POLICY CONCEPT AND ACTION PLAN FOR ASYMMETRIC FISCAL DECENTRALIZATION IN NORTH MACEDONIA

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EXECUTIVE SUMMARY

New policy options for fiscal decentralization is a top priority of the Government of North Macedonia, demonstrating a renewed interest to improve the quality of local public services and local governance. Local governments (LGs), represented by ZELS, also have high expectations to receive more responsibilities, more fiscal authority and funds for decentralized competencies.

North Macedonia has de facto and de jure asymmetrical fiscal decentralization, reflected in the special legal status of the City of Skopje, and in differences for allocation of block grants. This asymmetry has both positive and negative outcomes. Serious weaknesses are recognized in financing institutions of culture, sport, and environment, and weaknesses also exist in education.

The most significant problem is that NM has institutional, but not functional decentralization, whereas the Government finances the competences with block (non-earmarked) grants for the transferred institutions, based only on historical costs. Improvements are anticipated in proposed policy options for asymmetric fiscal arrangements between LGs with higher and lower fiscal capacity; reform of the intergovernmental grant system with an introduction of equalization grants, and authorization of LGs for broader use of non-earmarked (block) grants. The proposed policy options are based on previously analyzed problems of fiscal disparities across LGs and on comparative findings on international practices in seven European countries. They might require legislative changes, including special asymmetric fiscal responsibilities in taxation and intergovernmental grants.

The introduction of new solutions requires prior estimation and assessment of LGs’ performance in various sectors. Given data unavailability and country-specific circumstances, local fiscal capacity and fiscal effort appear to be the most appropriate tools for assessment. In a later phase, after measuring the performance of service delivery in education, culture and social protection, the asymmetric approach in fiscal decentralization could be introduced accordingly.

The justifications for urban asymmetric fiscal decentralization include utilization of local cost factors, more efficient tax collection, and possibilities to extend fiscal administration capacities of urban LGs. Given the wide disparities in tax collection among LGs in North Macedonia, the application of urban asymmetric fiscal decentralization has potential to increase own-revenue collection rates. A reformed system of equalization transfers is expected to reduce fiscal disparities among rich and poor LGs, with options based on Robin Hood principle or funding by the Central Government Budget. Finally, empowering more advanced LGs for broader fiscal assignments and policy discretion over the use of block grants could bring cost saving in the entire system of LG financing and improve local public finance management. Most importantly, it’s a tool for shifting from institutional to more functional decentralization.

These policy options, institutional actions, and potential costs must be strategically planned. They must be discussed and communicated with LGs and ZELS through an inclusive policy dialogue. We also provide a general estimation of the costs and a roadmap of necessary activities for stakeholders.
1. INTRODUCTION

This report is prepared for the USAID's Strengthening Resource Mobilization Activity (here and after: “USAID’s Project”), through the Center for Development Policies IDEAS DePo as a subcontractor to Cardno Emerging Markets, Ltd., financed by USAID. The Strengthening Resource Mobilization Activity aims to assist government institutions to develop and manage the administrative, fiscal, and policy changes as foreseen in the Project’s Work Plan, including offering expert analysis, reviews, and drafting policy concepts for supporting fiscal decentralization. The deliverables of this report include a comparative analysis on asymmetric fiscal decentralization (FD) from relevant international experience for North Macedonia, and Policy Concept and Action Plan for asymmetric fiscal decentralization with concrete explanations related to improvement of fiscal disparities of local governments (LGs), and proposed indicators for assessment and implementation of an asymmetric FD model. As a result, this policy concept is constructed on the following grounds: first, findings from the Comparative research on asymmetric fiscal decentralization and intergovernmental grants in seven relevant countries with applicable solutions to North Macedonia; second, the needs of North Macedonia to reform its decentralization process, having in mind municipal fiscal, institutional, and functional capacities.

Objective. This report presents how relevant comparative asymmetrical solutions from international experience could be adjusted in North Macedonia to provide an evidence-based new policy concept of asymmetrical fiscal decentralization, with an action plan for a smooth transition. The study recognizes the government agenda and its strategic documents, such as the Fiscal strategy, the Strategy for regional development, the Program for sustainable local development and decentralization, and other research studies by international organizations, such as the World Bank, aimed for further democratization of the society, more efficient public service delivery, and enhanced local financing.

Structure. The report is organized as follows: (1) a brief discussion of intergovernmental grants and problems in financing assigned competencies in education, culture and social welfare, and firefighting; (2) explanation of existing asymmetrical fiscal arrangements in North Macedonia and the need to assess fiscal capacity and fiscal effort; (3) a policy concept that visualizes new relations between existing LGs for three policy options for introducing urban fiscal decentralization, including a Robin Hood based equalization scheme, and a proposal for broader use of non-earmarked grants; (4) the financial implications of these proposals; (5) a road map of actions for their implementation and (6) annex of data and figures of calculations for various policy options.

Questions. The report explores whether North Macedonia will spend more on services that are currently decentralized if new policy options are accepted. In line with all three proposals, their pros and cons are identified and will be discussed in close cooperation with the Ministry of Finance (MoF), Ministry of Local Self-Government (MLSG), the Association of Local Self-Government Units (ZELS), and other stakeholders.
2. INTERGOVERNMENTAL FISCAL RELATIONS IN NORTH MACEDONIA TODAY

2.1. How the System of Fiscal Decentralization Grants Works in North Macedonia

The decentralization process that started in 2005 relies on intergovernmental grants to finance assigned competencies in education, culture, social welfare, and firefighting. Although there are minor assigned competencies for health, no grants for health have been distributed in practice. The grant system includes an all-purpose VAT grant that is not a subject of this research and earmarked and non-earmarked grants. Intergovernmental grants contributed 51% of total local revenues in 2008, 54% in 2017, 53% in 2020, and 58% during the first three quarters of 2021. (See Annex 6.3.) These grants pursue several objectives: to reduce vertical fiscal imbalances; to allow sufficient funds for managing local functions; to improve horizontal fiscal balance by providing support to poorer communities; and to fund national priorities in education, culture, social protection, emergency response.

The distinction between earmarked and block grants in 2005 was intended to help LGs transition in financing competencies from phase 1 (mainly using earmarked grants) to phase 2 (mainly using block grants).¹ The main difference between the first and the second phases concerns entitlement for receiving a non-earmarked grant rather than earmarked grants for financing specific functions in education, culture, and social welfare. Firefighting is exclusively financed by earmarked grants in both phases. An illustration of the system of intergovernmental grants is provided in Table 1.

