

FISCAL DECENTRALIZATION LEVEL IN ALBANIA

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Abstract

This study analyzes Albania's fiscal decentralization level, taking into consideration fiscal decentralization measures using both combined and separate indicators, vertical imbalances, dependency ratios, etc. The study highlights fiscal decentralization data from various European countries and analyzes Albania's fiscal decentralization from 2014 to 2023.

This analysis investigates the impact of fiscal decentralization measures and reforms undertaken in Albania, particularly following the administrative-territorial reform, on the enhancement and improvement of local government revenues and expenditures. Additionally, the study explores and analyzes the evolving relationship between central and local governments and their dynamics since 2014. Based on the analysis carried out through statistical and comparative methods, it has been observed that while autonomous revenue for local governments has increased, there has been a parallel rise in transfers and grants from the central government. Local expenditures have grown at a rate consistent with the overall budgetary expenditures and GDP, significantly contributing to the local deficit. The study also examined various associations between decentralization indices and different variables.

It is recommended that in the future, the types and size of taxes be determined through cooperation between local self-government units and business communities. This will help increase the pace of local revenue collection. As a result, it will contribute to the reduction of the local fiscal deficit and will simultaneously affect the reduction of the financial gap between the transfer of functions and powers to the local government and the financial resources required to exercise them.

Keywords: Local Taxes, Local Revenues, Fiscal Decentralization Index, Fiscal Autonomy, Gross Domestic Product, Local Expenditure

1. INTRODUCTION

In the institutional context, fiscal decentralization is intertwined with comprehensive economic development, the legal system's evolution alongside economic and political reforms, the organization of financial and monetary institutions, as well as economic differences between regions or units [1]. This context determines the structure of the intergovernmental financial system and the effects of fiscal decentralization reform.

Fiscal decentralization can be realized in various ways, such [2], [3] as self-financing or covering costs through revenue generated by users, from co-financing or co-production, where users contribute to the provision of services and infrastructure through monetary contributions and labor, and by increase of local revenue through direct and/or indirect taxes. Another form of fiscal decentralization is intergovernmental transfers of the total revenue from taxes collected by the central government. The last form of fiscal decentralization is borrowing from institutions that offer loans. Despite those public policies of fiscal decentralization, the practically assessing methodology is based more on political perceptions. Based on a scientific quantitative methodology assumption, which is the current level of decentralization in Albania? In the development of this paper, several questions arise such as if explores the autonomy of revenue collection and administration contributes positively to the increase in the Local Government Fiscal Decentralization Index? Additionally, it examines the impact of revenue and expenditure decentralization on this index. Furthermore, the analysis considers whether the Transfers to

Revenue variable and the Transfers to Expenditure variable play a significant role in enhancing the Fiscal Decentralization Index of Local Government.

The decentralization of power and local finances in Albania began with the establishment of the Albanian state in 1912. Throughout different historical periods, the extent and nature of decentralization, including fiscal decentralization, varied according to the prevailing regimes. It was only after the 1990s, following nearly half a century of dictatorship and centralized governance, that Albania began to build its democratic institutions. In early 1991, the country embarked on a new approach to decentralization and local governance, moving away from a centralized state towards a more decentralized and participatory governance system. Until 1998, the process of decentralization has increased local autonomy and fiscal decentralization developed gradually. After this period, the process developed with a faster dynamic. Between 1998 and 2000, the country officially ratified the European Charter of Local Self-Government, incorporated its main principles into the new Constitution, and adopted legal reforms for local self-government.

In 2002, a significant fiscal reform for local government was implemented, which included the adoption of new legislation on local taxes and fees. This reform strengthened the local tax regime and established a sound revenue base for local authorities. This reform marked a significant change from the previous structure of local government financing, which was characterized by an extreme level of centralization in fiscal decision-making. The fiscal reform has reorganized the allocation of revenue sources by redefining certain former national as local taxes (property tax on buildings and land, the small business tax, and vehicle registration tax), introducing new local taxes and fees (property transaction tax, simplified profit tax, temporary tax), and reclassifying and rationalizing local tariffs. Also, the concept of unconditional transfer to local government was introduced and, at the same time, the unconditional transfer formula was distributed to local self-government units. Following the administrative-territorial reform and the transfer of some functions and powers to the local government, fiscal decentralization was further advanced. This included revising the local tax system to introduce new taxes, such as the land or urban land tax and infrastructure impact tax, and liberalizing public fees [4].

