REFORMING ARREARS MANAGEMENT TO ENSURE FINANCIAL STABILITY IN LOCAL GOVERNMENT

Fran Brahimi[1], Mariel Frroku[1], Monika Brahimi[2]

[1]Department of Finance, Faculty of Economics, University of Tirana, Street "Arben Broci", Tirana, Albania

[2]Albanian Investment Corporation, Ibrahim Rugova Street, Tirana, Albania

Abstract

Structural reforms post-1990s, in politics and economy, have been accompanied by deep reforms in the management of public finances at the central and local level. In recent years, significant reforms have been implemented across all cycles and procedures of public financial management. A "good" budget document is characterized by its ability to provide sufficient information in a format that enables policymakers to allocate insufficient resources efficiently and effectively, ensuring spending aligns with priorities.

Arrears continue to pose a threat to the financial health of local self-government units, although the stock of arrears has decreased year on year. At the end of fiscal year 2016, a stock of 12.9 billion ALL was recorded and currently, at the end of 2023, the stock of arrears is 4.8 billion ALL, marking a reduction of approximately 63% of it. Despite the reduction of this stock, arrears remain a threat to the financial stability of local self-government units.

In recent years, it has been observed that local self-government units, even with existing arrears, ended their fiscal years with unspent budget funds. In order to prevent the creation of arrears and improve their management, several legal changes were made in 2023. These changes include calculating the weight of arrears against the actual budget rather than the projected budget and utilizing inherited funds to pay off arrears.

This paper analyzes and evaluates the risk of creating arrears using statistical models and the use of time value of money formulas.

Keywords: *Local Government, Central Government, Public Finance, Fiscal Decentralization, Local Self-Government Units, Arrears*

JEL Codes: *H72; H73; H75; H77*

1. LITERATURE REVIEW

The progress of the decentralization process, particularly its fiscal dimension, remains one of the most critical issues in Albania, especially following the administrative-territorial reform of 2014. The stakeholders of fiscal decentralization expect it to positively impact local government.

At the local level, financial management faces the challenges of many risks which have a direct impact on the management of public finances at the local level. Numerous studies have been conducted on borrowing and local debts which converge on the need to establish fiscal rules for local governments in order to avoid facing serious financial problems. Various studies have highlighted the importance of fiscal decentralization for local government. Different authors, foreign and domestic, along with international institutions such as the World Bank and the International Monetary Fund, emphasize that Albania has made progress in this area, yet significant work remains. Increasing fiscal autonomy is a key challenge for the future, as it is a crucial element of public finance administration at the local level.

Maintaining fiscal discipline in a decentralized environment is challenging, and local government fiscal rules are considered one of the most effective solutions to the problem of debt and arrears. The theoretical and empirical literature primarily focuses on the effectiveness of these rules in controlling

deficits and local debt, while less attention has been given to the potential trade-offs and side effects these rules may have on the structure of local expenditures.

Various authors have explored and analyzed the structure and composition of local expenditure. Fiorelli, C., Pontarollo, N., Serpieri, C., Sapienza Università di, Rome, Italy, studied and analyzed Italian municipalities which for fifteen years (1999-2015) were subject to a set of rules named the "Internal Stability Pact". This set of rules applied only to municipalities above a population threshold (5000 inhabitants), allowing the use of quasi-experimental techniques to investigate the effects of these rules set by the municipalities within the framework of the pact. The study provides rigorous empirical evidence that the transition in 2007 to stricter fiscal discipline rules led to a re-composition of local expenditure versus investment expenditure [1].

In the last three decades, trends toward fiscal decentralization have strengthened in many countries. This decentralization has encompassed not only federal states such as Austria and Germany but also unitary countries like Italy, and the Nordic countries, as well as unitary and traditionally centralized ones like France. In 2015, the ratio of local government spending to total general government expenditure was over 60% in Denmark and 30-40% in Austria, Belgium, Finland, Germany, Italy, and Spain. The breakdown of local expenditures according to ECOG (method for measuring the level of performance) reveals that investments account for more than 50% in most of these countries, with Belgium and Germany exceeding 70%. In terms of spending expenditures, the European Commission notes that local governments typically handle 60-80% of general government spending on environment and housing, followed by more than 40% on education, cultural, and recreational services. In this context, local governments are highly exposed to the creation of liabilities and bad debts [2,3,4,].