Table 1. System of earmarked and block grants

<table>
<thead>
<tr>
<th>VAT GRANT</th>
<th>All competencies, both phases</th>
</tr>
</thead>
<tbody>
<tr>
<td>EARMARKED GRANT</td>
<td>Firefighting</td>
</tr>
<tr>
<td></td>
<td>All municipalities, both phases</td>
</tr>
<tr>
<td>Education</td>
<td>First phase</td>
</tr>
<tr>
<td>Culture</td>
<td>First phase</td>
</tr>
<tr>
<td>Social welfare</td>
<td>First phase</td>
</tr>
<tr>
<td>NONEARMAKED GRANT (BLOCK GRANT)</td>
<td>Education</td>
</tr>
<tr>
<td></td>
<td>Second phase</td>
</tr>
<tr>
<td>Culture</td>
<td>Second phase</td>
</tr>
<tr>
<td>Social welfare</td>
<td>Second phase</td>
</tr>
<tr>
<td>CAPITAL GRANT</td>
<td>All municipalities, both phases</td>
</tr>
<tr>
<td>GRANTS FOR DELEGATED FUNCTIONS</td>
<td>Both phases; until now no such grants have been transferred</td>
</tr>
</tbody>
</table>

Earmarked grants are transfers from the central government budget to local budgets. Each relevant ministry proposes to MoF the allocation grant formula, monitors the use of earmarked grants, and can stop the allocation in case of incorrect use. Earmarked grants do not include funds for salaries, except earmarked grants for firefighting. Nonearmarked grants (block grants in further text) are transfers where the relevant ministries propose an allocation methodology, which must be adopted by the government, after prior approval from MoF and from the

¹ Qualifying for the second phase of fiscal decentralization (article 45 of LFLSG) was conditional on fulfilling the following conditions: municipality achieves good financial management during the first phase for 24 months; municipality reports correctly and on-time to the Ministry of Finance (MF); municipality has no remaining obligations.
Commission for Monitoring of Development of Financing System of Municipalities. **Block grants in education** are aimed at financing new schools, management of primary and secondary education, student transportation, and student dormitories. **Block grants in culture** are aimed at financing institutions, not functions. For example, the block grant formula for culture in 2022 is based on the following criteria: (1) number of employees in the local institutions in the field of culture by municipalities, and (2) costs for realization of activities in the field of culture according to the total area of the facilities in which the local institutions in the municipality are located. Another example is **block grants for primary education**, where the distribution of grants is based on: (1) basic amount by municipality; (2) number of students and students with special needs; (3) population density of the municipality. In addition, a threshold mechanism (lower and upper threshold) is used in the distribution. **Block grants for social welfare** are aimed at financing kindergartens and houses for elderly. Block grants for education represent over 76% in total grants; social welfare grants represent less than 10% of the total; grants for culture represent 1.7% of the total; and the earmarked grants for firefighting are nearly 2% (see Annex 6.4).

### 2.2. What Seems to Be Working and What Does Not Seem to Be Working?

**Encouraging developments.** North Macedonia has only 15 years of experience with intergovernmental transfers. Still, the decentralization trend - especially the fiscal decentralization trend - is upward, having in mind that:
- the share of local expenditures has grown from 1.0% to 5.5% of GDP, and
- 80 out of 81 LGs are almost a decade in to the second phase and receive only block grants for education, culture, and social welfare.

**Detected problems.** The progress of LGs is not completed and not all have accomplished the requirements for the enlarged competencies of the second phase.

- The ratio between LG expenditures and general government spending is 14,5: 85,5;
- There are significant regional discrepancies in availability and quality of local services. The most noticeable discrepancy is between urban and rural communities, as reflected in the percentages of populations satisfied with local services (only 33% in rural vs. 45% urban). The reasons for the discrepancies are numerous.
- The allocation of competencies for services is not connected to the local institutional capacity to deliver services and to discharge responsibilities. The institutional capacity and service performance is not assessed properly, and there is a lack of “service cost” estimated by the government or by a national standard.
- Intergovernmental block grants are, in effect, earmarked grants, aimed at financing institutions but not functions. This is recognized by representatives of ZELS, and confirmed by data from the Municipal Development Index, which show that a large

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2 Including VAT grant as intergovernmental all-purpose grant.
3 The municipality of Plasnica is still in the first phase.
4 Ministry of Finance, North Macedonia
number of local authorities, particularly rural ones, do not attain the 50% index level of
development. That is a method for detecting institutional instead of functional
decentralization in municipalities in North Macedonia. The competencies in
education, social welfare and culture cannot be financed adequately because many
municipalities do not receive any grants, as they do not have such institutions in culture
and social welfare. In other words, the government finances with block grants the
transferred institutions (not the assigned local functions in general), and as a result, most
rural municipalities cannot develop many assigned competencies since they have no funds
to do so. Each line ministry develops a specific methodology for distribution of block
grants in its area of competence. The problem with this method is that if a municipality
does not own any institution covered by the grant, the respective grant becomes zero.
Such an example is found in the extreme case of financing housing for the elderly, located
only in three LGs in the country. The outcome is decreased satisfaction with quality of
life and local service provision for citizens during the last years.

- LGs do not have sufficient financial resources to ensure satisfactory levels of local services
  and are not authorized to decide freely how to use block grants.
- Block grants are treated as earmarked grants because they finance specified activities, since
  the central government transferred institutions and employees from the central to the
  local level, assigning grants for salaries and management, keeping significant control over
  those functions by laws and financing mechanisms. Similarly, institutions in education,
  culture, and social welfare (established before 2005) that were transferred to LGs, are
  funded by block grants, while newly founded institutions (in the same area of assigned
  competencies) are to be financed by local own revenues. This causes unequal development
  of municipalities.
- At the same time any new employee has to be approved both by the line ministry
  and the Ministry of Finance.

A conclusion is that current block grant formulas have had a damaging effect as they are based
on historical costs of specific institutions, and there is no local motivation to optimize the delivery
of services. This is because any decrease of recurrent costs would lead to a decrease in the
allocation. In addition, there is no growth in block grants in education even though ZELS has been
asking for an increase of 30%. Therefore, introducing functional decentralization by transferring
real block grants for competencies in all municipalities, will increase the efficiency, effectiveness,
and quality of public services. In addition, it will achieve greater proximity to the end users, the
citizens.

\[ \textbf{2.3. Indicators of Asymmetry in Fiscal Decentralization} \]

Even if subnational governments belonging to the same government tier are treated symmetrically
in terms of the political and legal system, there might be de facto asymmetry in implementation
(Bird and Ebel, 2006; Martinez-Vazquez, 2007). Asymmetry in fiscal decentralization does not
mean a status as outlined in the constitution; rather, it is established in a lex specialis law. The
purpose is to bring out solutions that are not politically motivated and are directed towards fiscal
effort and the improvement of service delivery, based on the fiscal and administrative capacity of
the LGs. Put differently, any deviation from the symmetry of assignment of fiscal powers and
responsibilities from the central government to LGs can be treated as asymmetrical fiscally decentralized system.

Based on our earlier Comparative study on asymmetrical fiscal decentralization among seven countries (September 2021), we identify basic indicators for detecting asymmetrical fiscal arrangements: the ratio between LG expenditures and general government spending; the organization of intergovernmental grants; LGs’ empowerment to decide on spending of distributed grants; established equalization scheme; special fiscal rules that prevent excessive spending within asymmetrical expenditure arrangements; and metropolitan asymmetrical decentralization.

Generally, in North Macedonia, there is de facto and de jure asymmetrical fiscal decentralization. De jure asymmetrical decentralization is based on the special legal status of the capital (City of Skopje) and in differences within formulas for allocation of block grants for various areas of competencies.