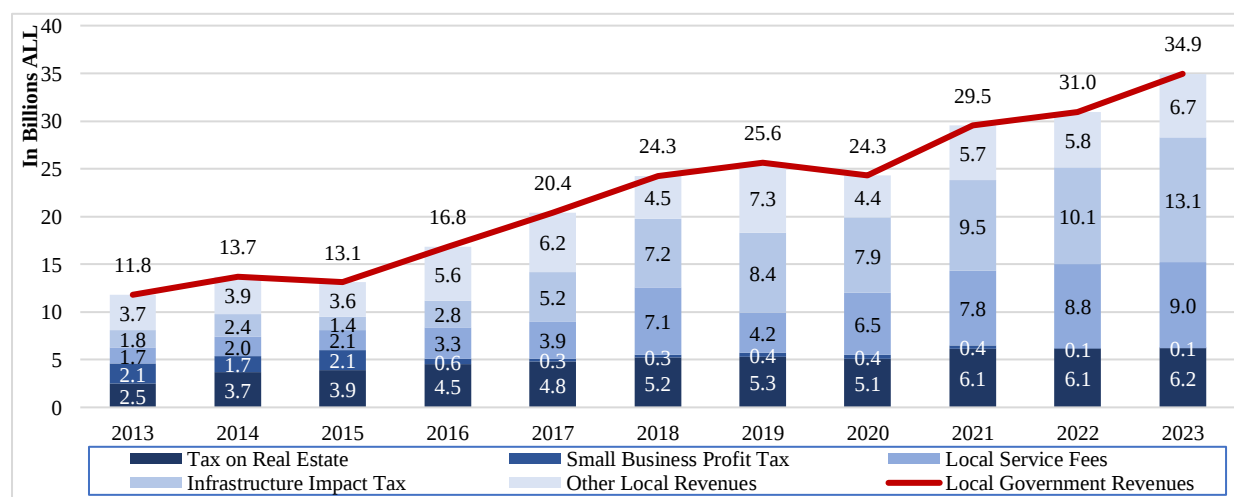


Fig. 1. Local own revenues over the years

Source: Ministry of Finance, compiled by the authors [5], [6].

The infrastructure impact tax represents the largest component of local revenue, accounting for approximately 37% of local revenue over the past two years. Although this source is the most important for the local government at the aggregate level, 72% of the revenue from this tax is generated in the municipality of Tirana, with 87% collected in Tirana and the six largest municipalities of the country. The infrastructure impact tax constitutes 48% of its own revenue in Tirana, 65% in Kamza, 52% in

Kavaja, 49% in Himara, and 39% in Vora and Saranda. Although this source of revenue expands the building's tax base in the future, it does not ensure long-term financial sustainability [5].

Despite the positive progress of the generation of own revenue, fiscal power remains highly concentrated in the Municipality of Tirana and some of the municipalities with the largest population in the country. The Municipality of Tirana alone generates 56% of the total local revenue at the national level. Additionally, three-quarters of all local revenues are concentrated in the municipality of Tirana and the six municipalities with the largest population in the country, such as Durrës, Elbasan, Fier, Shkodër, Vlora, and Kamza. In contrast, medium and small municipalities see a smaller share of own revenue in their budget structure, increasing the dependence on funding from the state budget. This concentration of own revenues in a small number of municipalities highlights significant disparities between different municipalities, which are related not only to structural issues of the economy and local context but in some cases also to local capacities to enhance fiscal performance [7]. Also, an explained situation on the comparison between Own Source Revenues and the GDP of OECD countries is in Figure 2 below.

