was developed and applied in more than 60 municipalities. The model also includes a function for multi-year capital investment planning and complete investment analysis. The author of the report participated in the development and application of the model. Similar models have been used in Poland, Moldova. For the benefit of the readers, screenshots of the key functionalities of the model are attached.
- **A MoF of Bulgaria methodology for financial recovery of local governments in Bulgaria.** This methodology is developed by the Bulgarian MoF in consultations with international experts and is a binding document in Bulgaria. A copy of the methodology is attached herein and a sample of very recent municipal financial recovery plans approved by the MoF in Bulgaria.
- **E-Public Debt Register including a section on Municipal Debt Register of the MoF in Bulgaria.** This register was developed under the recommendations from USAID and later on upgraded to the heigh EU standard on public debt reporting and monitoring.
- **Local Government creditworthiness indicators - Financial Risk Profile Analysis according to Standard and Poor's credit rating methodology (refer to Annex 3) .**

ANNEX 1: INITIAL ASSESSMENT OF LOCAL GOVERNMENTS

Methodological approach

For the needs of the assessment, an initial analysis of the relevant legal framework has been considered. As sources of the analysis, are used published researches on the subject, the publicly available secondary fiscal data about the municipalities and the data from the Ministry of Finance. With the aim of more detailed analysis of the bottlenecks, Possible Solutions and Tools for Improving Municipal Debt/Liability Management in North Macedonia, and a representative sample of 6 municipalities has been created (Ohrid, Tetovo, Karpos, Kumanovo, Vrapciste and Pehcevo) that in the past experienced problems with the debt and two municipalities that had successful and disciplined management with their debt and finances (Ilinden and Veles). During the selection of the municipalities, a specific methodology has been employed. Data analysis of the specifics and challenges of the individual municipality's financial management has been conducted, population characteristics, rural and urban areas, and their capacity for collecting their incomes and debt management, vs. their continuous challenges associated with generating debt/debt serving and repayment capacity. Like additional selection criteria for municipalities that have issues related to debt generation, the evaluation was used done by the Ministry of Finance (per capita) on the due unpaid liabilities of the municipalities (September 2018).

For the purpose of this study, 8 municipalities were being analyzed, which represents a mix of cities that have been experiencing debt problems in the past and currently, as well as two municipalities that have potential for borrowings for capital expenditures. The objective is to identify immediate problems associated with the LGs debt /obligations and their debt serving and repayment capacity based on past 3 years financial performance.

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Veles	518 km^2	Vardar	55.108	12.837	14.016

Municipal Financial Indicators

In order to get deep insight in financial structure and fiscal/financial performance of the selected 8 municipalities as representative sample of municipalities that experienced in the past liabilities/debt problems for each municipality detailed financial/fiscal indicators are calculated (see table below)[21]:

[21] The calculated indicators in tables for each municipality are very clear - so having in mind the limited space for detailed elaborations, only a shot discussion for each municipality is presented. If there is a need more detailed elaboration could be provided.

Municipal financial/fiscal indicators 2019[22]	Tetovo	Ohrid	Karpos	Kumanovo	Vrapciste	Pehcevo	Ilinden	Veles
OPERATING SURPLUS/DEFICIT	-6.667.773	-25.902.954	513.385	9.376.769	12.719.465	342.611	10.953.868	62.777.556
CURRENT SURPLUS/DEFICIT	232.086.802	110.700.457	273.283.486	190.918.282	63.402.199	23.738.029	149.467.780	138.109.319
CAPITAL SURPLUS/DEFICIT	-238.754.575	-136.603.411	-272.770.101	-181.541.513	-50.682.734	-23.395.418	-138.513.912	-75.331.763
BUDGET SURPLUS/DEFICIT	0	7.701.256	5.485.628	21.774.085	4.015.706	993.586	21.032.190	64.946.094
Current surplus as % of current revenues	13,0	7,8	26,7	11,7	20,3	22,4	48,7	18,5
Capital deficit as % of current revenues	-13,4	-9,7	-26,7	-11,1	-16,3	-22,1	-45,1	-10,1
Budget surplus as % of current revenues	0,0	0,5	0,5	1,3	1,3	0,9	6,8	8,7
% current revenues /total revenues	0,97	0,94	0,96	0,97	0,97	0,92	0,90	0,97
% own revenues /total revenues	14,82	27,06	34,76	26,74	8,99	10,60	46,41	18,78
% transfers /total revenues	83,36	68,25	63,27	71,59	88,37	86,71	43,87	79,34
% capital revenues/capital expenditures	12,23	25,07	3,71	13,33	14,41	11,76	2,72	16,14
% capital expenditures/own revenues	100,58	44,71	76,57	46,73	204,46	215,85	90,06	61,93

[22] The data for 2019 as more representative are presented due to CORONA-19 pandemic in 2020

Revenue and Expenditure Profiles of the Municipalities

This assessment will be based on past financial performance and is meant to provide a sense of which municipal governments from the pool are in a position to generate initial budget surplus before debt service and repayment. This assessment is not a reflection of the LGs creditworthiness, but merely measures debt serving capacity on a conservative basis.

Tetovo

Tetovo is one of the largest cities in North Macedonia by its size and population. The city is a home of two universities and a siginificant number of multinational companies. The municipality had an **operating surplus in 2018** of 7.698.573 denars, while in 2019 it had operating deficit of 6.667.773 denars and in 2020 it has an **operating deficit of 44.650.244.** Tetovo is also one of the municipalities with most liabilities in the country.

REVENUES	Actual 2018	Actual 2019	Actual 2020
Current revenues (1+2)	1.310.738.268	1.779.240.875	1.433.321.816
1. Own revenues (A+B)	295.998.282	270.447.518	203.604.564
A. Tax revenues	256.132.511	229.505.446	168.951.194
Personal income tax, profit tax and capital gains tax	10.940.416	12.453.315	14.864.562
Property taxes	126.477.331	108.452.754	80.396.767
Taxes on specific services	118.545.654	108.276.427	73.662.145
Tax for usage or licences for performing an activity	169.110	322.950	27.720
B. Non-tax revenues	39.865.771	40.942.072	34.653.370
Revenue from entrepreneurship and revenue from property	14.940	10.450	11.861
Fees and allowances	6.885.825	5.826.568	5.059.604
Administrative fees and allowances	26.602.696	28.535.469	22.936.959
Other Government services	1.490	7.980	1.316.698
Other non-tax revenues	6.360.820	6.561.605	5.328.248
C. Transfers and donations	1.021.970.381	1.521.230.458	1.245.249.341
2. Transfers from other Government levels	1.014.739.986	1.508.793.357	1.229.717.252
Donations	7.230.395	12.437.101	15.532.089
Donations from abroad	6.055.920	11.262.301	15.507.264
Current donations	1.174.475	1.174.800	24.825
3. Capital revenues	86.313.108	33.258.939	11.046.722
Selling land and investment in intangible assets	86.313.108	33.258.939	11.046.722
4. Financing - Loans	0		50.541.420
4.I. TOTAL REVENUES	1.404.281.771	1.824.936.915	1.510.442.047
EXPENDITURES	Actual 2018	Actual 2019	Actual 2020
5. Current expenditures (D+E+F)	1.183.778.760	1.547.154.073	1.392.281.098
D)Salaries, rents and allowances	867.333.058	917.417.844	1.042.644.002
Base salaries and allowances	627.028.353	660.069.777	746.358.283

Contribution for social insurance from employers	231.134.518	248.278.457	288.889.859
Compensations	9.170.187	9.069.610	7.395.860
E) Goods and services	296.036.811	592.391.315	251.132.859
Travel expenditures	3.839.898	5.919.355	4.283.377
Utilities, heating, communication and transport	102.855.263	203.581.003	55.544.712
Materials and tools	25.056.517	33.531.054	25.326.692
Repair and current maintenance	18.351.414	34.679.934	32.572.595
Contractual services	138.426.168	294.893.740	130.179.452
Other current expenditures	7.507.551	19.786.229	3.226.031
F. Subsidies and transfers	20.408.891	37.344.914	98.504.237
Transfers to Non-governmental organizations	2.955.000	3.415.100	175.000
Miscellaneous transfers	17.353.891	33.929.814	98.264.237
Payment by executive documents	100.000		65.000
6) Interest and reserves	4.385.000	5.769.328	4.526.060
Current reserves (various expenditure)	4.385.000	5.769.328	4.526.060
7) Capital expenditures	205.574.043	272.013.514	96.737.684
Capital expenditures reserves	4.368.901	588.640	
Other construction objects	174.838.409	266.074.988	89.273.644
Purchase of furniture, equipment, vehicles and machinery	4.887.445		35.000
Other nonfinancial assets	21.139.988	5.349.886	7.429.040
Financial assets	339.300		
II. TOTAL EXPENDITURES	1.393.737.803	1.824.936.915	1.493.544.842
8). Repayment of capital	0	0	0
TOTAL SPENDING (Total expenditures +9)	1.393.737.803	1.824.936.915	1.493.544.842
OPERATING SURPLUS/DEFICIT (1+2+3-5-7)	7.698.573	-6.667.773	-44.650.244
CURRENT SURPLUS/DEFICIT (1+2- 5)	126.959.508	232.086.802	41.040.718
CAPITAL SURPLUS/DEFICIT (3-7)	-119.260.935	-238.754.575	-85.690.962
BUDGET SURPLUS/DEFICIT (I - II)	10.543.968	0	16.897.205
Current surplus as % of current revenues	9,7	13,0	2,9
Capital deficit as % of current revenues	-9,1	-13,4	-6,0
Budget surplus as % od current revenues	0,8	0,0	1,2
% current revenues /total revenues	0,93	0,97	0,95
% own revenues /total revenues	21,08	14,82	13,48
% transfers /total revenues	72,78	83,36	82,44
% capital revenues/capital expenditures	41,99	12,23	11,42
% capital expenditures/own revenues	69,45	100,58	47,51

Ohrid

Ohrid is the eighth-largest city in the country and it’s the most popular touristic destination in North Macedonia. Ohrid and Lake Ohrid, are on the UNESCO list, protected as a rare cultural and natural heritage. Ohrid had an **operating surplus** of 22.732.305 denars in 2018, **operating deficit** of 25.902.954 in 2019 and operating surplus again in 2020 of 23.717.344 denars.