Based on these indicators for detecting asymmetrical arrangements, we have the following characteristics:

**Administrative or territorial asymmetry.** Ten of the 80 municipalities are organized with the 81st and largest, the city of Skopje, with special status and as regulated by the Law on the City of Skopje. In the capital unlike in the rest of the country, there is a de facto two-tier system of local government, with separated assigned competencies for the ten municipalities within Skopje and for the City of Skopje, and with separate revenues.

**Fiscal asymmetrical rules in City of Skopje.** Skopje’s municipalities are not collecting their own revenues (local taxes, fees, and user charges). The city of Skopje collects them for the Mutual City Fund (the Common Fund) and distributes them between the City and the municipalities according to following ratios: 50%:50% for local property taxes; 50%:50% for communal fees, music, and camping fees; 70%:30% or 60%:40% for construction land user charge. As a result, some of the richest NM municipalities, such as Karpos or Centar, are neither authorized nor responsible for property taxes or fees collection, although they can have more employees in their finance departments, in comparison to a rural municipality that is authorized and responsible for collection of local taxes and fees. The practical outcome is that rural, poorer municipalities often neither have satisfactory collection rates nor can finance new employees. On the other hand, the city of Skopje is motivated to collect local revenues on behalf of the municipalities because a substantial share of the collected taxes goes to the City.

**Fiscal asymmetry in intergovernmental grants.** Asymmetric arrangements are not specifically detected in intergovernmental grants among the City’s municipalities. However, there is asymmetry within block grants, especially for culture and social welfare, whereas some LGs do not receive such grants at all.

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7 The capital includes both the richest municipalities of Macedonia (Karpos and Centar) and some very poor ones (Saraj and Shuto Orizari).
LG empowerment to decide on spending of distributed grants. Nonearmarked grants are, in effect, earmarked grants, as the LGs cannot transfer the revenues according to their decision (or needs) but have to follow strict rules for distribution. For example, they are not empowered to spend less on salaries for employees in education; similarly, they cannot decide freely for new employment without approval by the government (Ministry of Finance).

Equalization grants. Although there is a general-purpose grant (the VAT grant) and it plays a significant role for complementing local revenues, there is no equalization scheme to support the poorer or fiscally weaker municipalities. Moreover, there is no performance-based fund that provides for better performing LGs. However, creating such funds (grants) is already in a legal procedure as amendments to the Law, proposed by the Ministry of Finance. This would be beneficial for decreasing the discrepancies among LGs and would encourage North Macedonia’s decentralization process.

Metropolitan asymmetrical decentralization. Except for the City of Skopje, there is no special status for any other large urban LG in North Macedonia.

2.4. Lessons learned – usable comparative future solutions for North Macedonia?

Our comparative research of the selected countries that have more developed and efficient fiscally decentralized systems provides useful guidance. Given the socio-economic circumstances, the legal architecture, and the government’s strategic development documents for North Macedonia, the following comparative solutions are instructive: a higher share of local spending in government spending; a smaller dependence on intergovernmental grant systems; the empowerment of LGs to decide on spending of distributed intergovernmental grants; metropolitan asymmetric fiscal decentralization; strict fiscal rules for monitoring asymmetric fiscal decentralization; and special fiscal rules that prevent excessive spending.

Table 2: Possible directions for intergovernmental finance in North Macedonia

<table>
<thead>
<tr>
<th>Best comparative practices</th>
<th>Decreasing dependence on intergovernmental grants based on block grants; equalization grants based on fiscal capacity or fiscal effort</th>
<th>Empowering LGs to decide on spending distributed intergovernmental grants as they see fit</th>
<th>Special fiscal rules that prevent excessive spending</th>
<th>Municipal collaboration and intermunicipal contracts</th>
<th>Metropolitan/Urban asymmetric fiscal decentralization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Countries</td>
<td>Sweden, Slovenia</td>
<td>Sweden, Croatia</td>
<td>Denmark Italy Slovenia Croatia</td>
<td>Denmark</td>
<td>Denmark Slovenia</td>
</tr>
</tbody>
</table>

Whether North Macedonia opts for a rearrangement of intergovernmental grants, creating equalization funds, or introducing metropolitan asymmetric decentralization, we cannot simply replace or copy-paste solutions from other countries’ practices. North Macedonia has diverse
local legal, political, and socio-economic considerations. Before adopting new options, we must gather relevant facts and relate to future needs. The following are relevant:

- North Macedonia needs modifications in the system of local government financing in order to transform the process of fiscal decentralization from institutional to functional;
- To effectively perform assigned competencies, municipalities in North Macedonia need higher local expenditures (as a share of general government expenditure and of GDP). This is strongly connected to strengthening local economic development tools and requires modifications in the intergovernmental grant system;
- Asymmetric decentralization can take place because some LGs are in a better position concerning their cost structure, i.e., they can provide public goods at lower costs than the central government.

The comparative local fiscal solutions identified as good practices in countries that have a more developed system of local financing offer constructive options for North Macedonia. These options must be considered carefully in order to be appropriate for North Macedonian conditions. Prior actions, including assessment and evaluation of performance of local tasks and services, should be undertaken.

### 3. POLICY OPTIONS FOR ASYMMETRIC FISCAL DECENTRALIZATION

There are several policy options that target the detected problems. The application of *urban asymmetric fiscal decentralization* is given as a powerful tool with potential to increase own-revenue collection rates. By enriching the system of grants with equalization transfers we propose two options. First is based on the Robin Hood principle, and the second is viewed in supporting LGs with central government budget funds of VAT, in order to smooth the municipal fiscal disparities. The empowering of all or only the more advanced LGs for broader fiscal assignments and policy discretion over the use of block grants could bring valuable changes in short time, and additional cost saving in the entire system of LG financing. Most importantly, all proposed policy options are not exclusive, they could be used both cumulatively and alternatively. However, prior the explanation of these policy options, the need for assessing fiscal capacity and fiscal effort is elaborated. The data for calculations is collected by the official site of the Ministry of Finance (Annex 6.8) and drafted formulas are based on international theory and practice.

#### 3.1. Fiscal capacity and fiscal effort in North Macedonia

Whether we need to introduce new solutions such as asymmetrical schemes in metropolitan fiscal decentralization, or to organize equalization grant funding for weaker LGs, or to opt for broader use of block intergovernmental grants, we need prior estimation and assessment of LG performance in various sectors, such as education, culture and social welfare, or capital investment. Unfortunately, such performance-based or results-based assessment requires decisions about indicators, with indexes for performance in all assigned competencies and application of other measurement tools. In addition, we need the cost of performance in each
area of service delivery. In North Macedonia the intergovernmental grant system formulas rely on historical costs for services that may not measure real local costs of performance. Consequently, we must use other performance measures that can demonstrate overall LG performance or could be useful in making decisions as to whether to give a grade of good/moderate/bad performance or whether that LG is under or below the national average or supposed threshold, such as fiscal capacity and fiscal effort.