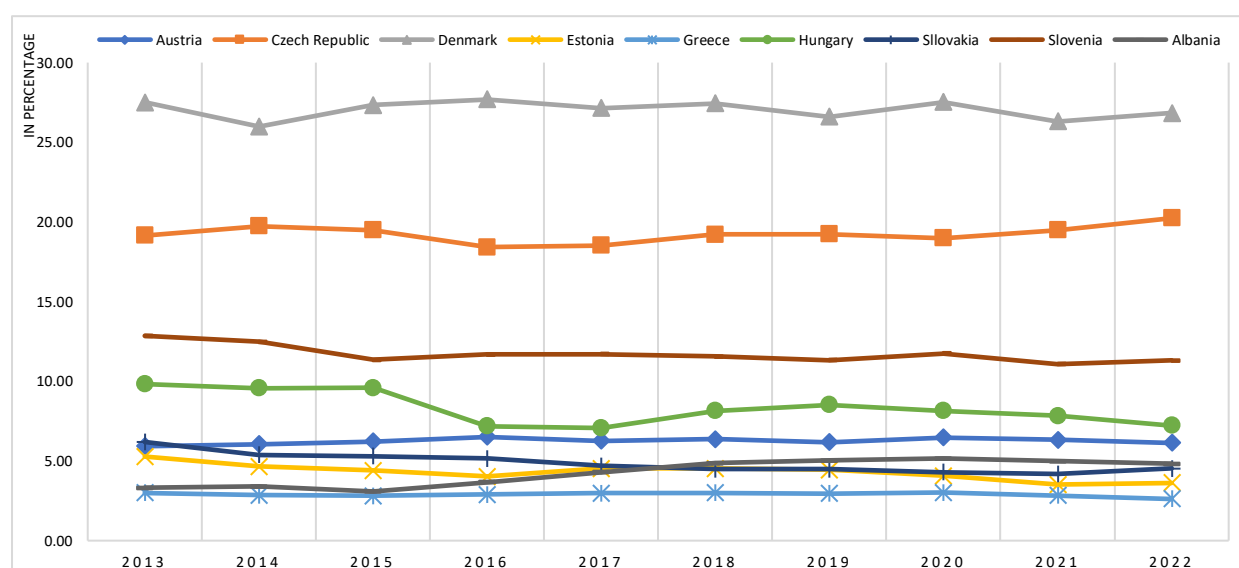


Fig. 2. Local own revenues to GDP (2013-2022)

Source: OECD Fiscal Decentralization database (2024), for Albania, Ministry of Finance; compiled by the authors [8].

Albania has a low level of its own revenue of local government on Gross Domestic Product (GDP). During 2022 and 2023, the local government in Albania provided revenue from its own sources, which amounted to approximately 1.5% of the GDP. The growth of local autonomy is closely related to the performance of the ratio of local own revenue to GDP [8]. On this context of active discussions by referring to the political impacts that the fiscal decentralization process has had in a developing country like Albania, this study contributes to providing an in-depth scientific level on the measurement of decentralization. Based on progress of local government in Albania on the last year by this paper aims to evaluate the fiscal decentralization in Albania. This study, through empirical statistical evaluation, is an important contribution to providing a scientific response to the level of fiscal decentralization that Albania has had over the years.

2. LITERATURE REVIEW

Fiscal decentralization is a key component of decentralizing power and enhancing local government autonomy. This form of decentralization, which aims to increase the authority and responsibility of local authorities for the collection and administration of local taxes and fees, is vital not only for increasing

the financial resources available to local government for more investment and public services but also for being oriented towards local development policies through fiscal offers [9], [10].

These policies are particularly significant for developing countries aiming to attract foreign investment. Theoretically, decentralized fiscal authority enhances competition between local self-government units and motivates local politicians to adopt appealing fiscal stimulus programs [11]. However, local revenue autonomy implies that local governments must primarily finance their expenditures through tax revenues and their own resources. The impact of fiscal decentralization on excessive tax incentives depends on the extent of taxing authority and revenue autonomy granted to local governments. An international empirical analysis of a sample of over 50 developing countries from the early 2000s provides supporting evidence for this relationship [12].