REVENUES	Actual 2018	Actual 2019	Actual 2020
Current revenues (1+2)	899.011.929	1.414.576.779	941.617.882
1. Own revenues (A+B)	446.022.505	407.741.654	395.451.137
A. Tax revenues	410.257.697	372.263.857	375.199.224
Personal income tax, profit tax and capital gains tax	11.172.967	12.206.357	15.383.909
Property taxes	182.757.110	181.805.541	179.181.588
Taxes on specific services	215.736.916	177.776.844	180.403.659
Tax for usage or licences for performing an activity	590.704	475.115	230.068
B. Non-tax revenues	35.764.808	35.477.797	20.251.913
Revenue from entrepreneurship and revenue from property	12.238	8.544	1.000
Fees and allowances	4.008.757	3.058.207	2.258.673
Administrative fees and allowances	27.178.583	25.948.023	12.968.739
Other Government services	55.315	30.000	2.980
Other non-tax revenues	4.509.915	6.433.023	5.020.521
C. Transfers and donations	480.269.942	1.028.503.385	556.282.267
2. Transfers from other Government levels	452.989.424	1.006.835.125	546.166.745
Donations	27.280.518	21.668.260	10.115.522
Donations from abroad	27.280.518	21.668.260	10.115.522
3. Capital revenues	54.082.867	45.714.441	33.039.265
Selling land and investment in intangible assets	54.082.867	45.714.441	33.039.265
4. Financing - Loans	2.777.729	24.999.562	0
4.I. TOTAL REVENUES	983.153.043	1.506.959.042	984.772.669
EXPENDITURES	Actual 2018	Actual 2019	Actual 2020
5. Current expenditures (D+E+F)	740.578.246	1.303.876.322	795.024.080
D)Salaries, rents and allowances	440.050.269	463.398.856	519.242.575
Base salaries and allowances	315.174.110	329.881.936	370.231.797
Contribution for social insurance from employers	116.696.773	125.111.772	144.129.176
Compensations	8.179.386	8.405.148	4.881.602
E) Goods and services	221.562.929	262.423.032	195.732.103
Travel expenditures	2.672.077	2.418.410	642.964
Utilities, heating, communication and transport	95.717.792	121.068.147	93.701.448
Materials and tools	10.798.890	13.792.546	8.429.202
Repair and current maintenance	32.253.857	33.382.606	33.870.704
Contractual services	58.903.142	63.556.301	34.462.708
Other current expenditures	13.743.310	13.940.817	13.552.155
Temporary employments	7.473.861	14.264.205	11.072.922

F. Subsidies and transfers	78.965.048	578.054.434	80.049.402
Subsidies to public companies	2.807.379	1.300.000	4.754.053
Transfers to Non-governmental organizations	12.949.680	16.490.450	16.633.000
Miscellaneous transfers	62.932.794	559.971.484	58.333.920
Social assistance benefits	275.195	292.500	328.429
6) Interest and reserves	575.046	358.240	260.477
Interest payments to domestic creditors	182.736	247.895	109.199
Current reserves (various expenditure)	392.310	110.345	151.278
7) Capital expenditures	189.784.245	182.317.852	155.915.723
Capital expenditures reserves	5.435.198	10.419.438	3.357.517
Construction objects	768.319	3.429.735	234.258
Other construction objects	171.265.284	126.777.892	139.962.360
Purchase of furniture, equipment, vehicles and machinery	410.243	849.375	28.000
Other nonfinancial assets	9.027.472		9.528.121
Financial assets	2.877.729	8.682.082	2.805.467
Capital subsidies for the companies and NGOs		32.159.330	
II. TOTAL EXPENDITURES	930.937.537	1.486.552.414	951.200.280
8). Repayment of capital	12.705.372	12.705.372	12.705.372
Repayment of capital to other Government levels	12.705.372	12.705.372	12.705.372
TOTAL SPENDING (Total expenditures +9)	943.642.909	1.499.257.786	963.905.652
OPERATING SURPLUS/DEFICIT (1+2+3-5-7)	22.732.305	-25.902.954	23.717.344
CURRENT SURPLUS/DEFICIT (1+2- 5)	158.433.683	110.700.457	146.593.802
CAPITAL SURPLUS/DEFICIT (3-7)	-135.701.378	-136.603.411	-122.876.458
BUDGET SURPLUS/DEFICIT (I - II)	39.510.134	7.701.256	20.867.017
Current surplus as % of current revenues	17,6	7,8	15,6
Capital deficit as % of current revenues	-15,1	-9,7	-13,0
Budget surplus as % of current revenues	4,4	0,5	2,2
% current revenues /total revenues	0,91	0,94	0,96
% own revenues /total revenues	45,37	27,06	40,16
% transfers /total revenues	48,85	68,25	56,49
% capital revenues/capital expenditures	28,50	25,07	21,19
% capital expenditures/own reveneues	42,55	44,71	39,43

Karposh

Karposh is a municipality in the City of Skopje which covers 12 urban areas and 2 villages. It is known as one of the most transparent municipalities in the country concerning accessibility to public documents, including the liabilities of the municipalities. In 2020 Karposh is also on the list, together with Ohrid and Tetovo of municipalites with highest amount of current unpaid liabilities. Karposh has **operating surplus for all three years (2018, 2019, 2020).**

REVENUES	Actual 2018	Actual 2019	Actual 2020
Current revenues (1+2)	879.100.623	1.022.949.671	793.680.219
1. Own revenues (A+B)	412.280.217	369.952.800	343.686.206
A. Tax revenues	358.642.882	321.226.791	316.651.296
Personal income tax, profit tax and capital gains tax	13.738.906	15.406.954	19.848.343
Property taxes	155.240.570	171.277.304	178.211.244
Taxes on specific services	189.419.197	134.398.100	118.514.635
Tax for usage or licences for performing an activity	244.209	144.433	77.074
B. Non-tax revenues	53.637.335	48.726.009	27.034.910
Revenue from entrepreneurship and revenue from property	4.470	12.144	1.490
Fees and allowances	2.198.327	1.867.489	1.440.929
Administrative fees and allowances	42.551.091	44.461.385	23.534.435
Other Government services	13.322	18.756	11.044
Other non-tax revenues	8.870.125	2.366.235	2.047.012
C. Transfers and donations	483.447.786	673.425.235	466.973.243
2. Transfers from other Government levels	466.820.406	652.996.871	449.994.013
Donations	16.627.380	20.428.364	16.979.230
Donations from abroad	16.082.436	20.175.196	16.869.760
Current donations	544.944	253.168	109.470
3. Capital revenues	13.450.863	10.499.506	9.916.998
Selling land and investment in intangible assets	13.450.863	10.499.506	9.916.998
4. Financing - Loans (foreign)	0	10.527.509	40.055
4.I. TOTAL REVENUES	909.178.866	1.064.405.050	820.616.502
EXPENDITURES	Actual 2018	Actual 2019	Actual 2020
5. Current expenditures (D+E+F)	635.324.671	749.666.185	720.383.905
D)Salaries, rents and allowances	366.640.277	395.232.476	453.174.752
Base salaries and allowances	261.031.301	281.776.189	320.901.716
Contribution for social insurance from employers	96.233.056	106.437.043	124.349.725
Compensations	9.375.920	7.019.244	7.923.311
E) Goods and services	236.313.586	311.159.514	228.245.226
Travel expenditures	2.082.138	4.350.374	3.445.360
Utilities, heating, communication and transport	70.791.355	73.487.348	60.121.490
Materials and tools	35.177.808	44.771.439	28.033.610
Repair and current maintenance	46.002.675	91.878.444	38.755.952
Contractual services	18.228.582	17.726.651	18.291.039
Other current expenditures	9.765.046	13.109.918	6.575.130
Temporary employments	54.265.982	65.835.340	73.022.645
F. Subsidies and transfers	32.370.808	43.274.195	38.963.927
Subsidies to public companies			
Transfers to Non-governmental organizations	3.952.113	4.646.000	2.040.000

Miscellaneous transfers	24.607.959	34.361.110	31.485.323
Social assistance benefits	3.810.736	4267085	5.438.604
6) Interest and reserves	8.110.538	7.240.555	3.277.474
Interest payments to domestic creditors	8.110.538	7.240.555	3.277.474
7) Capital expenditures	136.847.797	283.269.607	78.562.714
Capital expenditures reserves	3.718.433	2.797.390	4.104.042
Construction objects	38.731.668	71.979.994	17.620.451
Other construction objects	89.807.931	199.918.927	49.212.255
Purchase of furniture, equipment, vehicles and machinery	2.072.798	3.707.415	857.520
Other nonfinancial assets	1.916.967		1.512.295
Financial assets	600.000	3.948.165	5.256.151
Capital subsidies for the companies and NGOs		917.716	
II. TOTAL EXPENDITURES	780.283.006	1.040.176.347	802.224.093
8). Repayment of capital	17.693.215	18.743.075	6.631.407
Repayment of capital to undomestic creditors		18.743.075	2.421.247
Repayment of capital to domestic institutions	17.693.215		4.210.160
TOTAL SPENDING (Total expenditures +9)	797.976.221	1.058.919.422	808.855.500
OPERATING SURPLUS/DEFICIT (1+2+3-5-7)	120.379.018	513.385	4.650.598
CURRENT SURPLUS/DEFICIT (1+2- 5)	243.775.952	273.283.486	73.296.314
CAPITAL SURPLUS/DEFICIT (3-7)	-123.396.934	-272.770.101	-68.645.716
BUDGET SURPLUS/DEFICIT (I - II)	111.202.645	5.485.628	11.761.002
Current surplus as % of current revenues	27,7	26,7	9,2
Capital deficit as % od current revenues	-14,0	-26,7	-8,6
Budget surplus as % od current revenues	12,6	0,5	1,5
% current revenues /total revenues	0,97	0,96	0,97
% own revenues /total revenues	45,35	34,76	41,88
% transfers /total revenues	53,17	63,27	56,91
% capital revenues/capital expenditures	9,83	3,71	12,62
% capital expenditures/own reveneues	33,19	76,57	22,86

Kumanovo

Kumanovo is one of the 10 largest municipalities by its area and according to the number of inhabitants 105,484 thousand is the largest municipality, after the city of Skopje. Kumanovo has a large agricultural area and it has significant industrial facilities. **The total revenues of the municipality in 2020 are 1.756.366.278, while the total expenditures are 1.627.027.438.** There was an operating deficit in 2018 with 17.550.636 denars, in 2019 operating surplus with 9.376.769 denars and in 2020 the surplus amounted to 97.754.126 denars.