Fiscal capacity is such a tool for decision making and assessment. Therefore, before considering possible policy options for changes in intergovernmental grant system, or options for introducing asymmetrical fiscal solutions, this report describes fiscal capacity and fiscal effort, and offers an assessment for all LGs according to data in 2020 and 2021.

### 3.1.1. Fiscal capacity

Fiscal capacity refers to the potential revenue that can be obtained from the tax bases assigned to a LG if an average level of effort (by national standards) is applied to those tax bases. Ideally, tax capacity should be measured by the size of the tax bases available to local governments, or the revenue that these tax bases would yield under standard (or average) tax rates. Examples of such proxy measures include the per-capita level of personal income or the local equivalent of national-level GDP, which can be called gross municipal product, or GMP (Cyan, Martinez-Vazquez, Timofeev, 2012). The basic idea underlying a proper estimation of revenue capacity is to calculate the amount of revenue that a LG would collect given the level of income or economic activity in its territory if it were to exert an average revenue-raising effort. While the collection of the national PIT is a good proxy of the income generated in the formal economy, it would not account for income generated in the shadow economy.

Good proxies for fiscal capacity are represented by combining (1) the amount of PIT collected per capita and (2) the value of housing stock. Collected PIT revenue would capture the income of citizens, and the market value of properties would capture their wealth. As a result, fiscal capacity would reflect both income and wealth, or simply said, the economic power of the citizens in one LG.

Per-capita PIT is probably the most convenient measure since PIT is administered by the State Public Revenue Office (PRO), the collection effort is uniform across the territory, and the information is readily available at the Ministry of Finance. Unfortunately, information for market value of property is not readily available for all LGs. Therefore, the proposed proxy indicators will be based on the locally collected PIT (to capture the impact of the formal economy). The assessment of the housing stock (to capture wealth generated by the informal sector) could be used once it is published from the Census 2021. As a result, our measure of fiscal capacity is based on only one proxy but gives a reasonable presentation of the conditions in North Macedonia.

In principle fiscal capacity measures should analyze own-revenue sources, those sources over which the LG has control, either over the tax base, tax rate or the tax administration. Shared taxes over which the municipality has no control should not be included in a fiscal capacity measure. However, the collection of own revenues in North Macedonia is not uniform across LGs with data showing that municipalities have different fiscal base.
The estimation of fiscal capacity using proxy measures can be done in three steps: (1) selection of proxy measures; (2) definition of average effective tax rate (AETR); (3) computation of the estimated revenue capacity.

A measure of local fiscal capacity can be made using local per-capita PIT collections, with the formula for local fiscal capacity (LFC):

\[
\text{Local Fiscal Capacity} = \frac{\text{Shared Personal Income Tax}}{\text{Number of local inhabitants}}
\]

where shared personal income tax (PIT) refers to the 3% of PIT revenues that are collected by the central government for the local area, and then redistributed according to the principle of residence. It is important that employees working in some urban municipalities are taxed by the central government, and a share of their taxes goes to the municipalities where they live and use local services. Also, the wealth of the citizens living in one municipality is not determined by the place of employment but by the place of residence. ZELS and the government are considering increasing the percentage of shared PIT from 3% to 6% (already announced by the Ministry of Finance). The benchmark for the fiscal capacity threshold can be set at the national average or some percentage (e.g., 20%) above the national average. For example, all municipalities with fiscal capacity below the national threshold of fiscal capacity will benefit by some of the suggested policy options given in the next section.

Data from the Ministry of Finance for all 81 LGs have been calculated and assessed, given in separate table (Annex 6.5.). We will use the generated local fiscal capacities to also calculate local fiscal effort and we will revisit it, once elaborating the urban asymmetric fiscal decentralization as a policy option.

### 3.1.2. Fiscal effort

Fiscal effort can be defined as the degree to which a LG utilizes the revenue bases available to it (Cyan, Martinez-Vasquez and Timofeev, 2012). The level of fiscal effort can be influenced by numerous factors. The most direct influence will be given by changing the tax rate (LGs can vary the tax rate) or by granting tax exemptions. Local governments can also increase tax enforcement effort exerted by tax administration bodies. The level of fiscal effort is typically measured as the ratio of the actual amount of revenues collected to some measure of fiscal capacity. In many transition countries such as North Macedonia, local governments do not take full advantage of the tax bases assigned to them, preferring to rely on revenues collected by the central government and then transferred as intergovernmental grants to local budgets. This has also been identified as one of the reasons for low participation in local expenditure in general government expenditure, and also as a reason for major local dependence on intergovernmental grants.

In this report the preferred model for assessing fiscal effort defines fiscal effort as the ratio of own revenues per capita (actual) to fiscal capacity per capita (a national average). In our case total PIT per capita is used as a proxy for fiscal capacity.
The formula for fiscal effort is\(^8\): \[
\frac{\text{actual own revenues per capita in the municipality}}{\text{total PIT per capita in the LG}}
\]

Actual own revenues per capita show us how much one LG has collected as own revenues. In this formula, own revenues are locally raised revenues by the LG and include:\(^9\)

- Personal income tax (PIT) for craftsmen;
- Property taxes;
- Communal, business, and all administrative fees (including fees for services and other government services);
- Other nontax revenues and charges from concessions.

This is divided by a measure of fiscal capacity based on total PIT per-capita. Data from the Ministry of Finance for all 81 LGs have been analyzed and assessed, presented in the next section, to be used as a tool for proposed policy options. Local fiscal effort can also be used in the design of performance-based intergovernmental grants.

### 3.2. Urban asymmetric fiscal decentralization

**Responding to capacity challenges.** LGs across countries often differ in their administrative, fiscal, and human capacities. The traditional ways to address capacity problems of weak LGs include merging local government units, enhancing intermunicipal cooperation, or partially outsourcing tasks to private-sector producers for service delivery (see Asymmetrical decentralization: Brief for policy makers - Options for Republic of North Macedonia, USAID’s Project report, 2021). Given that North Macedonia has one tier of local self-government with symmetrically assigned competencies for all LGs, the merging of LGs could create new territorial organization that is not a policy option currently. On the other hand, the City of Skopje and 10 city municipalities successfully share assignments in communal affairs, education, culture, social welfare, and firefighting as a two-tier organization. Such sharing of responsibility and service provision gives satisfactory results compared to the other LGs. Most importantly, the fiscal competences are precisely divided and allocated, in a context with wealthy city municipalities, such as Kisela Voda, Gjorche Petrov, Gazi Baba, and Aerodrom (according to our fiscal capacity assessment, Annex 6.5), and city municipalities with stronger fiscal effort, such as Centar (see annex 6.7). The city of Skopje is authorized according to the Law to collect all these municipalities’ own revenues in a Common Fund and redistribute them according to a formula. The two-tier local government organization is not established on the grounds of fiscal capacity and fiscal effort, but more on principles of service efficiency, effectiveness, and reduced tax costs. It is a form of asymmetrical decentralization (when compared to the organization of local government in the rest of the country). However, based on fiscal capacities of the remaining 70 LGs, there is an opportunity to further benefit from urban (urban-led) asymmetric fiscal decentralization.