Public debt is a key issue for government institutions, both because of the amount of its revenue, which partially compensates for a possible shortfall in tax collection, and because it is an essential instrument of fiscal policy for the government. Local borrowing is one of the fundamental pillars of fiscal decentralization, however, the undisciplined use of local debt can lead to negative consequences in the financial health of the local government and can affect the country's macroeconomics and stability [5,6,7].

2. RESEARCH METHODOLOGY

This study is based on primary and secondary data collected by the authors from official sources of the Ministry of Finance for 61 municipalities, utilizing the Government Financial Information System (GFIS Treasury System), official information, and fiscal indicators provided by the local self-government units for the period 2022-2023 [8]. The data have been processed by the authors of the paper to format them appropriately for the analysis of arrears.

In the general analysis of local government, the fiscal indicators taken in the analysis are presented in accordance with the national financial reporting methodology approved in the official manuals of the Ministry of Finance. Data on municipal arrears have been collected according to the tabular format specified in the 2019 Ministry of Finance Instruction "On procedures for managing financial difficulties for local self-government units," as well as information generated by the Government's Financial Information System. This paper also focuses on the amendments made to the Law "On the Finances of Local Self-Government" related to the reform of arrears management, which include changing the basis for comparing obligations and establishing a new rule or standard that mandates 30% of inherited and uncommitted funds to automatically go towards the settlement of arrears [9].

The paper introduces a new approach to calculating liabilities and legacies based on the time value of money, highlighting the risks and fiscal losses local self-government units experience due to these negative financial management phenomena at the local level. This study aims to present not only the causes of arrears and the new methodological approach to managing them but also to propose several theses that require more in-depth studies in the future. This study will serve not only researchers but also policymakers in improving the management of public finances at the local level.

3. GENERAL INDICATORS OF ARREARS OF MUNICIPALITIES

The stock of arrears for municipalities in 2022 stands at 5.3 billion ALL or approximately 6.3% of the total expenditures approved by each municipality. The average exchange rate of the Albanian ALL currency for the year 2022 was 1 Euro = 114 ALL [10]. Compared to 2021, the stock arrears have been a reduction of 1.1 billion ALL in the absolute value of liabilities and a decrease in the average indicator of liabilities as a percentage of planned expenditure for each municipality, from 12.1% in 2021 to 8.7% in 2022.

Based on the data analysis, it is found that four municipalities have a status as units in financial difficulties, eight municipalities are experiencing financial problems, while the other 49 municipalities do not have financial problems.

Fig. 1. Status of financial difficulties for municipalities for 2022

Source: Government Financial Information System (GFIS), Ministry of Finance [8]

4. METHODOLOGICAL APPROACH TO ASSESS THE FINANCIAL IMPACT OF LAW CHANGES

Following the amendment of the law "On Local Self-Government Finances" of 2017, as well as following the work for the implementation of a monitoring system to identify local self-government units facing financial problems, financial difficulties, serious financial difficulties, or insolvency, these changes and the overall reform have direct effects on local self-government units [9].

4.1 The situation before the reform of managing arrears

Based on the forecasts of the regulatory framework approved in 2017 as well as data from the Government's Financial Information System, the stock of arrears for local self-government units-municipalities amounted to 5.3 billion ALL [10] by the end of 2022, or **about 6.3% of the total approved expenditures** by each municipality. The approved expenditures were for 84.7 billion ALL [10]. According to the approved methodology for arrears in 2022, there were identified 8 municipalities

with financial problems, with arrears comprising 15-25% of their total planned expenditures, and 4 municipalities with financial difficulty, with arrears comprising 25-80% of their total planned expenditures.

Based on these data, we conducted various simulations considering the changes to the 2017 Law "On Local Self-Government Finances," as if these changes had entered into force in 2022 [9].