REVENUES	Actual 2018	Actual 2019	Actual 2020
Current revenues (1+2)	1.452.626.922	1.633.419.125	1.697.652.758
1. Own revenues (A+B)	418.135.509	448.194.900	494.708.867

A. Tax revenues	351.197.359	369.535.283	444.738.336
Personal income tax, profit tax and capital gains tax	13.084.447	14.614.675	19.404.829
Property taxes	191.650.712	177.059.053	178.817.337
Taxes on specific services	133.520.195	150.099.595	243.761.841
Tax for usage or licences for performing an activity	12.942.005	27.761.960	2.754.329
B. Non-tax revenues	66.938.150	78.659.617	49.970.531
Revenue from entrepreneurship and revenue from property	2.682	2.682	3.417
Fees and allowances	4.987.267	4.135.655	3.124.581
Administrative fees and allowances	56.650.137	59.288.169	37.331.379
Other Government services	408.154	216.728	29.762
Other non-tax revenues	4.889.910	15.016.383	9.481.392
C. Transfers and donations	1.065.420.867	1.199.871.202	1.242.150.018
2. Transfers from other Government levels	1.034.491.413	1.185.224.225	1.202.943.891
Donations	30.929.454	14.646.977	39.206.127
Donations from abroad	30.840.664	14.451.987	38.881.787
Current donations	88.790	194.990	324.340
3. Capital revenues	28.057.008	27.912.145	19.507.393
Sale of capital means	969.686	0	
Selling land and investment in intangible assets	27.087.322	27.912.145	19.507.393
4. Financing - Loans	0	0	0
4.I. TOTAL REVENUES	1.511.613.384	1.675.978.247	1.756.366.278
EXPENDITURES	Actual 2018	Actual 2019	Actual 2020
5. Current expenditures (D+E+F)	1.353.874.584	1.442.500.843	1.417.648.731
D)Salaries, rents and allowances	832.033.443	889.921.165	1.002.244.415
Base salaries and allowances	599.275.247	633.714.007	712.427.786
Contribution for social insurance from employers	221.988.868	240.026.503	276.823.786
Compensations	10.769.328	16.180.655	12.992.843
E) Goods and services	450.456.603	454.568.452	288.383.089
Travel expenditures	7.285.635	12.734.525	5.429.176
Utilities, heating, communication and transport	116.171.281	116.119.959	68.491.696
Materials and tools	28.462.168	27.627.748	26.360.657
Repair and current maintenance	140.769.855	128.045.425	95.469.670
Contractual services	134.978.631	147.019.893	62.252.336
Other current expenditures	13.164.719	13.389.043	16.048.986
Temporary employments	9.624.314	9.631.859	14.330.568
F) Subsidies and transfers	71.384.538	98.011.226	127.021.227
Transfers to Non-governmental organizations	18.909.415	14.000.000	12.500.000
Miscellaneous transfers	51.675.132	83.739.460	114.023.461
Social assistance benefits	799.991	271.766	497.766
6) Interest and reserves	1.232.186	2.249.661	7.621.413
Current reserves (various expenditure)	1.232.186	2.249.661	7.621.413

7) Capital expenditures	144.359.982	209.453.658	201.757.294
Capital expenditures reserves	14.221.613	5.807.342	17.805.823
Construction objects	6.263.502	4.049.096	2.176.302
Other construction objects	105.115.898	186.250.537	165.481.860
Purchase of furniture, equipment, vehicles and machinery	78.723	329.752	1.025.555
Other nonfinancial assets	18.680.246	12.077.181	12.798.875
Financial assets	0	939.750	2.468.879
II. TOTAL EXPENDITURES	1.499.466.752	1.654.204.162	1.627.027.438
8). Repayment of capital	0	0	0
TOTAL SPENDING (Total expenditures +9)	1.499.466.752	1.654.204.162	1.627.027.438
OPERATING SURPLUS/DEFICIT (1+2+3-5-7)	-17.550.636	9.376.769	97.754.126
CURRENT SURPLUS/DEFICIT (1+2- 5)	98.752.338	190.918.282	280.004.027
CAPITAL SURPLUS/DEFICIT (3-7)	-116.302.974	-181.541.513	-182.249.901
BUDGET SURPLUS/DEFICIT (I - II)	12.146.632	21.774.085	129.338.840
Current surplus as % of current revenues	6,8	11,7	16,5
Capital deficit as % of current revenues	-8,0	-11,1	-10,7
Budget surplus as % of current revenues	0,8	1,3	7,6
% current revenues /total revenues	0,96	0,97	0,97
% own revenues /total revenues	27,66	26,74	28,17
% transfers /total revenues	70,48	71,59	70,72
% capital revenues/capital expenditures	19,44	13,33	9,67
% capital expenditures/own reveneues	34,52	46,73	40,78

Vrapciste

The Municipality of Vrapcishte is a rural municipality, located between the city of Tetovo and Gostivar, in the valley of Shar Planina, in the northwestern part of the Republic of North Macedonia, which includes a large part of the Polog field. In 2018 and 2019 Vrapcishte has achieved operating surplus of 674.724 denars and 12.719.465 denars respectively. Howevver in 2020 the municipality had an operating deficit of 25.641.035 denars.

REVENUES	Actual 2018	Actual 2019	Actual 2020
Current revenues (1+2)	231.618.872	311.645.139	301.248.656
1. Own revenues (A+B)	35.690.129	28.960.994	39.334.139
A. Tax revenues	25.251.355	27.047.172	38.259.303
Personal income tax, profit tax and capital gains tax	1.049.037	1.096.858	1.025.484
Property taxes	9.922.549	11.243.915	9.660.310
Taxes on specific services	14.189.421	14.706.399	27.573.509
Tax for usage or licences for performing an activity	90.348		
B. Non-tax revenues	10.438.774	1.913.822	1.074.836
Fees and allowances	485.060	587.507	461.786

Administrative fees and allowances	332.635	572.532	511.241
Other Government services	9.358.400		36.150
Other non-tax revenues	262.679	753.783	65.659
C. Transfers and donations	197.881.049	284.827.906	266.759.130
2. Transfers from other Government levels	195.928.743	282.684.145	261.914.517
Donations	1.952.306	2.143.761	4.844.613
Donations from abroad	1.952.306	2.143.761	4.844.613
3. Capital revenues	4.833.631	8.530.246	5.512.035
Sale of capital means	400.000		
Selling land and investment in intangible assets	4.433.631	8.530.246	5.512.035
4. Financing - Loans	0		23.063.932
4.I. TOTAL REVENUES	238.404.809	322.319.146	334.669.236
EXPENDITURES	Actual 2018	Actual 2019	Actual 2020
5. Current expenditures (D+E+F)	214.831.718	248.242.940	239.273.747
D)Salaries, rents and allowances	159.369.941	172.057.294	197.357.589
Base salaries and allowances	114.626.325	121.695.488	139.677.162
Contribution for social insurance from employers	42.280.952	45.880.193	54.026.491
Compensations	2.462.664	4.481.613	3.653.936
E) Goods and services	50.279.448	73.486.049	40.359.659
Travel expenditures	102.489	242.564	207.944
Utilities, heating, communication and transport	15.877.928	43.769.528	16.524.242
Materials and tools	6.012.284	3.829.802	6.228.160
Repair and current maintenance	5.775.219	3.677.715	3.078.599
Contractual services	19.687.709	16.101.604	11.338.548
Other current expenditures	2.823.819	5.864.836	2.982.166
F. Subsidies and transfers	5.182.329	2.699.597	1.556.499
Block grants		30.000	
Transfers to Non-governmental organizations	231.000	76.000	18.450
Miscellaneous transfers	4.553.829	2.195.597	1.332.049
Social assistance benefits	397.500	398.000	206.000
6) Interest and reserves	103.333	847.520	864.790
Permanent reserve (unpredictable expenditures)		444.050	464.790
Current reserves (various expenditure)	103.333	403.470	400.000
7) Capital expenditures	20.946.061	59.212.980	93.127.979
Capital expenditures reserves	1.055.352	427.227	2.368.637
Construction objects	19.013.619		89.396.631
Other construction objects	650.702	57.605.548	714.078
Purchase of furniture, equipment, vehicles and machinery	166.488	1.076.605	82.065
Other nonfinancial assets	59.900	103.600	30.000
Financial assets			536.568
II. TOTAL EXPENDITURES	235.881.112	308.303.440	333.266.516

8). Repayment of capital	0	10.000.000	0
Repayment of capital to other Government levels		10.000.000	
TOTAL SPENDING (Total expenditures +9)	235.881.112	318.303.440	333.266.516
OPERATING SURPLUS/DEFICIT (1+2+3-5-7)	674.724	12.719.465	-25.641.035
CURRENT SURPLUS/DEFICIT (1+2- 5)	16.787.154	63.402.199	61.974.909
CAPITAL SURPLUS/DEFICIT (3-7)	-16.112.430	-50.682.734	-87.615.944
BUDGET SURPLUS/DEFICIT (I - II)	2.523.697	4.015.706	1.402.720
Current surplus as % of current revenues	7,2	20,3	20,6
Capital deficit as % of current revenues	-7,0	-16,3	-29,1
Budget surplus as % of current revenues	1,1	1,3	0,5
% current revenues /total revenues	0,97	0,97	0,90
% own revenues /total revenues	14,97	8,99	11,75
% transfers /total revenues	83,00	88,37	79,71
% capital revenues/capital expenditures	23,08	14,41	5,92
% capital expenditures/own reveneues	58,69	204,46	236,76

Pehcevo

Pehcevo is one of the smaller municipalities in North Macedonia with an area of only 208 km2 and about 3,200 inhabitants. It is located in the far eastern part of the country, along the border with Bulgaria[23]. Pehcevo had an operating deficit of 24.804.252 denars in 2018, then an operating surplus in 2019 of 342.611 denars and an operating deficit of 8.945.342 denars in 2020.

REVENUES	Actual 2018	Actual 2019	Actual 2020
Current revenues (1+2)	72.076.280	106.053.102	76.097.896
1. Own revenues (A+B)	11.804.876	12.283.285	11.781.840
A. Tax revenues	7.348.517	7.217.475	8.093.288
Personal income tax, profit tax and capital gains tax	648.594	714.010	742.863
Property taxes	1.389.625	1.642.976	1.279.646
Taxes on specific services	5.310.298	4.209.985	6.020.779
Tax for usage or licences for performing an activity		650.504	50.000
B. Non-tax revenues	4.456.359	5.065.810	3.688.552
Fees and allowances	110.200	131.760	91.080
Administrative fees and allowances	3.789.459	4.266.850	3.457.720
Other Government services	0	27.000	0
Other non-tax revenues	556.700	640.200	139.752
C. Transfers and donations	84.348.112	100.445.285	70.869.370
2. Transfers from other Government levels	60.271.404	93.769.817	64.316.056
Donations	24.076.708	6.675.468	6.553.314