**Urban asymmetric fiscal decentralization.** Our research supports the proposition that large local fiscal potential remains unutilized and could be acquired through the model of urban asymmetric fiscal decentralization. Introducing asymmetrical schemes envisages allocating tasks of fiscal (tax)
administration and collection of some own revenues by one urban, fiscally stronger LG, for other weaker fiscally less efficient LGs. Typically, these would be neighboring LGs of an urban LG. This option for urban asymmetric fiscal decentralization is supported by positive effects of: (1) demonstrated metropolitan asymmetric fiscal decentralization in the territory of the capital, the city of Skopje, and (2) the findings of our earlier Comparative study on seven successful country case studies.

Feasibility, goals, and expectations. The question of feasibility is the most important, as the urban asymmetric fiscal decentralization should be based on several complementary actions. First, we need to tackle the fiscal administrative capacity challenges in tax service provision in order to detect the weaker LGs with lower fiscal effort. Second, we need to encourage stronger urban LGs to take over some of the fiscal responsibilities of neighboring fiscally weaker LGs, so as to fulfill these tasks on their behalf. Third, by introducing urban asymmetric fiscal decentralization, the fiscal independence of the selected urban LGs would not be enlarged by new fiscal assignments. On the contrary, they will only enlarge the scope of current tax collection activities in terms of collecting own revenues such as local taxes (property taxes or business fees) for some LGs that have shown weaker fiscal effort. This system is based also on the beneficial effects of economies of scale, whereas the additional tax costs of one selected urban LGs are less than the existing tax costs of some weaker (rural) LG. The goals are to ensure:

- lower tax costs for LGs with weaker fiscal effort
- more fiscal efficiency in tax collection
- higher rate of collection of local taxes for the weaker LGs
- Higher collection rate of own revenues in general

3.2.1. Urban asymmetrical arrangements – what can we expect in practice?

There are several practical questions to be examined. First, how does one select the urban local governments that would take on the role of centers (“promoters”) of asymmetrical fiscal decentralization? Second, should this decision be regulated in new legislation, or can it be introduced through the existing legal framework? Third, given that the status of being a fiscally stronger or weaker LG is not permanent, but more a process, should there be indicators, or a threshold given by the central government (or legislative body) that would serve as guidance for the process?

Selection of urban local governments. It is clear that the collection rate of own revenues is one of the weakest points in local fiscal management (see Asymmetrical decentralization: Brief for policymakers - Options for Republic of North Macedonia, USAID's Project report, 2021). This problem leads to low own revenues, unsatisfactory shares in total local revenues, dependence on intergovernmental grants, and weak fiscal discipline. The selection of centers (“promoters”) for local tax collections should be based on their high degree of own-revenue collection (mainly property taxes and business fees). LGs do not have comprehensive property ownership records (as discussed previously). Their incomplete registries and outdated data contribute to low property tax collections. Collection data are calculated on the basis of issued tax bills, which do not represent property tax capacity and therefore are not suitable as an indicator for selecting urban governments as providers of enlarged tax tasks. Thus, we suggest that local fiscal capacity and local fiscal effort be
taken as determinants for selection. Given the PIT-based fiscal capacity used in this report (as we do not have yet property ownership data based on Census 2021), we can make preliminary estimates for the selection of promoters of urban asymmetric fiscal decentralization. In Figure 1 we have extracted only urban local governments in North Macedonia and calculated fiscal effort as described earlier.\textsuperscript{10}

Figure 1. Fiscal effort of urban local governments in North Macedonia (2020)

Average urban fiscal effort (equal to 1) is used as an example (the horizontal line). The government could decide to lower or increase this threshold. In addition, the threshold could be based on additional criteria, such as the history of fiscal effort (average for the past three or five years), a combination of fiscal effort and fiscal capacity, and so on.

3.2.2. Intermunicipal contracts

The legal framework provides intermunicipal cooperation as a tool for collaboration since 2009, as a contract between two or more LGs due to more efficient and more economical performance of competencies. Intermunicipal cooperation, in accordance with the Law on Local self-government and the Law on Inter-Municipal Cooperation, represents a voluntary activity of LGs. It can be established between two or more LGs for the realization of their common interests and goals, and it represents joint commitment. Also, it is one of the ways of achieving the goals of central government to increase and improve capacity of LGs and to ensure better delivery of

\textsuperscript{10} According to data by State Statistical Office, LGs are divided into urban and rural.
services. Intermunicipal cooperation means that one municipality acts on the account of one or more other LGs, on the basis of an agreement. There are several models:

(1) **Joint service delivery**, which covers long-term cooperation of joint legal entities, enterprises, institutions, associations, and foundations. For example, the municipality of Ohrid and the municipality of Struga as a form of intermunicipal cooperation have established a joint venture for water supply ("Proakva").

(2) **Joint administration** may include many different areas of municipal competence, such as tax collection and administration, spatial planning (including mapping and licensing of buildings), execution of inspection, and internal audit. An example of this type of cooperation is the establishment of joint offices or organizational units that deliver services for two or more partners.

European practice shows that forms of joint administration include advice on intermunicipal cooperation and steering and supervisory committees. The administrative set-up of offices or organizational units is intended to serve the interests of two or more LGs. For example, through amendments to the Law on territorial organization in 2013 the merger of five municipalities (Kicevo, Drugovo, Vranestica, Zajas, and Oslomej) was a joint administration that serves citizens of the merged municipalities in the new municipality of Kichevo.

(3) **Selling and buying services** between LGs. This is in situations when administrative or financially stronger LGs provide services to other municipalities with weaker capacity. It may include administration and services. Selling and buying services between LGs aim to achieve economic rationality in the delivery of services and goals. For example, in North Macedonia there is a practice in many areas, such as in internal audit, urban planning, inspection, and others where a municipality – for appropriate compensation - provides services to another municipality. Veles provides services for Caska and Lozovo, Gostivar for Mavrovo-Rostuse and Vrapchishte.

(4) **Joint financing** is practiced when a merger of funds is required by several neighboring municipalities that pool resources to share the financial burden. This means that investment decisions are made jointly, and risks are shared.

Additional motivating factors that encourage municipalities to establish intermunicipal cooperation are:

- The expectations of citizens for better services and improved service delivery;
- Easier access to capital market and joint financing of investment projects;
- Exploiting opportunities for public-private partnerships, and expanding services to the private sector and citizens’ associations;
- Making balanced regional development, which requires a regional approach to planning, programming, and project creation and their implementation. For example, European Union integration and the use of pre-accession instruments (IPA) encourages partnerships and larger funded projects where small municipalities need to cooperate.
Intermunicipal cooperation for urban asymmetrical fiscal decentralization confirms the importance of cooperation of municipalities in conditions of one-tier local self-government. It is also a reason for the central government to create optimal legal, personnel, technical, and financial conditions for the smooth running of operations.