4.2 Comparison of arrears with actual expenditures (considering amendments to the law and the reform of arrears management)

Based on data from the Government Financial Information System (GFIS) [8], the stock of arrears for municipalities by the end of 2022 was 5.3 billion ALL [10], or 9.1% of the total actual annual expenditures for each municipality. The actual expenditures for the 61 municipalities in 2022 amounted to 58.4 billion ALL [10] of the 84.7 billion ALL [10] that were anticipated and committed expenditures for 2022.

According to the methodology approved in 2019 and considering the situation of arrears and actual expenditures of the 61 municipalities, 8 municipalities with financial problems and 7 municipalities with financial difficulties were identified from the 4 that were before changing the law and 46 municipalities without financial problems from the 49 that were before the law change. Municipalities like Libohova, Delvina, and Peqini shifted from municipalities with financial problems to municipalities with financial difficulties after the change of law, while municipalities like Përmet, Selenica, and Rrogozhina shifted from municipalities without financial problems to municipalities with financial problems.

The situation in the municipalities of Kavaja and Vora is much more serious, where arrears represent 74.8% and 68.4% of actual expenditures in 2022, respectively.

Fig. 2. Status of financial difficulties following the amendment of the law on municipalities for 2022

Source: Government Financial Information System (GFIS), Ministry of Finance [8]

4.3 Arrears payments from inherited funds (30% of uncommitted funds)

The other component of this reform foresees that at least 30% of inherited and uncommitted funds must be allocated for the repayment of arrears. Following this new approach, the situation is as follows. For 2022, the uncommitted inherited funds under Chapter 05 (from own income) amount to 18.3 billion ALL [10] across the country's 61 municipalities. Their use to the extent of 30% for the settlement of arrears provides that, based on the calculations, a fund of 5.4 billion ALL [10] will be established for the immediate settlement of arrears.

For municipalities such as Bulqiza, Durrës, Fushë-Arrëz, Gjirokastër, Himara, Kolonja, Korça, Kruja, Librazhd, Prrenjas, Pustec, Saranda, Shkodër, Tirana, Vau Dejës, and Vlora, utilizing 30% of uncommitted inherited funds results in the total repayment of the stock of arrears. After applying this 30% allocation, the total stock of arrears across these municipalities is reduced to approximately 3.4 billion ALL [10] with a total effect estimated at 1.8 billion ALL [10] less liabilities compared to the situation before the law change, i.e. before the reform in the management of arrears.

Based on the data generated by the Government Financial Information System and after calculating the repayment of a part of the arrears in the amount of 30% from the inherited and uncommitted funds, the new stock of the calculated liabilities is about 3.4 billion ALL [10], or otherwise, about 5.9% of the total actual annual expenditures from each municipality. Based on this situation, there are identified 9 municipalities with financial problems, 6 municipalities with financial difficulties, and 46 municipalities without financial problems.

Fig. 3. Status of financial difficulties with the amendment of the law on municipalities for 2022

Source: Government Financial Information System (GFIS), Ministry of Finance [8]

The new financial situation following the change in the status of arrears compared to actual expenditures shows an improvement for the municipality of Libohova, elevating its financial status from a municipality in financial difficulty to one facing financial problems. Additionally, the situation of the municipality of Përmet is notable, as it has transitioned from a state of financial problems to a

municipality without financial problems, with a low percentage of 15.1%, just below the 15% threshold for a normal financial situation.

4.4 Considering the time value of money

Financial decisions involve costs and benefits that occur at different times. Understanding the time value of money is crucial to effective financial management. The time value of money allows the comparison of cash flows over different periods because the benefits and expenses for each aspect of the financial field in each sector usually occur at different times. Based on this fact and considering the time value of money, this part of the paper tries to highlight the benefits of changing the law by looking beyond the immediate effects [11].

The concept of the time value of money, considered one of the most important techniques used in the financial field, is based on the principle that "money has a different value at different times". This concept assumes that well-managed funding sources (money) at time ***t***, used to indicate the present, are considered much more important than the same funding sources used for the same purpose in the future. Therefore, we can state that *the time value of money is a concept that includes calculations for the revaluation of monetary amounts owned or used in one period of time and their evaluation in another period.* Both financial managers in local self-government units and investors must have a clear understanding of the time value of money and its cost-benefit effect as well as the value of an asset [11].