[23] https://www.macedonia-timeless.com/eng/cities_and_regions/cities/pehcevo/

Donations from abroad	22.916.848	5.942.468	6.448.314
Current donations	1.159.860	733.000	105.000
3. Capital revenues	468.185	3.117.682	2.194.530
Selling land and investment in intangible assets	468.185	3.117.682	2.194.530
4. Financing - Loans	6.600.000	0	6.155.167
4.I. TOTAL REVENUES	103.221.173	115.846.252	91.000.907
EXPENDITURES	Actual 2018	Actual 2019	Actual 2020
5. Current expenditures (D+E+F)	69.841.142	82.315.073	70.584.529
D)Salaries, rents and allowances	38.715.685	44.735.057	45.757.327
Base salaries and allowances	28.107.986	30.262.657	32.221.426
Contribution for social insurance from employers	10.309.388	11.296.537	12.445.847
Compensations	298.311	3.175.863	1.090.054
E) Goods and services	22.027.526	32.743.057	16.917.587
Travel expenditures	373.235	228.964	88.601
Utilities, heating, communication and transport	5.665.056	9.294.496	4.466.695
Materials and tools	4.926.151	5.024.228	3.588.898
Repair and current maintenance	1.043.766	6.640.109	1.810.094
Contractual services	5.423.162	6.341.195	2.203.420
Other current expenditures	1.259.359	1.998.665	1.230.940
Temporary employments	3.336.797	3.215.400	3.528.939
F. Subsidies and transfers	9.097.931	4.836.959	7.909.615
Transfers to Non-governmental organizations	15.300		
Miscellaneous transfers	8.874.131	4.636.459	7.730.415
Social assistance benefits	208.500	200.500	179.200
6) Interest and reserves	228.573	503.350	179.823
Interest payments to domestic creditors	228.573	415.350	149.823
Permanent reserve (unpredictable expenditures)		10.000	
Current reserves (various expenditure)		78.000	30.000
7) Capital expenditures	27.507.575	26.513.100	16.653.239
Capital expenditures reserves	6.551.311	2.377.935	2.406.221
Construction objects	1.021.857	4.345.050	1.968.641
Other construction objects	19.789.140	18.568.906	12.063.481
Purchase of furniture, equipment, vehicles and machinery	35.100	176.287	166.600
Other nonfinancial assets	110.167		48.296
Financial assets		263.480	
Capital subsidies for the companies and NGOs		781.442	
II. TOTAL EXPENDITURES	97.577.290	109.331.523	87.417.591
8). Repayment of capital	2.636.143	5.521.143	2.890.381
Repayment of capital to domestic institutions		4.200.000	1.700.000
Repayment of capital to other Government levels	2.636.143	1.321.143	1.190.381
TOTAL SPENDING (Total expenditures +9)	100.213.433	114.852.666	90.307.972

OPERATING SURPLUS/DEFICIT (1+2+3-5-7)	-24.804.252	342.611	-8.945.342
CURRENT SURPLUS/DEFICIT (1+2- 5)	2.235.138	23.738.029	5.513.367
CAPITAL SURPLUS/DEFICIT (3-7)	-27.039.390	-23.395.418	-14.458.709
BUDGET SURPLUS/DEFICIT (I - II)	3.007.740	993.586	692.935
Current surplus as % of current revenues	3,1	22,4	7,2
Capital deficit as % of current revenues	-37,5	-22,1	-19,0
Budget surplus as % of current revenues	4,2	0,9	0,9
% current revenues /total revenues	0,70	0,92	0,84
% own revenues /total revenues	11,44	10,60	12,95
% transfers /total revenues	81,72	86,71	77,88
% capital revenues/capital expenditures	1,70	11,76	13,18
% capital expenditures/own reveneues	233,02	215,85	141,35

Ilinden

Ilinden is located in between three big cities in North Macedonia Skopje-Kumanovo-Veles. There are 9 local economic zones in the Municipality, as well as the Technological Development Industrial zone Skopje 1 and Skopje 2 in Bunardzik. All economic zones are connected to road, water and electrical infrastructure, and there is a possibility for connection to the primary gas pipeline infrastructure. All of these factors make Ilinden a popular area for big industrial companies. Ilinden has acheieved an **operating surplus** in the **previous three years**: 38.579.358 denars (2018), 10.953.868 denars (2019) and 44.736.248 denars (2020).

REVENUES	Actual 2018	Actual 2019	Actual 2020
Current revenues (1+2)	237.070.106	307.154.512	277.778.983
1. Own revenues (A+B)	105.603.923	158.093.232	103.844.679
A. Tax revenues	97.745.996	150.390.170	99.266.462
Personal income tax, profit tax and capital gains tax	2.923.650	3.167.354	3.815.242
Property taxes	56.778.569	92.571.621	54.617.260
Taxes on specific services	37.570.371	54.176.141	40.156.528
Tax for usage or licences for performing an activity	473.406	475.054	677.432
B. Non-tax revenues	7.857.927	7.703.062	4.578.217
Fees and allowances	860.605	783.865	857.960
Administrative fees and allowances	6.741.617	6.873.838	3.719.657
Other Government services	39.000	12.000	0
Other non-tax revenues	216.705	33.359	600
C. Transfers and donations	132.216.183	149.451.428	176.469.034
2. Transfers from other Government levels	131.466.183	149.061.280	173.934.304
Donations	750.000	390.148	2.534.730
Donations from abroad	0	390.148	2.534.730
Capital donations	750.000	0	0
3. Capital revenues	6.231.840	3.870.981	4.266.039

Sale of capital means	2.373.187		0
Selling land and investment in intangible assets	3.858.653	3.870.981	4.266.039
4. Financing - Loans	0	29.248.781	0
4.I. TOTAL REVENUES	244.051.946	340.664.422	284.579.752
EXPENDITURES	Actual 2018	Actual 2019	Actual 2020
5. Current expenditures (D+E+F)	146.907.528	157.686.732	146.299.238
D)Salaries, rents and allowances	87.387.089	92.693.395	103.893.831
Base salaries and allowances	61.993.581	65.415.770	73.318.789
Contribution for social insurance from employers	22.810.603	24.650.587	28.275.116
Compensations	2.582.905	2.627.038	2.299.926
E) Goods and services	57.578.639	64.120.008	42.088.557
Travel expenditures	51.556	166.474	1.600
Utilities, heating, communication and transport	16.213.950	18.763.126	12.088.128
Materials and tools	6.397.446	6.878.437	6.078.995
Repair and current maintenance	14.448.148	18.428.163	13.733.486
Contractual services	12.164.950	10.655.922	4.975.396
Other current expenditures	3.996.258	5.890.302	1.697.251
Temporary employments	4.306.331	3.337.584	3.513.701
F. Subsidies and transfers	1.941.800	873.329	316.850
Transfers to Non-governmental organizations	366.550	410.000	316.850
Miscellaneous transfers	1.575.250	463.329	
6) Interest and reserves	3.188.910	2.421.148	1.614.702
Interest payments to domestic creditors	3.188.910	2.421.148	1.614.702
7) Capital expenditures	57.815.060	142.384.893	91.009.536
Capital expenditures reserves	2.893.570	3.825.339	9.274.372
Construction objects	30.255	0	
Other construction objects	50.443.678	137.887.193	76.713.217
Purchase of furniture, equipment, vehicles and machinery	4.436.757	660.361	743.995
Other nonfinancial assets	10.800	12.000	3.097.952
Financial assets	0	0	1.180.000
II. TOTAL EXPENDITURES	207.911.498	302.492.773	238.923.476
8). Repayment of capital	16.344.100	17.139.459	18.002.447
Repayment of capital to domestic institutions	13.147.024	13.942.383	14.805.371
Repayment of capital to other Government levels	3.197.076	3.197.076	3.197.076
TOTAL SPENDING (Total expenditures +9)	224.255.598	319.632.232	256.925.923
OPERATING SURPLUS/DEFICIT (1+2+3-5-7)	38.579.358	10.953.868	44.736.248
CURRENT SURPLUS/DEFICIT (1+2- 5)	90.162.578	149.467.780	131.479.745
CAPITAL SURPLUS/DEFICIT (3-7)	-51.583.220	-138.513.912	-86.743.497

BUDGET SURPLUS/DEFICIT (I - II)	19.796.348	21.032.190	27.653.829
Current surplus as % of current revenues	38,0	48,7	47,3
Capital deficit as % of current revenues	-21,8	-45,1	-31,2
Budget surplus as % of current revenues	8,4	6,8	10,0
% current revenues /total revenues	0,97	0,90	0,98
% own revenues /total revenues	43,27	46,41	36,49
% transfers /total revenues	54,18	43,87	62,01
% capital revenues/capital expenditures	10,78	2,72	4,69
% capital expenditures/own reveneues	54,75	90,06	87,64

Veles

Veles is one of the largest munucupalites in North Macedonia with 28 populated locations, one town and 27 villages. It is a home of 5 industrial zones: Mamutcevo, Karaslari, Recani, Recani 2 and Uzus. Veles was named as one of the most transparent municipalities in the country. The municipality has achieved an operating surplus in all three previous years: 19.066.103 (2018), 26.507.261 (2019) and 62.777.556 (2020).

REVENUES	Actual 2018	Actual 2019	Actual 2020
Current revenues (1+2)	660.922.689	713.964.017	745.788.804
1. Own revenues (A+B)	175.936.536	168.438.877	145.043.764
A. Tax revenues	135.456.010	129.042.790	126.529.896
Personal income tax, profit tax and capital gains tax	9.305.142	9.711.976	12.995.464
Property taxes	40.388.517	46.109.468	30.066.639
Taxes on specific services	81.168.458	67.564.089	77.507.125
Tax for usage or licences for performing an activity	4.593.893	5.657.257	5.960.668
B. Non-tax revenues	40.480.526	39.396.087	18.513.868
Revenue from entrepreneurship and revenue from property		8.659	3.573
Fees and allowances	1.608.156	1.310.572	1.010.780
Administrative fees and allowances	32.197.725	31.945.081	14.434.247
Other Government services	4.470	924	4.624
Other non-tax revenues	6.670.175	6.130.851	3.060.644
C. Transfers and donations	504.478.956	563.549.585	612.858.932
2. Transfers from other Government levels	484.986.153	545.525.140	600.745.040
Donations	19.492.803	18.024.445	12.113.892
Donations from abroad	19.399.779	12.009.460	11.607.892
Current donations	93.024	6.014.985	506.000
3. Capital revenues	23.290.867	42.805.277	14.495.852
Selling land and investment in intangible assets	23.290.867	42.805.277	14.495.852
4. Financing - Loans	0		0
4.I. TOTAL REVENUES	703.706.359	774.793.739	772.398.548