3.2.3. Justification of urban asymmetrical fiscal decentralization

Political and socio-economic justification are needed to bolster the fiscal arguments. Cities and metropolitan regions are gaining importance in an increasingly globalized world where central state structures are weakened. Especially in Europe, cities and regions are increasingly embedded in European governance structures. In North Macedonia we can expect selected urban LGs to acquire a different status compared to the rest of local governments. This is a common form of fiscal asymmetry, which already exists for the capital city, and is also seen in other countries, for example, in Slovenia. It should not be treated as regional territorial reorganization, but more as efficient asymmetrical fiscal decentralization. The main argument is that major urban areas are “engines of growth” in the economy. It is therefore not sufficient to maintain the current levels of agglomeration economies and urban concentration, but to have spillover effects on other neighboring LGs. The application of urban asymmetric decentralization is advantageous for both rich and poor LGs. The rationale behind this policy proposal is that large local fiscal potential remains unutilized and could be acquired by the model of urban asymmetric fiscal decentralization.

Summary of pros and cons. A significant benefit of urban asymmetric fiscal decentralization is that it can provide more own local revenues for smaller municipalities due to cost savings that are available through economies of scale. The surplus of local revenues could be used for supporting local service delivery in various assignments. The main benefit of the urban asymmetrical fiscal decentralization is to increase the collection rate and to reduce the costs in the local financial department, while providing LGs with more revenues compared to the years before. Possible obstacles in higher costs for administering own revenues given created by intermunicipal contracts can be addressed through central government support, if the Government decides for such option. Moreover, urban asymmetric decentralization could be an initial practice for the assigned local competencies in education, culture, social welfare, or health. However, given the lack of data for costs of services in these competencies, we cannot foresee the implementation at this phase.

3.3. Equalization scheme: State Funded or Robin Hood Based

Policy options can be explored through a redesign of intergovernmental grants. There are large socio-economic and fiscal disparities among LGs in North Macedonia. The existing distribution of the general-purpose VAT grant from the central government to LGs has an equalization effect. Numerous policy studies (e.g., Cyan, Martinez-Vazquez, and Timofeev, 2012) underscore the need for introduction of a fiscal equalization framework.
Socio-economic and fiscal differences can be mitigated through equalization transfers, which can be funded by (1) the central government, or (2) more developed (richer) municipalities through the so-called Robin Hood principle. All seven countries under investigation in our comparative study have some form of these two equalization transfers.

**Equalization grants funded by the central government.** One option is to finance a fiscal equalization fund for LGs in North Macedonia from future increases in VAT (net) revenue. For example, 0.5% to 1.0% in higher VAT rates could finance the equalization fund. In this way the central government in cooperation with LGs could develop criteria for distribution, based on fiscal capacity, expenditure needs, and so on. Other options – such as an equalization fund based on a combination of PIT and VAT revenue – could be explored, as these could provide a more stable source of financing over time. This is based on comparative research and lower variation of the mix of sources. However, there is a proposal law amendment in the Parliament, where the Ministry of Finance has started introducing an equalization fund, in three phases. Therefore, the suggested options from this Report could be an addition to the future reforms.

**Robin Hood based equalization grants.** Another policy option that may be more difficult from a political economy perspective is introduction of the solidarity or the Robin Hood principle, which is based on taking from the rich and giving to the poor. Such is the case of Slovenia, where an equalization fund is financed by shared taxes (personal income tax) collected by the government. 70% of the shared PIT for municipalities is retained by municipalities, and the remaining 30% is allocated to an equalization fund. The 30% is distributed to less well-off municipalities in accordance with the formulas explained in Box 1.

**BOX 1: The “target” expenditure level**

<table>
<thead>
<tr>
<th>In the case of Slovenia, the “target” expenditure level is a policy criterion for determining a municipality’s income from personal income tax to finance eligible expenditure, calculated by the Ministry of Finance for each year according to the equation: $P_{Os} = O_i \cdot P_o \cdot (0.3 + 0.7 \cdot \text{Iro})$.</th>
</tr>
</thead>
<tbody>
<tr>
<td>$P_{Os}$ = target amount of funds; $O_i$ = number of inhabitants in the municipality; $P_o$ = average target expenditure per capita in the country calculated by the equation: $P_o = \frac{GSP}{O}$, where: GSP - total target expenditures for municipalities for an individual financial year; $O$ - population of the country; $\text{Iro}$ = municipality diversity index, calculated by the equation: $\text{Iro} = \frac{P_{Pi}}{(O_i \cdot P_o)}$, where: $O_i$ = number of inhabitants and $P_{Pi}$ - target expenditure level of the municipality for an individual financial year. If the calculated target amount of funds is more than 15% higher than the calculated target expenditure of the municipality, the surplus above 15% is reduced by 50%.</td>
</tr>
</tbody>
</table>

In North Macedonia LGs receive only 3% of the total PIT (and 100% of PIT from craftsmen). Since 2018, ZELS has been asking for a major restructuring of shared taxes so that the current 3% of collected PIT revenues would be increased to 50%. In this case, there would be a policy option to introduce a similar Robin Hood equalization formula.

Which LGs would participate in the equalization fund as providers of funds, and which would be beneficiaries of the fund?
This is a sensitive political and financial issue, as citizens and LGs from richer municipalities – where tax evasion and the informal economy is smaller – would likely complain and oppose it. One possibility is to target as providers LGs with high fiscal capacity. It would be wrong to use fiscal effort as a criterion for identifying the rich LGs, as that would discourage LGs that make more effort in terms of revenue collection. Therefore, introducing a performance-based grant for the benefit of LGs with higher local fiscal effort could mitigate potential dissatisfactions of participation in a Robin Hood based fund. The performance-based fund could also target municipalities that provide the best local services. However, an assessment of performance would have to be introduced.

Pros and Cons. The application of the Slovenian solution for Robin Hood based equalization grants in North Macedonia would require a major reform. Regardless of whether we use fiscal capacity, fiscal effort, total revenue collection rates (as a share of planned revenues), or target expenditure levels, it would be politically challenging to introduce the Robin Hood principle because LGs have never given shares of their revenues to other LGs. Therefore, this policy option might better be considered once a system of performance-based grants has been implemented for several years and after careful examination of its effects. So far, the positive effects of equalization grants provided by the government’s central budget have been beneficial in supporting fiscal decentralization for North Macedonia.

3.4. Broader use of block fiscal grants for assigned local competencies

The problem of institutional instead of functional decentralization is crucial, as it generates other decentralization troubles among LGs. The narrowed local management of block grants comes from an unclear division between earmarked and block intergovernmental grants. In practice, the block grants are strictly transferred for special purposes: wages, material costs, etc., and municipalities do not have the discretion to reallocate them. Therefore, if the budgeted amounts of block grants are not properly planned, there will be unspent amounts or shortages. For example, according to the Annual Report of the State Audit Office in 2021, block grants’ accounts have significant unspent funds. Although LGs have received the grants according to central government estimations and annually approved municipal programs, often they are unable to spend the entire amounts. Block grants are mainly for salaries that are used by LGs. Consequently, the realization rate of the block grants in some areas is well below 100%. The reason is twofold: (1) municipalities are not perfect in budget planning, and (2) the central government cannot make adjusted estimation of the grant, because there are no determined real costs of services in assigned competencies. Formulas for block grants in education fail because grants are based on historical costs for managing institutions that were transferred at the beginning of the decentralization in 2005. For example, the use of block grants for salaries in education is in the range between 62% and 94%. Thus, large percentages of funds for salaries remain unused and cannot be reallocated to other purposes. Although these grants are block grants, the system essentially treats them as being earmarked.