This paper will address the concept of the time value of money, showing that cash flows in time affect the financial performance of municipalities. The object of this paper is the monetary values that represent:

- Funds inherited (carried over) from the previous year,
- The stock of arrears of municipalities.

Analyzing the above monetary values from the point of view of the cost and benefits of the change, we will present both the devaluation of the inherited and stock-held funds, as well as the increase over time of the value of liabilities due to the reformation of the management system of arrears (resulting from the changes of the 2017 law, "On the finances of local self-government") [9].

4.4.1 Arrears and future value of money

This section of the paper addresses the reduction of future risk associated with the stock of arrears, which municipalities are legally obligated to settle over time. As of the end of 2022, the stock of arrears for municipalities, based on data generated from the Government Financial Information System, amounts to **5.3 billion ALL [**10]. The potential financial effect of the stock of arrears is evaluated using the concept of "missing profit" or "opportunity cost" from which we have identified two possible cases.

At first, we address the Future Value (FV) of the value of the arrears. Future value or FV is the value of an investment or asset at a specific date in the future. Essentially, future value is the amount of money that a certain investment or a certain amount of income (money) will be worth after a certain period, assuming a specific rate of return (interest rate). For our analysis, the future value is the value of the arrears of the municipalities accumulated until December 2022, projected at a certain date/time in the future. Given that the arrears are more than two years, we will use two years to calculate the future value. Using this method of calculating the future value we can determine the nominal amount of money that the current arrears will be “worth” at a certain time in the future, assuming a certain interest rate, or in general, a rate of return. The equation and the assumed situation do not include corrections for inflation or other factors that affect the true value of money in the future [12[,[13]. If the payment of the arrears was made by the municipality at a time *t*, which in this case we have assumed 2 years, then the situation will be presented as follows:

$$FV = PV\,(1+r)^n$$

Where:

- **PV** = Present value of the arrears
- **r** = Rate of return, which in our case is the interest rate
- **n** = Number of years, which in our case is 2 years.

To concretize the case studied and to apply the formula practically with the available data, we consider only the total arrears for the 61 municipalities on 31.12.2022, and the arrears after payment from inheritance (Unobligated funds from Chapter 05 (own revenue)) where according to new legal changes in the arrears management system, which provides that no less than 30% of inherited and uncommitted funds must be used for:

- Settlement of arrears; and
- Payment of unpaid sub-loans in due time.

We emphasize that the same way that the formula is applied to totals would be applied to each unit of local self-government separately without any change in logic and implementation.

Case 1: Calculation of FV by applying the formula for arrears of municipalities on 31.12.2022

$$FV = PV\,(1+r)^n$$

Where:

- **PV** = 5,325,909,813 ALL or 5.3 billion ALL total arrears
- **r** = 5% (average market interest rate during December 2022)
- **n** = 2 years

Therefore***:***

$$FV = 5{,}325{,}909{,}813\ ALL\ (1+0.05)^2$$

$$FV = 5{,}871{,}815{,}569\ ALL\ [10]$$

Therefore, as observed from the application of the formula, the Future Value of the liability not being settled by the municipalities after 2 years will increase from **5.3 billion ALL** [10] to **5.9 billion ALL** [10] after two years. Under these conditions and without considering the influence of any other factor, our initial assumption at the beginning of the analysis, suggests that merely maintaining the stock of these liabilities will result in an increase of **546 million ALL** [10] in 2 years.

If the municipality fails to pay off the liability for two years, the companies that did not receive the financing would incur a loss in their profits of **546 million ALL** [10]**, which they could justifiably claim**. This presents a risk that, if creditors were to take legal action, this would be the minimal costs that the municipalities would bear.

Case 2: Calculation of FV by applying the formula for arrears of municipalities for the remaining liability after the implementation in practice of payment from inheritance in the amount of 30% with unobligated inherited funds from Chapter 05 (own revenue). On the other hand, we first demonstrate the second case in terms of reducing liabilities by practically implementing another element of the reform: using no less than 30% of inherited and uncommitted funds for the repayment of arrears.