EXPENDITURES	Actual 2018	Actual 2019	Actual 2020
5. Current expenditures (D+E+F)	600.131.599	659.430.646	607.679.485
D)Salaries, rents and allowances	359.454.207	381.958.468	428.710.960
Base salaries and allowances	258.443.326	272.801.903	304.925.364
Contribution for social insurance from employers	95.764.711	103.414.490	118.642.410
Compensations	5.246.170	5.742.075	5.143.186
E) Goods and services	213.275.737	184.568.945	124.845.788
Travel expenditures	2.619.645	5.026.180	2.892.267
Utilities, heating, communication and transport	52.375.810	51.746.541	46.931.325
Materials and tools	17.430.547	18.696.602	12.777.181
Repair and current maintenance	52.041.250	30.044.021	22.104.858
Contractual services	62.504.009	59.997.967	28.805.643
Other current expenditures	18.847.893	13.672.358	8.290.943
Temporary employments	7.456.583	5.385.276	3.043.571
F. Subsidies and transfers	27.401.655	92.903.233	54.122.737
Transfers to Non-governmental organizations	8.170.415	4.978.570	3.052.300
Miscellaneous transfers	18.875.240	87.429.663	50.557.437
Social assistance benefits	356.000	495.000	513.000
6) Interest and reserves	833.214	856.587	1.647.796
Interest payments to domestic creditors	4.014	3.758	3.730
Current reserves (various expenditure)	829.200	852.829	1.644.066
7) Capital expenditures	65.015.854	70.831.387	89.827.615
Capital expenditures reserves	3.756.579	8.147.586	12.540.212
Other construction objects	58.171.345	60.493.774	74.481.751
Purchase of furniture, equipment, vehicles and machinery	91.185	312.270	231.009
Other nonfinancial assets	2.996.745	1.877.757	2.574.643
II. TOTAL EXPENDITURES	665.980.667	731.118.620	699.154.896
8). Repayment of capital	8.297.558	8.297.558	8.297.558
Repayment of capital to undomestic creditors	8.297.558	8.297.558	8.297.558
TOTAL SPENDING (Total expenditures +9)	674.278.225	739.416.178	707.452.454
OPERATING SURPLUS/DEFICIT (1+2+3-5-7)	19.066.103	26.507.261	62.777.556
CURRENT SURPLUS/DEFICIT (1+2- 5)	60.791.090	54.533.371	138.109.319
CAPITAL SURPLUS/DEFICIT (3-7)	-41.724.987	-28.026.110	-75.331.763
BUDGET SURPLUS/DEFICIT (I - II)	29.428.134	35.377.561	64.946.094
Current surplus as % of current revenues	9,2	7,6	18,5
Capital deficit as % of current revenues	-6,3	-3,9	-10,1
Budget surplus as % of current revenues	4,5	5,0	8,7
% current revenues /total revenues	0,94	0,92	0,97
% own revenues /total revenues	25,00	21,74	18,78
% transfers /total revenues	71,69	72,74	79,34

% capital revenues/capital expenditures	35,82	60,43	16,14
% capital expenditures/own reveneues	36,95	42,05	61,93

Basic indicators for fiscal decentralization

In order to determine the general progress of the decentralization process, the importance of the local in relation to the national economy, as well as the shifts in the fiscal autonomy of the LSGU, it is of special importance to look at some basic indicators that will indicate the trends in these processes. In this context, the analysis of the local public revenues and expenditures in relation to GDP, in relation to total public revenues and expenditures at the national level, as well as the comparison with other variables is of particular importance. In order to determine the direction of movement of these processes, the indicators of interest are calculated for a period of 7 years.

Table 1: Indicators for fiscal decentralization in the period 2013-2019

Category	2013	2014	2015	2016	2017	2018	2019
Local revenues (million denars)	27.799	28.244	30.132	31.024	30.845	31.804	37.089
Local expenditures (million denars)	27.837	27.732	29.251	30.314	30.419	30.361	35.983
GDP (million denars)	501.891	527.631	558.954	598.881	616.600	660.308	689.425
Total revenues of central government budget and funds (million denars)	140.267	145.929	161.207	174.291	179.706	192.484	N/A
Total expenditures of central government budget and funds (million denars)	159.520	168.063	180.632	195.472	195.561	210.536	N/A
Local revenues as % GDP	5,54	5,35	5,39	5,18	5,00	4,82	5,40
Local expenditures as % GDP	5,55	5,26	5,23	5,06	4,93	4,60	5,22
Local revenues as % of the total revenues on central government budget and funds	16,54	16,22	15,75	17,80	17,16	16,52	N/A
Local expenditures as % of the total expenditures on central government budget and funds	14,86	14,16	13,94	15,51	15,55	14,42	N/A
Total revenues of the central budget and funds as % of GDP	27,95	27,66	28,84	29,10	29,14	29,15	N/A
Total expenditures of the central budget and funds as % of GDP	31,78	31,85	32,32	32,64	31,72	31,88	N/A

Source: Ministry of Finance of North Macedonia and author

Table 2: Municipal liabilities

Municipalities	Liabilities	Citizens	Liabilities per capita
Ohrid	971.132.394	55.749	17.420
Demir Kapija	55.640.024	4.545	12.242
Pehčevo	62.479.281	5.517	11.325
Tetovo	918.811.611	86.580	10.612
Staro Nagoričane	47.309.209	4.840	9.775

Municipalities	Liabilities	Citizens	Liabilities per capita
Karpoš	486.927.773	59.666	8.161
Sopište	45.097.712	5.656	7.973
Gradsko	26.724.666	3.760	7.108
Novaci	24.723.725	3.549	6.966
Resen	99.969.503	16.825	5.942
Plasnica	25.951.171	4.545	5.710
Debar	109.549.692	19.542	5.606
Gevgelija	118.876.728	22.988	5.171
Vrapčište	126.261.400	25.399	4.971
Vasilevo	59.256.990	12.122	4.888
Brvenica	76.059.367	15.855	4.797
Probištip	72.737.150	16.193	4.492
Karbinci	17.109.200	4.012	4.265
Studeničani	73.001.317	17.246	4.233
Struga	262.203.073	63.376	4.137
Bogdanci	32.832.127	8.707	3.771
Negotino	71.704.574	19.212	3.732
Krivogaštani	22.428.503	6.150	3.647
Želino	87.985.792	24.390	3.607
Berovo	47.822.235	13.941	3.430
Delčevo	57.375.797	17.505	3.278
Bitola	307.830.474	95.385	3.227
Makedonski Brod	21.994.258	7.141	3.080
Rankovce	12.217.421	4.144	2.948
Saraj	92.974.614	35.408	2.626
Kičevo	146.371.050	56.734	2.580
Aračinovo	29.807.192	11.597	2.570
Strumica	126.151.606	54.676	2.307
Zrnovci	7.518.009	3.264	2.303
Vevčani	5.496.210	2.433	2.259
Kisela Voda	127.027.735	57.236	2.219
Kumanovo	233.130.023	105.484	2.210
Češinovo i Obleševo	16.487.906	7.490	2.201
Čair	138.505.129	64.773	2.138
Mogila	13.417.166	6.710	2.000
Vinica	39.286.970	19.938	1.970
Gazi Baba	140.344.585	72.617	1.933
Veles	91.355.625	55.108	1.658
Sveti Nikole	30.522.839	18.497	1.650
Lozovo	3.660.021	2.858	1.281

Municipalities	Liabilities	Citizens	Liabilities per capita
Gostivar	100.616.249	81.042	1.242
Bosilovo	15.639.255	14.260	1.097
Kočani	40.595.622	38.092	1.066
Čaška	7.518.282	7.673	980
Petrovec	7.886.358	8.255	955
Ilinden	11.902.914	15.894	749
Čučer Sandevo	6.200.637	8.493	730
Kruševo	6.746.908	9.684	697
Bogovinje	19.293.072	28.997	665
Tearce	14.671.089	22.454	653
Lipkovo	14.519.307	27.058	537
Konče	1.884.516	3.536	533
Novo Selo	6.072.489	11.567	525
Makedonska Kamenica	3.991.861	8.110	492
Dolneni	6.647.225	13.568	490
Debrca	2.087.392	5.507	379
Kavadarci	13.627.777	38.741	352
Demir Hisar	3.175.567	9.497	334
Zelenikovo	1.016.339	4.077	249
Štip	8.390.513	47.796	176
Rosoman	715.844	4.141	173
Jegunovce	1.857.966	10.790	172
Radoviš	4.201.546	28.244	149
Prilep	9.991.469	76.768	130
Centar Župa	845.346	6.519	130
Kriva Palanka	2.551.477	20.820	123
Dojran	333.000	3.426	97
Aerodrom	6.280.387	72.009	87
Butel	3.111.099	36.154	86
Šuto Orizari	1.704.440	22.017	77
Centar	3.266.280	45.412	72
Ǵorče Petrov	2.979.417	41.634	72
Grad Skopje	30.387.447	506.926	60
Kratovo	561.027	10.441	54
Mavrovo i Rostuše	342.054	8.618	40
Valandovo	167.171	11.890	14

ANNEX 2: CASE STUDIES

LGs debt context in Slovenia

Source: IMF https://www.imf.org/en/Countries/POL

Level of government debt [historic data & *projections*]

The deficit of the general government sector in 2020 amounted to 8.4% of GDP, while gross debt amounted to EUR 37,429 million or 80.8% of GDP.

Imposed by central government restrictions and or limits on local governments' debt and borrowings

Slovenia has a single tier of local government consisting of 212 municipalities recognised as selfgoverning by the 1991 Constitution. In 2005 the government established a new criterion stipulating that municipalities must have a minimum of 5 000 inhabitants. Among the municipalities, 11 urban municipalities have a special status. There is also a structured sub-municipal level of 6 035 settlements (local communities and districts which are optional). Each municipality has a mayor and a municipal council, normally elected by proportional representation for a four-year mandate. Slovenia has been a member of the European Union since 2004. The Financing of Municipalities Act (2007), which was a substitute for the Act on Financing Municipalities (1998), sets the municipal financial framework. It introduced a general legal framework and a financial system in which financial resources of local authorities must be proportional to the "eligible expenditure" of a municipality. Costs that are taken into account when determining a municipality's eligible expenditure include spending that is directly related to carrying out the tasks that municipalities are required to perform according to the Constitution and relevant acts. Article 142 of the Slovenia Constitution states that municipalities must raise their own revenue, and the Act on Local Self Government stipulates that local matters of public interest are to be financed by the municipality's own resources, state budget and loans.

Since 2015 the municipalities are required to apply a balanced budget approach and the Fiscal Balance Act has introduced several measures to reduce the general governments' debt and deficit. In particular, limits were set in order to limit labour-related costs for public employees including at the local level.

Amendments introduced in 2008 strengthened existing restrictions on debt service and outstanding debt. LGs ***indebtedness leves may not exceed 8% of the revenue generated by the municipality in the year prior to the year of borrowing***. Municipalities incur debt mainly to finance schools and electricity-related projects. Until 2018, there were no special laws or guidance in the event of a municipality's insolvency. Municipal borrowing reached 3% of GDP.

The possibilities of borrowing for municipalities are limited by strict rules. **Municipalities are allowed to borrow domestically for liquidity purposes up to a ceiling of 5% of the budget of the previous year**. Borrowing for investment purposes is also subjected to quantitative limits and, for any medium to long-term investment, a specific authorisation by the Ministry of Finance is required. Municipalities are not allowed to issue bonds, but they can guarantee loans to certain public entities (legal entities that provide public services). **The total annual ceiling for the repayment of loans principals and interest, financial leasing, trade credits and contingent liabilities is set at 8% of the revenues of the previous year.**

Is there clear authorization in legislation to undertake debt-related transactions and to issue loan guarantees on behalf of the local governments?

Local government borrowing rights are regulated by the Public Finance Act (1999) and the Financing of Municipalities Act (2006). Municipalities have the right to borrow to finance certain types of investment projects ("Golden Rule"), such as housing, water networks, and sewerage. **However, they must obtain prior consent from the Ministry of Finance.**

Are there requirements for mandatory debt reporting to the local assembly or similar body covering debt management and, where applicable, issued loan guarantees?