Setting national standards. Our proposal is to increase policy discretion of LGs by offering them more freedom for full usage and possible reallocation of funds. This could be done in two ways: 1) symmetrically for all LGs; 2) at least initially, for LGs with better performance and results (fiscal
The first suggested option is that all LGs should be provided more discretion in spending the block grants, in order to freely decide what is best for their local service delivery, and most importantly to have a chance to finance local competencies in the cases where they do not have any transferred institutions by the Central Government. In both cases, it is important to set national standards for evaluation of performance in education, culture, and social welfare. The Law on financing LGs calls for supplementary national standards for quality of service delivery, in order to obtain a minimum standard for each service. For example, all pupils in elementary schools should have equal access to education services, no matter the location of the institution providing the service. This would be regulated in sector-specific laws (lex specialis), but such national standards are missing and should have been introduced by each line ministry. For example, each LG should be required by the national standard to have a particular number of employees per student, or costs of services per students, etc. That would be beneficial both for the users and for the LGs. The action plan at the end of this document foresees the steps and actions for establishing national standards for quality of each competence.

The second suggested option contains an asymmetrical approach that would provide more spending discretion to LGs with higher fiscal effort. This could be a transitional solution while the cost of services and national standards are being set. Afterward, the central government should estimate the performance or effort in delivering local services in education, culture, and social welfare.

A third option is to introduce a system that tracks cumulative funds generated by all central grants, including the VAT block grant. A shortcoming in this approach could reside in the central government’s fear of grants being easily manipulated by LGs. However, this could be resolved by clear systems of regular auditing, revisions, and assessment of performance. Fiscal rules are important in systems of more advanced fiscal decentralization. As discussed in the comparative report, all countries have established mandatory fiscal rules as pre-conditions for any asymmetrical fiscal approach. We suggest two options:

- Empower all LGs (no matter their fiscal capacities, fiscal efforts, or municipal indebtedness) to have broader powers for reallocating block grants in all areas of assigned competencies. A justification for this option is that all LGs receiving block intergovernmental grants have already (8 to 9 years ago) passed the fiscal criteria and entered the second decentralization phase;
- Select LGs with stronger fiscal capacities or efforts, or with satisfactory levels of budget execution or indebtedness, for entering a “third phase” of fiscal decentralization, where they would be granted broader use of block intergovernmental grants. The justification for this option is based on the weak fiscal discipline among most LGs in the second decentralization phase (see section 2.2).

**Pros and cons and their implications in the assigned competencies.** These options are motivated by the idea of asymmetric fiscal decentralization as a remedy for municipal fiscal disparities.
For example, education is financed by block grants that a municipality distributes to schools of its area, in accordance with criteria from the line ministry and supporting the local council’s decisions. In addition, some wealthier LGs use their own revenue sources, as they have the right to plan additional funds intended for education. This is an indicator that shows that a particular LG (based on data from annual financial plans, final accounts of schools, documents published in the official gazette) is ready for broader use of intergovernmental block for education. That is a beneficial technique to ensure transition from institutional to functional decentralization, not just in education but also in other assigned competencies. Social protection and child protection should be more freely managed by the LGs, without imposing conditions of having transferred institutions by the Ministry of Labor and Social Policy. Municipalities, the City of Skopje, and municipalities in the City of Skopje do not have functional decentralized competence for social protection. Therefore, the pros of broader usage of block grants is to ensure larger revenues for developing these functions, where these grants are not tied to centrally transferred institutions and will promote establishment of new local institutions. Possible problems of fiscal management in decision making could be countered by imposing strict fiscal rules by the government, which is seen as an effective solution in international practice (Comparative First Report).

3.5. Financial implications of proposed policy options: how much will they cost?

Assessment of fiscal capacity is a key prerequisite. Fiscal capacity based on PIT per capita is more appropriate than using own-revenues per capita. This is because there could be LGs with low own-revenue collection rates, but having wealthier (higher-income) citizens, indicating stronger fiscal capacity. Furthermore, fiscal effort of LGs is a better base for various intergovernmental grants. Consequently, the central government should create a database and refine a methodology for calculating local fiscal capacity and local fiscal effort. Costs for such analysis could be in-house (regular administrative tasks of the Ministry of Finance), perhaps initially financed by international development partners. The database should be transparent and publicly available, not just for the LGs, but also for other stakeholders.

Policy costing of urban asymmetric fiscal decentralization. Urban asymmetric fiscal decentralization, based on intermunicipal cooperation (contracts), would be highly beneficial for LGs. The rationale includes saving municipal resources, optimizing staff capacities, reducing operating and maintenance costs, increasing collection rates of municipal revenues, better managing decentralized competencies, and using equipment and expertise to exploit economies of scale. As a result, some LGs (selected urban ones) could absorb extra work or even hire new staff. In these cases, they will make sure that the price of their service (revenue collection) at least covers the costs of that service. It is expected that the larger urban LGs would not entail significant additional costs, based on economies of scale and expertise. On the other hand, the beneficiaries of urban asymmetric fiscal decentralization – the neighboring LGs with weaker fiscal effort--would pay for the service (revenue collection), but would expect in return higher rate of collection, i.e., more revenues. The cost of the respective tax service should be defined in the intermunicipal contract. The central government could subsidize such intermunicipal contracts at the initial stage, in order to stimulate the intermunicipal cooperation, but the cost will be
insignificant compared to the potential tax revenues collected by the urban asymmetric fiscal decentralization novel system. In general, urban asymmetric fiscal decentralization - based on economy of scale and expertise - consequently would generate higher revenues at lower tax costs.

In addition, the LGs – the users of this system--will have the opportunity to manage more effectively the employees in their financial departments, in order to increase efficiency in other departments of the LG.

**Costing of an equalization fund.** If an equalization fund is provided by the central budget, the estimated cost for such a policy option is already proposed by a draft law of the Ministry of Finance. The VAT grant will be gradually increased, as a share of collected VAT revenue at central level, starting from 0.25% in the first year, continuing 0.75% and finally in the last stage it is expected to be 1% increase of VAT share. (source: Draft Law amendments in legal procedure in the Macedonian Parliament, 2021). Our estimation is that if an equalization fund follows the Robin Hood principle, the situation is different in terms of the burden for LGs. In other words, LGs with the highest fiscal capacity would have to contribute. If we follow the Slovenian case example, where 30% of the shared PIT revenues are distributed to solidarity equalization fund, but Slovenian LGs, are entitled to 56% of centrally collected PIT, or 18.7 times more than the shared PIT in North Macedonia. (See our comparative study for details.) So, the 30% of 56% is solid amount to be transferred in that Robin Hood principle based equalization fund. Most important is that if Slovenian solution is implemented, the Government will have no additional costs, and in the case of providing the funds for equalization by the Central Budget, there will be additional costs, depending on the increased share of the VAT grant.