Viewed through this lens, the situation changes. Previously inherited uncommitted funds in Chapter 05 (own revenue), generated by the Government's Financial Information System, have been utilized up to 30% for repaying arrears until 31.12.2022. Consequently, the stock of arrears, a portion of which has now been repaid, based on the provisions of the law with the new amendment, according to which the measure and method of reducing liabilities are indicated through the use of these inherited and

uncommitted funds, from **5.3 billion ALL** [10] to **3.4 billion ALL**, [10] i.e., with a difference **of 1.9 billion ALL** [10] less liabilities for the municipalities.

In this case, we would use the same logic in the implementation but with a different value as shown below:

$$FV = PV* (1+r)^n$$

Where:

- **PV** = 3,427,563,596 ALL or 3.4 billion ALL arrears after settlement with inherited funds
- **r** = 5% (interest rate)
- **n** = 2 years

Therefore:

$$FV = 3,427,563,596\ ALL * (1+0.05)^2$$

$$FV = 3,778,888,865\ ALL$$ [10]

So, as observed from the application of the formula, the future value (FV) of the arrears paid off at the rate of 30% using unobligated inherited funds, as dictated by law, shows that the remaining liability after two years, if unpaid by the municipalities, will increase **3.8 billion ALL** [10]. Under these conditions, and without considering the influence of any other factors, our initial assumption indicates that merely maintaining this stock of arrears will result in an increase of **351 million ALL** [10] over two years.

If the municipality fails to pay off the liability for two years, the companies that did not receive the financing would incur a loss in their profits of **351 million ALL, which they could justifiably claim.**

The situation presented above highlights the impact of the reform in managing arrears (through legal amendments) when considering the time value of money. Specifically, based on the calculations in cases 1 and 2, in the long term, repaying part of the liability according to the reform's provisions (system reform) would save the municipal budget approximately 195 million ALL over two years. This saving results from the difference between the increase in the liability's value over two years due to the interest rate, and the increase after repaying 30% of the liability using unobligated inherited funds, as shown below:

The financial effect of the change in the law (system reform) over 2 years = The difference in the increase in the total liability over 2 years due to the interest rate (FV) and the difference in the increase in the liability after paying off a part of it with unobligated inherited revenue over 2 years due to the interest rate = 545,905,756 ALL - 351,325,269 ALL = 194,580,487 ALL[10] saved in the municipal budget as a direct consequence of the change in the law over 2 years.

This part of the paper is constructed to consider a hypothetical, unchanging situation where no other factors affect the stock of liabilities and inheritances. The goal is to analyze the opportunity cost of postponing the repayment of arrears and keeping them in stock, as well as the impact of keeping in stock the inherited funds and their loss in value over time without utilizing them promptly for the municipality's benefit for it to overcome the financial situation (from the ones experiencing financial difficulties, financial problems or even the municipalities with a normal financial situation to municipalities with zero arrears and not to carry stock throughout the years of their liabilities) and, on the other hand, to use inherited funds in a way that maximizes their value today. This is important because uninvested stock money is subject to *inflation*, which reduces its purchasing power, and *risks* associated with holding stock money rather than using it. The risk of future money flows is generally higher due to unpredictable future events. The *opportunity cost* always suggests that 1 ALL used today is more valuable than 1 ALL tomorrow [11]. By utilizing inherited funds now, municipalities can better leverage these resources to enhance their value and address their financial needs effectively [14],[15].

4.4.2 Inherited revenue and the concept of present value of money (PV)

This section of the paper analyzes the impact on the time value of money when using uncommitted inherited funds under Chapter 05 (own revenue) in light of the reform in managing arrears (legal amendments). It examines how the value of these uncommitted and unused inherited funds would change over an assumed 2-year period, similar to the analysis conducted for the first scenario of arrears.

To clarify this aspect and provide a different perspective on the opportunity cost of holding uncommitted inherited funds year after year, we emphasize the concept of the time value of money. Holding onto inherited funds without using them leads to a decrease in their value on the one hand because of the principle of the time value of money, and on the other hand, inflation, which reduces the purchasing power of the same amount of inherited funds, and the principle that 1 ALL today is worth more than 1 ALL in the future. The opportunity cost of holding uncommitted inherited funds means that their value declines if compared to using them now to pay off liabilities. Present value (PV) refers to the present value of a future sum of money or cash flows, taking into consideration a specified rate of return. The future cash flows are discounted at the discount rate, and the higher this rate, the lower the present value of the same cash flow in the future. Accurately determining the discount rate is crucial for properly valuing future cash flows, whether they are revenues or debt liabilities.