Yes. Also the central government has national legislative powers in all areas. Moreover, state authorities supervise the legality of the work of local community authorities.

Has there been any instance in the past five years in which local governments were bailout or involved in any insolvency procedure?

Not available

LGs debt context in Bulgaria

Level of government debt [historic data & projections]

Bulgaria Government debt accounted for 25.3 % of the country's Nominal GDP in Sep 2020, compared with the ratio of 21.3 % in the previous quarter. The data reached an all-time high of 29.4 % in Mar 2016 and a record low of 12.7 % in Mar 2009.

Imposed by central government restrictions and or limits on local governments' debt and borrowings

Local finances are regulated by the Local Self-Government and Local Administration Act (LSGLAA), the Municipal Debt Act, and the Public Finance Act.

The Public Finance Act imposes a balanced budget rule on municipalities and is monitored by the Ministry of Finance in a medium-term perspective (EC 2017). An unbalanced budget three years in a row breaks the rule and counts as one of the six criteria which indicate fiscal difficulties. However, this does not result in any consequences as long as a municipality does not hit more than three criteria indicating fiscal problems. Municipalities must draft a budget forecast every year for the upcoming three years, have it approved by the local council and submit it to the Ministry of Finance. The municipal budget draft must be developed on the basis of this forecast and forwarded to the local council. If the municipality is in a recovery plan, the draft must also be sent to the Ministry of Finance. The Council of Ministers must approve key figures of the municipal budget, such as the maximum amount of new expenditure commitments, the municipal debt expected to be incurred, etc.

The Municipal Debt Act and Public Finance Act – key elements include:

- Municipal debt shall be incurred by a decision of the Municipal Council and shall be formed by: 1. the emissions of municipal securities; 2. the debt incurred by municipal loan agreements; 3. due municipal guaranties; 5. interest-free loans, including repayable funding under Art. 103, para 3 of the Act; 6. financial leasing, commercial loans and other forms of debt as per Council Regulation (EC) No. 479/2009 of 25 May 2009 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community (OG, L 145/1 of 10 June 2009).
- The annual amount of payments on the municipal debt for each municipality in each year shall not exceed 15% of the midterm amount of own revenues and the general even subsidy for the last 3 years, calculated on the basis of data of the annual reports on the municipality budget implementation. (2) The nominal of the issued during the current budget year municipal guaranties shall not exceed 5% of the total sum of the revenues and the total levelling subsidy on the last annual report on the implementation of the municipal budget.
- The municipality may guarantee only a debt of trade companies, where the municipal share is above 50 per cent of the capital of the company, if the debt is incurred for funding of investment projects and current expenditures of local community benefit and an established security in favour of the municipality exists.
- If the municipality delays the debt servicing with more than 30 days, the Mayor of the municipality and/or the creditor shall notify the Municipal Council and the Audit Office.

Bulgaria also received technical assistance to build municipal capacity in capital investment planning and budgeting to produce marketable infrastructure finance packages. At that time most municipalities had typically funded infrastructure investments in a "pay as you go" manner, accumulating sufficient revenues from asset sales or minimal transfers from the operating budget. This was hardly a sustainable strategy and it could never mobilize the volumes needed to fund the considerable infrastructure deficit. Bulgaria at that point had little experience with capital market financing of municipal infrastructure and lacked a legal framework to regulate it. A tool/package was developed for capital investment planning applied in large number of municipalities. For further details please refer to Annex 3.

Is there clear authorization in legislation to undertake debt-related transactions and to issue loan guarantees on behalf of the local governments?

Local government borrowing rights are regulated by the Public Finance Act and the Municpal Debt Act Municipalities have the right to borrow to finance certain types of investment projects (“Golden Rule”), such as housing, water networks, and sewerage. **However, they must obtain prior consent from the Municipal Council and consent from the Ministry of Finance.**

Are there requirements for mandatory debt reporting to the local assembly or similar body covering debt management and, where applicable, issued loan guarantees?

As per the Municipal Debt Act, the Mayor of the municipality shall prepare up annual report regarding the status of the municipal debt and shall present it to the the Municipal Council as an integrate part of the report for the execution of the municipal budget.

In addition, when the local government issues a long-term debt, the Mayor of the municipality shall announce the project, which shall be funded by a long-term debt, by an invitation for discussion addressed to the local community. The invitation shall contain the general parameters of the project – purpose, amount, way of funding and securitizing, as well as the place and the date of the discussion.

The Mayor of the municipality shall send to the Minister of Finance with a copy to the Audit Office within 30 days period from its adoption, together with the annual report regarding the status of the municipal debt.

The National Audit Office (NAO) (Smetna palata) exercises control over implementation of the budget and other public resources. In accordance with the National Audit Office Act of 2015, it annually audits the financial statements of municipalities whose budgets exceed BGN 10 million (National Audit Office Act, art. 54 (1)). Smaller municipalities with budgets less than BGN 10 million do not have to be audited annually; audit dates are specified by the NAO or on the basis of a risk assessment (National Audit Office Act, art. 54 (2)).

In addition, the State Financial Inspection Agency and the Agency for Public Procurements perform regular audits and surveys. Private auditors can be hired by small municipalities which do not have their own unit for internal auditing.

According to the Bulgarian Law on Internal Audit in the Public Sector, each municipality whose budget exceeds BGN 10 million must establish a unit for internal audits; neighbouring municipalities with smaller budgets may establish a mutual unit of internal audit.

Has there been any instance in the past five years in which local governments were bailout or involved in any insolvency procedure?

Under the Public Finance Act, Chapter Eight “A” – “Municipalities in Financial Difficulties”, there is a procedure of municipalities’ financial recovery. The Local Government Financing Directorate monitors the implementation of the subject procedure as well as publishes information from the reporting data of municipalities on their financial situation.

As per the Public Finance Act, there is a procedure for financial recovery of municipalities in the form of interest-free loan granted from the state budget. Municipalities cannot officially declare bankruptcy.

Indicators to be monitored to identify financially troubled municipalities:

1. The annual amount of municipal debt payments for each municipality in each individual year may not exceed 15 per cent of the average annual amount of own revenues and the

total equalisation subsidy for the last three years calculated on the basis of annual performance reports of the municipality;

2. Payables for budget expenditures of the municipality available at the end of the year exceed by 15 per cent the average annual amount of reported expenditures for the last 4 years;

3. Commitments available for the budget of the municipality at the end of the year exceed 50 per cent of the average annual expenditure reported for the last 4 years;

4. The arrears of municipal budgets available at the end of the year exceed 5% of the municipal expenditures reported for the last year;

5. The budget balance of the municipality budget in the last three years is a negative figure for each of the three years;

6. The average collection rate for real estate tax and vehicle tax is below the average collection rate of the two taxes for all municipalities reported for the last year. The indicators described do not have the highest estimated value, but they provide a satisfactory basis for comparison even more so that the most reliable data are used in their calculation.

The recovery procedure works as follows: The mayor of a municipality is responsible for monitoring compliance with fiscal rules. He annually assesses (by March 10) the fiscal status of the municipality based on current data. If the municipality is defined as a "municipality with financial difficulties", the mayor must inform the municipal council within seven days and propose a financial recovery procedure. If the council agrees to a recovery procedure, it must determine the terms within 20 days. This plan must be agreed upon by the Minister of Finance. The municipality may request financial support from the minister in the form of a temporary interest-free loan to support the recovery plan. It reports quarterly on implementation. The municipality can request additional subsidies to repay the interest-free loan at the earliest 12 months following adoption of the recovery plan only if the municipality can provide evidence of its fiscal recovery. Nominal local government expenditure is subject to a growth ceiling stipulated in the Public Finance Act.

A number of local governments in Bulgaria had to prepare and implement financial recovery plans over the last 10 years.

LGs debt context in Croatia

Level of government debt [historic data & *projections*]

In 2019 70% of the general government debt [Maastricht debt] was made up by debt securities and 30% was made up by loans. At the end of 2019, government debt was mainly held by resident financial corporations [66.8 %]. Some 95% of general government gross debt was issued on a long-term basis.

Critical for Croatia under COVID-driven crisis [2020-2021] is balancing short-term priorities of economic support with medium-term priorities of restoring fiscal space and raising productivity and growth through green and digital public investment as well as implementation of the long-standing agenda on structural [healthcare&pensions, SOE governance, enhanced business climate] and fiscal reforms [aligned with objectives of lowering debt and balancing the budget]. The IMF expects GDP growth to rebound to about 6 percent in 2021, driven by higher public investment and a partial rebound in tourism assuming the effects of the pandemic fade.

Public debt rose back to 87.2% of GDP in 2020 and general government deficit of 8% of GDP due to lower tax revenues and fiscal support measures provided. The Croatian National Bank [CNB] has been proactive in responding to the crisis and the banking sector has thus far withstood pressures well.

Imposed by central government restrictions and or limits on local governments' debt and borrowings

Croatia has a three-tier government structure which consists of the central government, counties [regional self-government] and the local government level [towns, cities and municipalities]. The central government represented more than 90 % of the general government debt [not consolidated between subsectors] at the end of 2019. Croatia is among the EU MS that showed no consolidating amounts between subsectors of general government.

Local and Territorial (Regional) Self-Government Act [2001 and as amended] sets the legal framework for the division of competences between the different government levels and the Law on Local and Regional Self-Government Financing is the law for the local government finance system. There are certain more specific pieces of legislation such as the Law on the City of Zagreb 2001 and sectoral laws relating to the different functions of the local and regional units.

Sub-national government finance their revenues through own resources, shared taxes, grants from the state budget and equalisation grants, shared revenues and borrowing. Own resources include income from sub-national government property, from county, city, town or municipal taxes, and from fines, fees and charges. Shared revenues include fractions of income tax and the tax on real estate transactions.

Grants from the state's budget are allocated yearly to sub-national governments with low fiscal capacity in accordance with the Law on Execution of the State Budget. Specific equalisation grants are transferred to ensure proper coverage of expenditures in the areas of primary and secondary education, social welfare and health care.

Revenue autonomy [own revenues relative to total resources available] at the local level in Croatia is below the EU average [51% versus 53% in 2018], which entails a rate of dependency on central government transfers that is higher than the EU average.

Sub-national governments have access to debt markets [loans and municipal bonds] under the very strict conditions imposed by the Budget Act. Local and regional governments may incur short-term debt for a period not to exceed 12 months, without the possibility of further rescheduling or settling of existing short-term credit or loan liabilities by taking out new short-term lines of credit or loans to bridge the gap which emerged due to the varying dynamics of incoming revenues and due liabilities. Local and regional governments may incur long-term debt only for investments that are financed from their budgets and which are ratified by their representative bodies with the consent of the Government at the proposal of the Finance Minister. Regional governments may issue guarantees to local governments within their jurisdiction with the consent of the Government. The issued guarantee shall be included in the scope of borrowing allowed to regional governments. Local and regional governments may issue guarantees to legal persons under the majority ownership or indirect ownership of local and regional governments and to institutions founded thereby in order to meet the liabilities of said legal persons and institutions. The issued guarantee shall be included in the scope borrowing allowed to local and regional governments.