**Costing of broader usage of block intergovernmental grants.** By giving more discretion to LGs in using block grants, they can better prioritize and reallocate existing funds. This would have no fiscal implications for the central budget but would unlock a big potential for spending currently unused amounts, explained in section 3.4.

### 4. ROADMAP FOR AN ACTION PLAN

In line with the government agenda and the relevant strategic documents, we outline a roadmap for an action plan that provides for these policy options.
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<th>Responsible</th>
<th>Timeline and Deliverables</th>
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<tr>
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<td>No legislative changes</td>
<td>MoF, ZELS, USAID's Project experts</td>
<td>Jan-Jun 2022</td>
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<tr>
<td>1.2. Data collection for selected indicators</td>
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<td>MoF and USAID's Project experts</td>
<td>Jul-Dec 2022</td>
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<td>1.3. Calculation of local fiscal capacity and effort</td>
<td>No legislative changes</td>
<td>MoF and USAID's Project experts</td>
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<td>1.4. Decision about national thresholds</td>
<td>Bylaws</td>
<td>MoF, ZELS, and USAID's Project experts</td>
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<td>No legislative changes</td>
<td>USAID's Project experts</td>
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<td>Bylaws</td>
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<td>If state-funded:</td>
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<td>3.2. Size of the fiscal equalization fund</td>
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<td>3.3. Criteria for equalization grants for eligible LGs</td>
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<td>Bylaws</td>
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<td>If Robin-Hood based:</td>
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<td>3.2. Identification of contributing LGs and recipient LGs</td>
<td>Bylaws</td>
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<td>3.3. Percentage of revenue from LGs with higher fiscal capacity</td>
<td>FLGUs Law</td>
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<td></td>
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<td><strong>4. Broader use of nonearmarked (block) grants</strong></td>
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<td>Bylaws</td>
<td>MoF/Line Ministry</td>
<td></td>
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<td>4.2. Policy decision for broader use only in selected areas (education)</td>
<td>Bylaws</td>
<td>MoF/Line Ministry</td>
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<td>5.</td>
<td><strong>Assessment of costs and quality of services in assigned competencies in education, culture, social welfare (preschool, housing for the elderly), and modeling an asymmetric approach for implementation of a system of intermunicipal collaboration in providing those services.</strong></td>
<td>Amendments of the Law on local government</td>
<td>MLSP/ MoF</td>
</tr>
<tr>
<td>5.1.</td>
<td><strong>Setting national standards for service delivery in each assigned competence</strong></td>
<td>Amendments of the Law</td>
<td>MLSP/ MoF</td>
</tr>
</tbody>
</table>
5. REFERENCES

Laws and Bylaws (Secondary Legislation)


Law on Financing the Units of Local-self Government (Official Gazette 61/04, 96/04, 67/07, 156/09, 47/11 и 192/15)

Law on the City of Skopje (Official Gazette 55/2004; 158/2011)

Law on Intermunicipal Cooperation (Official Gazette 79/09)

Decree for the Methodology for distribution of revenues from Value Added Tax by Municipalities in 2020

Decree for the Methodology for Determination of Criteria for Distribution of the Block Grants in the Area of Culture in 2022 (Official Gazette 162/2021 from 16.07.2021)

Decree for the Methodology for Determination of Criteria for Distribution of the Block Grants in the Primary Education by Municipalities in 2021 (Official Gazette 221/2020 from 16.09.2020)

Decree for the Methodology for Determination of Criteria for Distribution of the Block Grants in the Secondary Education by Municipalities and the City of Skopje in 2021 (Official Gazette 243/2020 from 9.10.2020)


Policy Reports


USAID’s Strengthening Resource Mobilization Activity (2021b) Comparative study on asymmetrical fiscal decentralization among seven countries. Strengthening Resource Mobilization Activity (September 2021) / CARDNO.

6. ANNEXES

6.1. Map of municipalities in Republic North Macedonia

6.2. Assigned Local Competencies


The competencies of units of local government for municipalities and the City of Skopje, are set out in Law on Local Self Government. The competencies are listed in article 22 of the law and include (we do not include description of each competency, also provided in the same article 22):

1. Urban and rural planning,
2. Protection of living environment and nature,
3. Local economic development,
4. Communal services (water provision, rubbish collection, public hygiene, public transport, cemeteries, local roads, street and traffic lights, parking, local markets, green spaces, riverbeds, naming of streets, squares, bridges, and other public places),
5. Culture,
6. Sport and recreation,
7. Social protection and child protection,
8. Education (primary and secondary),
9. Protection of health,
10. Emergency services (including war and natural disasters),
11. Fire protection,
12. Monitoring of execution of own competencies,

Based on data from the Ministry of Finance (2021).
6.4. Size of Intergovernmental grants with VAT grant in 2021 (in denars and in percent of total transfers)

Revised (Supplementary) Budget of North Macedonia for 2021

<table>
<thead>
<tr>
<th>Type of intergovernmental transfers</th>
<th>In denars</th>
<th>Share (in %)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. General-purpose VAT grant</td>
<td>2,238,000,000</td>
<td>10.5</td>
</tr>
<tr>
<td>2. Earmarked grants</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Earmarked grants for primary education *</td>
<td>3,200,000</td>
<td>0.0</td>
</tr>
<tr>
<td>Earmarked grants for firefighters</td>
<td>403,500,000</td>
<td>1.9</td>
</tr>
<tr>
<td>3. Non-earmarked grants</td>
<td>18,684,331,000</td>
<td>87.6</td>
</tr>
<tr>
<td>Block grants for primary education</td>
<td>11,220,800,000</td>
<td>52.6</td>
</tr>
<tr>
<td>Block grants for secondary education</td>
<td>5,026,000,000</td>
<td>23.6</td>
</tr>
<tr>
<td>Block grants for culture</td>
<td>352,330,000</td>
<td>1.7</td>
</tr>
<tr>
<td>Block grants for child protection</td>
<td>2,034,834,800</td>
<td>9.5</td>
</tr>
<tr>
<td>Block grants for elderly care (nursing homes)</td>
<td>50,366,200</td>
<td>0.2</td>
</tr>
<tr>
<td>Total (1+2+3)</td>
<td>21,329,031,000</td>
<td>100</td>
</tr>
</tbody>
</table>

Note: * Refers only to the municipality of Plasnica. Source: Ministry of Finance (September 2021).

6.5. Local Government Fiscal Capacity (all municipalities) in North Macedonia in 2020

Source: Author’s calculations based on data from the Ministry of Finance (2021).
6.6. Urban Local Government Fiscal Capacity in North Macedonia in 2020

Source: Author’s calculations based on data from the Ministry of Finance (2021).

6.7. Local government Fiscal Effort in North Macedonia in 2020

Source: Author’s calculations based on data from the Ministry of Finance (2021).
6.8. Data for calculations of fiscal capacity and fiscal effort of LGs, based on official MoF data for 2020