Present value indicates that an amount of money today is worth more than the same amount in the future. In other words, the present value indicates that money received in the future is not worth as much as an equal amount received today. Money not spent today may lose value in the future by an implied annual rate due to inflation or the return rate if the money were to be invested (which is related to the interest rate in the banking market if the municipality in this case for example were to borrow or lend, that is, what it would receive in return). The present value calculation involves the assumption that a return rate can be earned by the funds over the period. Present value is calculated by taking the expected cash flows of an investment and discounting them to the present day.

$$\mathbf{PV = FVn / (1+r)^n}$$

In which:

- **FVn**= Future value of the inheritance,
- **r** = Discount rate, which in our case is the interest rate,
- **n** = The Number of years, which in our case is 2.

To make the case concrete and apply the formula practically with the available data, the situation is presented as follows, taking into consideration only the inherited totals for 61 municipalities as of 31.12.2022, and the uncommitted inherited funds under Chapter 05 (own revenue). According to the liability management reform (legal amendments) stipulated in Law No. 68, dated 27.04.2017, "On the Finances of Local Self-Government," at least 30% of these inherited and uncommitted funds are used for: i) Repayment of arrears ii) Payment of overdue sub-loans. It is important to note that the same formula applied to the totals will also be applied individually to each local self-government unit.

Case 3: Calculation of PV by applying the formula for the total inherited revenue of the municipalities on 31.12.2022.

$$\boldsymbol{PV = FVn /(1+r)^n}$$

In which:

- FVn=24,536,250,347 ALL or 24.5 billion ALL [10] total inherited revenue in total
- r = 5% (average interest rate)
- n= 2 years

Therefore:

$$PV = 24,536,250,347\ ALL / (1+0.05)^2$$

$$PV = 22,255,102,356\ ALL$$ [10]

Based on the fact that for the inherited funds as a future value for a period of n = 2 years, we will have the same value, so in total **24.5 billion ALL** [10] inherited funds or unobligated inherited funds under Chapter 05 (own income) in total for all 61 municipalities for the year 2023 for **18.3 billion ALL** [10], this is also the FV of our equation, the return rate identified with the interest rate in the banking market if it were to take a loan to pay off arrears or whatever to receive in return if the same amount which is held as stock, would be lent and received in return the amount together with the interest. The period taken into consideration is 2 years to see the effect in 2 years while the return rate is taken as the interest rate in the banking market if we assume the municipality would lend the inherited amount available or would pay as an interest rate if it used the credit as financing sources in the banking market at 5%. The calculations show that the inherited funds in total for the 61 municipalities after a short-term period of 2 years would be depreciated to the extent of **22.3 billion ALL** [10] from **24.5 billion ALL** [10], making a loss from the depreciation of the inherited funds kept in stock without using or investing them anywhere, for **2.3 billion ALL** [10].

So as observed from the application of the formula, the Present value of revenue after 2 years kept in stock by the municipalities would indicate a decrease in value compared to the value they have today if they were to be used. The amount is **2.3 billion ALL** [10]**.** Under these conditions and without considering the influence of any other factor, our initial assumption at the beginning of the paper suggests that merely maintaining the stock of these revenues will result in a decrease in their value over 2 years.

Case 4: Calculation of PV by applying the above formula for the total uncommitted inherited revenue under Chapter 05 (own revenue) of municipalities on 31.12.2022.