Sub-national governments borrowing is decided annually, according to two main restrictions: a general limit on the aggregate borrowing of all sub-national governments and an individual limit on each borrowing. ***A general constraint for all local government units is that total local loans cannot exceed 2.3% of the revenue generated by all local government units in the previous year, while the total annual liabilities of an individual sub-national government unit cannot exceed 20% of budget revenues from the previous year.***

Is there clear authorization in legislation to undertake debt-related transactions and to issue loan guarantees on behalf of the local governments?

Debt related transactions [long-term debt] of sub-national governments are subject of authorization by the Government at proposal by Minister of Finance under Budget Act. The Government consent shall be a mandatory annex to the borrowing agreement.

In addition to the above, sub-national governments are allowed to issue securities such as bonds, but the very strict criteria under which this is allowed and the limited development of Croatian capital markets have so far prevented the development of these instruments.

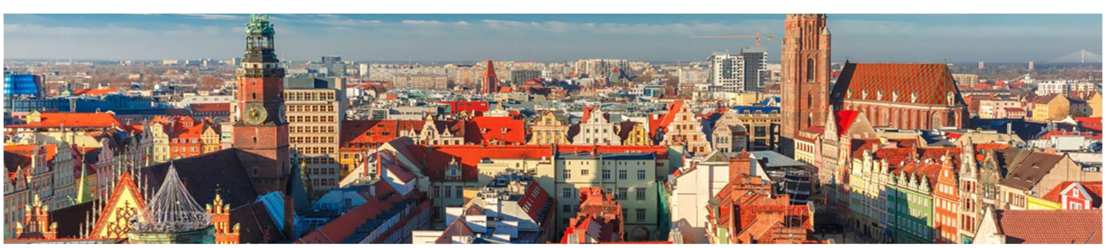
Are there requirements for mandatory debt reporting to the local assembly or similar body covering debt management and, where applicable, issued loan guarantees?

Debt related transactions [long-term debt] of sub-national governments are subject of ratification by their representative bodies. Quarterly reports on servicing of loans and on the status of active guarantees for which consent was granted are submitted to Minister of finance.

Has there been any instance in the past five years in which local governments were bailout or involved in any insolvency procedure?

Not available

LGs debt context in Poland



Source: IMF https://www.imf.org/en/Countries/POL

Level of government debt [historic data& *projections*]

According to recent Fitch Rating report the Poland's gross general government debt (GGGD) reached an estimated 58.9% of GDP at end-2020, up from 45.8% at end-2019. Their forecast is that the fiscal deficit to shrink to 5.7% of GDP in 2021 (official target: 6%) and 3.7% in 2022 on expectations of lower-than-projected take-up of Covid-related fiscal measures.

Imposed by central government restrictions and or limits on local governments' debt and borrowings

The fundamental principles of local government finance were introduced already in 1990, when the Local Government Act introduced regulations in which short-term loans in each local government could not exceed 5% of the planned expenditures in the budget year (LGA, 1990)., the debt cannot exceed 8% of the planned annual expenditure in the first half of the year and 4% in the second half; and finance expenditures which are not covered by revenues. If the amount of loan instalments with the interest would not exceed 5% of the planned expenditures in the year. In 1993, it was changed into the level of 10% (AoC, 1993). Whereas, limitations which existed between 1994 and 1998 assumed that the debt to be paid in the year (credits, loans, redemption of securities, guarantees, etc.) could not exceed 15% of the planned revenues (AFC, 1993). In 1999 significant amendments were introduced into this system, which were accompanied by the administrative reform of the local government in Poland (apart from communities, there were introduced provinces and voivodships – regions). As a result, the unit could take loans and credits or issue securities to finance budgetary shortages within a year (this kind of the debt ought to be paid during the same year), expenditures which are not covered by the planned revenues as well as earlier repayment of the debt (this provision was added in 2003). ***Moreover, the total debt at the end of the year could not exceed 60% of the revenues.*** Whereas, the total debt, which had to be paid in the budgetary year, could not exceed 15% of the planned revenues or 12% if the public debt to GDP would exceed 55% (PFA, 1998).

Key regulation was implemented from 2014. As a result, **debt limitation is estimated separately for each local government. Thus, the share of the planned credit instalments, redemption of securities along with the service costs and guarantees in total revenues cannot exceed the three year average of the operating surplus (positive difference between current revenues and current expenditure) together with revenues from the sale of assets in total revenues.** It should be also mentioned that since 2011 in Poland, it is forbidden to enact the local budget, in which planned current expenditures exceed expected current revenues with the budget surplus from previous years and free resources. Therefore, the growth of the debt does not result from the deficit in the current part of the budget and actually finances investment activity of the unit (PFA, 2009).

Poland is one of the most decentralized countries in the European Union (EU), with subnational spending accounting for about 33 percent of general government expenditures. In Poland, local authorities manage a substantial part of financial resources, which account for up to 31.3% of public expenditures. Their revenues correspond to 13% of the GDP (4.1% of the tax revenues, 7.5% of grants and subsidies; 1.3% of other revenues). However, the question is whether they are allowed to dispose freely of those resources and whether these are proportional to the level of local responsibilities. In Poland, the financial resources deriving from "local taxes" represent a significant part of the municipal income (43,3% according to the 2017 data of the Ministry of Finance), whereas they are limited for powiat (35,8%). However, it shall be noted that local governments are not allowed to create new taxes because this is the exclusive authority of the parliament. The revenue autonomy of the gmina is limited and their power to determine the structure of their resources is constrained.

In Poland, the main revenues for municipalities are the shared Corporate Income Tax and Personal Income Tax, together with grants and subsidies from the State budget, whose purpose is to support some tasks (especially education) and to equalise socio-economic inequalities. However, the limited possibility of establishing local taxes makes it difficult to consider local resources as having a sufficiently diversified and expanding nature to enable them to keep up as far as practically possible with the actual changes (increases) in the costs for carrying out their tasks.

Is there clear authorization in legislation to undertake debt-related transactions and to issue loan guarantees on behalf of the local governments?

Regional Accounting Chambers, which are independent bodies of financial oversight with the responsibility of overseeing local finances,

On 15 November each year, each municipality must send its total budget to the Regional Audit Chamber. There are 16 such chambers, one in each region. Execution reports must also be sent to the Chambers, and also to the Ministry of Finance at the central level. The Chambers are independent bodies who report to the Minister for Public Administration at the central level under the supervision of the Prime Minister. According to the Public Information Act, the budget must also be published and information given to all citizens.

Are there requirements for mandatory debt reporting to the local assembly or similar body covering debt management and, where applicable, issued loan guarantees?

Yes. There is a formal database of the Central Statistical Office of Poland, which offers data on municipal debt and debt performance indicators.

Has there been any instance in the past five years in which local governments were bailout or involved in any insolvency procedure?

Not available

LGs debt context in Hungary

In 2018, Hungary was one of the fastest growing economies in Europe. It was largely driven by domestic demand, including record-high EU funds-related investment. Public debt continued to decline and external deleveraging has been even more sizable. Despite being on a downward trend, public debt, gross funding needs increased and were among the highest in the EU in 2018, at around 20 percent of GDP.

Level of government debt [historic data& *projections*]

General government gross debt as % of GDP, April 2021 stood at 80% (65.3% in 2019)

In 2019 some 85% of the general government debt [Maastricht debt] was made up by debt securities and 15% was made up by loans. At the end of 2019, government debt was mainly held by resident financial corporations [some 55 %] and resident non-financial sectors [27,7%]. More than 10% of general government gross debt was issued on a short-term basis.

IMF expects growth to exceed 4% in 2021 and accelerate further in 2022. The efforts to contain the pandemic and support the economy were based on increased targeted fiscal spending that resulted in rise on above 80% of GDP of public debt, which has been on decline.

Fiscal targets and budget composition beyond this year will need to be regularly reassessed and flexibly adjusted. Given high gross financing needs, it would also be important to continue lengthening public debt maturity, as started in 2020.

Imposed by central government restrictions and or limits on local governments' debt and borrowings

Hungary is a unitary state organized on a decentralized basis. It consists of three levels of governance: central, regional (counties) and municipalities. The intermediate layer (counties) has limited power over local affairs and municipalities are not subordinated to the counties. There are effectively two layers of public administration. Despite the average size of the municipalities being rather small, they enjoy a wide range of freedoms but also extensive range of mandatory services. For this reason, the main role of counties had been to bundle together some of the public services of small municipalities. The central government represented some 99 % of the general government debt [not consolidated between subsectors] at the end of 2019. Hungary is among the EU MS that showed consolidating amounts [3,8% impact of consolidation on general government debt] between subsectors of general government.

The main to the decentralization process act – the Law on Local-Self Government was adopted in 1990. In 2012 a new Law on Local Self-Governments was adopted, which reduced the range of compulsory services by (re)centralising a certain number of competencies, in particular for health and education.

Hungarian municipalities enjoy a wide range of competences and responsibilities. The small size of the municipalities, the large number of competences and a lack of relation between financial capacity and obligations has led to difficulties – the sale of municipal assets and local indebtedness. Some innovative features such as the "multi-purpose micro-regional associations" were introduced to balance size and competences at the local level, but the situation has not yet been improved.

The municipalities benefit from some tax autonomy. They can levy local taxes, the most important of which is the business tax levied on gross corporate profit [local authorities can decide on the tax rate under a ceiling of 2%] and vehicle and property taxes. However, revenue autonomy [own revenues relative to total resources available] of municipalities is lower than the EU average, though on rise. The relatively low autonomy results in a dependency on central government transfers. The intra-government financial system is complex. The majority of the transfers from the central budget are provided as grants, a designed equalisation transfer and a mandatory deficit grant. Normative grants are allocated to narrowly specified functions, mostly in the fields of education, social protection and culture. These transfers are based on expenditure needs rather than on actual output. The equalisation grant has the function of assisting poorer regions. The mandatory deficit grant is designed to cover the deficits that the municipalities encounter through no fault on their own.

Local authorities are allowed to borrow from financial institutions or directly from the market. Furthermore, no golden rule exists; hence operational deficits have often been financed by borrowing or disinvestment (sales of assets). Consequently, assets in the local government had been declining while debt had been increasing throughout the past years.

Public debt in Hungary is managed by an independent agency - Hungarian Government Debt Management Agency, under the Ministry of Finance. The main focus of the agency is debt management, but it is also responsible for cash management as one of its main duties to "ensure that the central government deficit and debt redemption are financed, and the government debt and the temporarily free-cash-funds of the state are properly managed".

More strict rules came after the adoption of the Economic Stability Act of 2011. **Significant changes from January 2012 provided: (1) Constitutional debt brake rule - debt limit of 50% of GDP and (2) Veto power to the Fiscal Council [FC]. Fiscal Council members are (1) President of the FC (appointed by the President of the Republic for six years), (2) the Governor of the Central Bank and (3) the President of the State Audit Office.** The FC forms an opinion on the draft budget proposal – adoption or modification of the budget. Veto right linked only to the constitutional debt rule i.e. FC gives consent to the budget proposal if it ensures the decline of the debt ratio.

Is there clear authorization in legislation to undertake debt-related transactions and to issue loan guarantees on behalf of the local governments?

Municipalities engaging in new financial liabilities are in general subject to authorization by the central government. Detailed authorization procedure is provided in the legislation. Loans can be taken out only for investment purposes and only if the debt redemption would not exceed 50% of own revenues in any given year during the maturity of the loan contract.

Reflecting the developments noted between 2000 and 2010, the consolidated gross debt of the municipalities grew from 1.0% to 4.6%. The figure has since fallen back significantly to 0.5% in 2018. The net lending/net borrowing rate followed these developments with municipalities changing from being net borrowers to net lenders, while simultaneously cutting debt.

Hungary along with the other Central European countries, it was characterized by specific anomalies, such decentralization far exceeded the EU average, and thus decreased the effectiveness of the sector. Furthermore, municipalities in Hungary also took on foreign currency debt, causing major solvency and macro-economic risks.

Are there requirements for mandatory debt reporting to the local assembly or similar body covering debt management and, where applicable, issued loan guarantees?

Special administrative structures provided – pls. see above.

Has there been any instance in the past five years in which local governments were bailout or involved in any insolvency procedure?

Official no-bailout policy ["no-bailout clause enshrined in law] though bailouts implemented. Municipal insolvency legally possible. Not less than 45 municipalities insolvent since 1996, but none after nation-wide bailout 2011-2014, assuming all debt of all local governments.

In 2012, Prime Minister Viktor Orbán announced that the government would partially take over municipal debt. The consolidation took place in three consecutive steps and in the end, just a few months before the 2014 parliamentary elections, the government decided to take over all the remaining debt of the local governments and bailed out every single municipality that had accumulated debt (total consolidated local debt reached about 4.26 billion EUR (Lentner 2014)).

LGs debt context In Denmark

Level of government debt [historic data& *projections*]

The Nordic countries decentralisation is characterised by high degree of public sector tasks managed at the local government level. Municipalities in Denmark supply a long range of services and an important part of public infrastructure, planning and environmental protection is carried out by the municipalities. There is a comprehensive formula driven equalisation system that aims at securing equally economic conditions across the local governments.

Imposed by central government restrictions and or limits on local governments' debt and borrowings

Borrowing regulations of Danish municipalities: every municipality has to finance all its activities -operating costs as well as investment and debt service - by the way of current revenues, i.e. not by loans. The main rule is however modified in two respects. **First, the municipalities have so-called automatic permission to raise (long term) loans for investments in certain areas: investment on areas financed mainly by user fees (e.g. utilities and housing for elderly people) and investments which have been given a special political priority, e.g. urban renewal, energy saving measures and housing for refugees**. Second, the Ministry of the Interior and Health grants municipalities discretionary permissions to borrow, within yearly fixed ceilings of the aggregate value of such approvals.

The overdraft facility rule ("kassekreditreglen") The final element of the borrowing regulations concerns the short-term debt. The set of borrowing regulation rules acknowledges that municipalities meet significant swings in day-to-day outlays and revenues. Typically, the municipality receives taxes and grants in the beginning of the month but has outlays for wages and transfers later or at the end of the month. To secure that the general restrictions on borrowing do not disturb the daily cash management of the municipality or forces the municipality to hold unreasonably high cash reserves they are free to manage short term debt and short term positive balances via short term loans (cash credits) – provided that the annual average of short term deposits and loans, computed for the latest 365 days, is positive. This is the so-called "kassekredit-regel" or overdraft facility rule.

In Denmark, local association of municipalities (LGDK) participates in a Steering Group for Cross-national Initiatives (STS). This has actively involved municipalities in the discussion of methods and results in areas such as e-government initiatives and the De bureaucratisation Programme. An example of policy based on co-operation between central and local government is the creation of a common citizens' portal. Following an annual agreement of 2007, the government has developed a portal, in cooperation with municipalities and regions. LGDK is also usually involved at a very early stage in the process of making rules, in an informal way.https://www.oecd-ilibrary.org/sites/7698dd00-en/index.html?itemId=/content/component/7698dd00-en

Is there clear authorization in legislation to undertake debt-related transactions and to issue loan guarantees on behalf of the local governments?

The Ministry of the Interior and Health grants municipalities discretionary permissions to borrow.

Are there requirements for mandatory debt reporting to the local assembly or similar body covering debt management and, where applicable, issued loan guarantees?

Yes, on quarterly, semi-annualy and annualy basis.

Has there been any instance in the past five years in which local governments were bailout or involved in any insolvency procedure?

A violation of this overdraft facility rule is seen as an early sign of a municipality getting into financial difficulties. The Ministry of the Interior and Health has obligation to react to a violation of the rule. This is done in a standardized manner, consisting of the following elements: 1) the municipality in question is granted a time-limited temporary approval to deviate from the overdraft rule for at certain period, typically 3-4 years, 2) this approval is given on the condition that the municipality takes steps to restore the economic situation and resulting in cash reserves of a certain "robust" magnitude, possibly also to take steps to improve the economic management of the municipality, 3) the central government may or may not add some limited discretionary grants or loan sanctions to ease the immediate economic situation, 4) the municipality has to report frequently, typically every quarter if a year, on the economic (liquidity) situation to the Ministry. The situation is that the local government is "put under administration".

LGs debt context in Greece

Greece is a unitary and highly centralised state. As a consequence of the financial crisis and the joint IMF-EUECB bailout plan in 2010, the Greek central government fundamentally reformed the subnational government. The Memorandum of Understanding, signed by Greece and the IMF-EU-ECB (included explicitly that the "parliament should adopt legislation to reform public administration at the local level, notably by merging municipalities, prefectures and regions with the aim of reducing operating costs and the wage bill.") Since 2011, the Greek local level has consisted of 13 regions (the second tier of local government) and 325 municipalities (the first tier of local government), which are in a non-hierarchical relationship.

In general, local influence in public finance is low as local revenue mainly depends on state grants, namely the non-earmarked "central autonomous grants" and the "earmarked investment grants". Local autonomy on self-sourced revenue, in particular taxes, is minimal. There is no dominating public service implemented by the local level. Local authorities have hardly any say in typical local functions such as welfare, housing or education.

Debt limits: In 2010, the state imposed two debt limits, restricting local debt to a maximum of 60% and debt servicing to a maximum of 20% of annual revenue.

Three institutions are charged with monitoring and enforcing fiscal rules: The Independent Supervisory Authority, a decentralised agency by the Ministry of the Interior, is in charge of reviewing and approving a number of local budgetary decisions. The Economic Observatory for Financial Autonomy executes strict monitoring of budget execution, reports deviations to the Ministry of the Interior and evaluates every municipality annually. Moreover, the Financial Assistance Account of Local Government was established, aiming to support local budgets by conditional bailouts in the case of an emergency.

ANNEX 3 TOOLS FOR MUNICIPAL DEBT MANAGEMENT

Financial Risk Profile Analysis according to Standard and Poor's credit rating methodology

Table I: Financial Risk Analysis by areas

Surplus Generation and Debt Servicing Ability	Cash Flow Adequacy	Capital Structure	Liquidity and Financial Flexibility
• Analytical distinctions with profitability • Type and structure of debt • Analysis cash flow coverage and cash generation ability	• Focus on debt service capability • Analytical distinctions with profitability • Type and structure of debt • Analysis cash flow coverage and cash generation ability	• Leverage • Type and structure of debt • Hedging arrangements • Off-balance sheet obligations • Asset values	• Sources of liquidity • Potential calls on liquidity • Short term debt maturity • Bank credit facilities • Unencumbered assets and debt capacity

Overview of typical financial ratios used in assessing local governments' financial position

Ratios	Definitions	Interpretation
Recurrent Revenues / Total Revenues	Measures the degree to which a local government relies on recurrent revenues.	A ratio of 100% or close to 100% may be inappropriate for a local government that is funding the acquisition of significant nonfinancial assets.
Recurrent Revenues per Capita	Measures the relative burden of taxes and user charges on local taxpayers and service users.	A higher level of operating revenues per capita indicates a relatively high burden of taxes and charges.
Own-Source Revenues / Total Revenues	Measures a local government's own-source revenues compared to its total revenues.	A relatively high percentage of ownsource revenues (max indicator 100%) indicate that the local government is more reliant on recurrent, predictable revenues to fund its activities.
Own-Source Revenues / Operating Expenditures	Measures a local government's own-source revenues compared to its operating expenditures.	A ratio of 100% or more indicates that the local government has surplus own source revenues available to apply to non-operating expenses. A ratio of less than 100% indicates that a local Government that is dependent on non-own source revenues.
Key Own-Source Revenues / Total Revenues	Measures the reliance by a local government on each of the principal own-source revenues for local governments generally.	The relative reliance on each of the own source revenues by a local government can be indicator of creditworthiness.

Ratios	Definitions	Interpretation
Actual to budget	Measures the ratio of initial and final budget projections to actual results.	Show the degree of accuracy in budgeting. It represents how well a local government can plan and manage its finances over time
Relative growth	Shows how changes in revenue compare to changes in expenditures over time.	Faster growing expenditures will eventually lead to a deficit, if revenue growth decreases. Conversely, faster revenue growth will produce or maintain a future operating surplus.
Long-Term Debt Service / Recurrent Revenues	Measure of the ability of a local government to service debt.	The higher a local government's liquid short-term assets compared to its short term liabilities, the greater its liquidity and the greater its ability to cover its short-term liabilities during periods of unexpected revenue shortfalls.
Liquid Short-Term Assets / Short-Term Liabilities	Measures a local government's liquidity position.	The higher a local government's liquid short-term assets compared to its short term liabilities, the greater its liquidity and the greater its ability to cover its short-term liabilities during periods of unexpected revenue shortfalls.
Outstanding debt	This indicator looks at the structure and amount of long-term debt liabilities.	These are basic indicators and therefore the data must be consistently available from balance sheets to be a reliable indicator.
Net Financial Balance and Debt Service Coverage Ratios	Provides a margin of financial safety in case of unanticipated expenses or revenue shortfalls.	A portion of a net financial surplus can be used to support additional debt and/ or to pay the cost of acquiring nonfinancial assets to the extent that revenues from non-financial assets and the planned issuance of debt don't fully cover that cost.
Debt Service Coverage Ratios	It is a measure of the financial margin of safety provided in the local government's budget to ensure lenders that the local government will have sufficient funds available to service its debt.	A debt service coverage ratio of 1.0 indicates that the borrower will have funds available in exactly the same amount as the required debt service. A debt service ratio of less than 1.0 implies that that the borrower will have insufficient funds available to service the debt. Lenders typically require debt service coverage greater than 1.0 when they consider making a loan.

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