Since the reform of the management of arrears (legal amendments) affects only the use of uncommitted inherited funds under Chapter 05 (own revenue), this section analyzes the value of this fund over 2 years based on the assumed factors. Applying the formula for calculating Present Value (PV) to the total of inherited uncommitted funds under Chapter 05 (own revenue), we would have:

$$PV = FVn /(1+r)^{n}$$

In which:

- **FV**=18,313,830,664 ALL or 18.3 billion ALL total uncommitted inherited revenue under Chapter 05
- **r** = 5% (average interest rate)
- **n**=2 years

Therefore:

$$PV = 18,313,830,664\ ALL / (1+0.05)^2$$

$$PV = 16,611,184,276\ ALL$$ [10]

The calculations show that after a period of 2 years, uncommitted inherited funds would be depreciated to the extent of **16.6 billion ALL** from **18.3 billion ALL** [10], indicating a loss from the depreciation of unobligated inherited funds kept in stock without being used or invested anywhere, in the amount **1.7 billion ALL** [10]**.**

The focus of this analysis is to look beyond today (even in a period of 2 years or even beyond) where through the use of the concept of the time value of money we can clearly see the progress of the future. The recognition and use of the concept of the time value of money is crucial for effective financial management to anticipate beyond the present and make valuable decisions about the future that bring us benefit and profit.

In the first part of the paper, the focus was on the presentation of the situation before the reform of the management of arrears (legal amendments) and the financial consequences brought by the amendments of the law of 2017: "On the finances of local self -government", for the 61 municipalities, both in the reduction of the liability stock and in the change of the financial situation of the municipalities. On the other hand, in the second part of the paper, the focus was to see beyond today through the use of the concept of the time value of money, the recognition and use of which is crucial for the effective financial management of municipalities to predict beyond today and to obtain valid decisions for the future that bring us benefits and profits.

5. CONCLUSION AND RECOMMENDATIONS

Arrears constitute a major obstacle to the effective management of local finances, causing problems in the realization of public expenditures for providing services and making investments. One of the main reasons for the creation of arrears is the commitment of financial resources without having them available (e.g., by approving the budget with an inflated revenue plan, which is not realistic) [16], [17]. In 2022, taken as a case, four municipalities were in financial difficulties, eight municipalities resulted in financial problems, and 49 other municipalities with no financial problems.

Most municipalities with arrears exceeding 15% of approved expenditures have them in the form of capital expenditures [18]. Evaluating the situation of the arrears of the municipalities against the actual expenses of 2022 (post-reform for the arrears), there is an observed deterioration in the liability indicator. On average, budgets are realized at 75.9%, and 29 municipalities have a budget realization rate below this average. Following legislative changes to reform the management of arrears, in order to identify local self-government units facing financial difficulties, serious financial difficulties, or payment incapacity under two assumed scenarios [19],[20]:

- Scenario 1: The stock of arrears until December 2022, for local self-government units-municipalities, is in the value of about 5.3 billion ALL, about 9.1% of the total actual annual expenses compared to 6.3% that was before the change of the law.
- Scenario 2: The stock of arrears after their repayment at the rate of 30% from the inherited and uncommitted funds is about 3.4 billion ALL, with a total effect estimated at 1.8 billion ALL less liabilities compared to the situation before the law change, i.e. before the reform.

Based on the methodological approach of using the concept of time value of money, we estimate that municipalities lose about **558 million ALL** in 2 years from arrears. If we use the criteria and conditions of the legal changes, i.e., using 30% of their uncommitted revenue, the stock of liabilities would decrease by **1.8 billion ALL**. The reduction of the liability from 5.3 billion ALL to 3.4 billion ALL through the reform of arrears would ensure that in 2 years only by keeping the time value of money as an argument and no other factor affecting this situation, they could save about **199 million ALL** more, or in other words, with ALL paying off part of the liabilities today with the uncommitted inherited funds available, there will be a benefit of **199 million ALL** or less ALL to be paid by the municipalities in the future.

Municipalities should improve the budget planning cycle and procedures, assessing the potential sources of financing investment expenditures and their potential fiscal capabilities. All municipalities and regions that are found to have financial problems/financial difficulties, to pay off arrears, must:

- Reduce the value of the arrears by not undertaking new commitments.
- Propose the restructuring of fiscal indicators, both in revenue and expenditure.
- Revise the local revenue plan, mainly the sources of financing from own revenue, reassessing the possibilities for increasing taxes/fees.
- Partially liquidate the liability by carrying out reallocations or reductions in own expenses or sign an agreement for partial repayment of the liability with the beneficiary party.

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