The fiscal and political autonomy of local governments aims to ensure social and economic development and increase the quality of public services. There have been debates and varying positions regarding what should be included in the own revenue of SNGs (Sub-National Government) for local self-government units. This means that it is difficult to have standardized data [13]. In 1997, an OECD Working Group on Tax Analysis and Statistics for Fiscal Affairs conducted an analysis that classified tax autonomy into five categories. These categories range from complete freedom over tax rates and bases to no freedom over any tax variables. One of these five categories is the tax-sharing agreement, which is further categorized into four different subgroups in terms of the level of taxing power [14]. Some authors exclude part of the joint tax revenues from their calculation of the SNG's own revenues. Meanwhile, many others employ the conventional indicator of revenue decentralization. According to this indicator, all common tax revenues are included in the SNG's own revenues, regardless of the degree of tax autonomy or tax power [2].

The rigid division of fiscal responsibilities between central and local governments does not fully reflect the complex intergovernmental dynamics in modern economies. Studies show [15] that local governments can influence redistribution through regional policies, only central governments handle redistribution.

The horizontal dimension divides total public revenue (General Government revenue, GG) into SNG's own revenues (r), transfers from CG (Centre Government) to SNG ($R-r$), and CG revenues ($1-R$). According to the different authors, the own revenues of the SNG are defined as the sum of the tax revenues of the SNGs themselves, tax revenues from transfers and shared taxes, non-tax revenues, and capital revenues. The revenues of each government are defined as its total revenues minus the intergovernmental transferable revenues for each level of government [16]. Fiscal decentralization can lead to horizontal fiscal disparities, meaning wealthy regions have better public services while poorer regions struggle to fund basic services. This exacerbates regional inequality, requiring mechanisms like fiscal equalization, which Oates does not address sufficiently [17].

The vertical dimension consists of SNG, or expenditures administered by local governments (e), administration of local expenditures by the center ($E-e$), and CG's own expenditures ($1-E$). The difference between local administration and centrally administered expenditures is not related to the source of funding for the expenditures [16].

It is irrelevant for this categorization whether the expenditure was financed by the revenue of SNGs or grants. In the case of a co-financed project, what is ultimately paid for it is considered. The part of the total project expenditures paid directly from the central budget to the contractors or beneficiaries of the project is considered as local expenditure administered by the center. The part paid by the Local Government is considered as SNG or locally administered expenditure, regardless of whether it is financed from its own revenue or grants transferred from the central government [18].

One of the most well-known elements of fiscal decentralization is the SNG's own revenues and expenditures versus the GG's (General Government) revenues and expenditures, which are " r " and " e ". One of the definitions for vertical fiscal imbalance (VFI) is the share of transfers from SNG to SNG of total revenues, which translates to $(R-r)/R$. One of the indicators of revenue autonomy is the share of SNG's own revenue to total revenue, which is simply r/R . Reviewing the relevant literature, we observe that various measures of fiscal relations in a functional form are decomposed into four elements: r , e , R ,

and/or E. Table 1 illustrates the representation of these various measures of financial relations in a functional form within a two-dimensional space. The metrics are categorized into fiscal decentralization and vertical fiscal imbalance, where fiscal relations are significantly influenced by intergovernmental fiscal interaction. These measures focus on taxation power, transfers, and related expenditures, which means that tax autonomy is not covered by this representation [16]. Additionally, each group is divided into combined and composite measures based on metrics that reflect both revenues and expenditure aspects.

Measures			Formula	Function Form	Authors
Fiscal Decentralization Measure	Combined Indicators	Revenue Decentralization Index (RDI)	$\frac{\text{SNG Own Revenues}}{\text{GG Revenues}}$	$D'(r) = r$	Eyraud and Lusynian etc, (2011), Escolano (2012)
		Expenditure Decentralization Index (EDI)	$\frac{\text{SNG Expenditures}}{\text{GG Expenditures}}$	$D^e(e) = e$	Eyraud and Lusynian etc, (2011), Escolano (2012)
		Revenue Autonomy I (RAI)	$\frac{\text{SNG Own Revenues}}{\text{SNG Revenues}}$	$A^I(r, R) = \frac{r}{R}$	Stegarescu (2005)
	Composite Indicators	Revenue Autonomy II (RAII)	$\frac{\text{SNG Own Revenues}}{\text{SNG Expenditures}}$	$A^{II}(r, e; \bar{D}) = \frac{r}{e \bar{D}}$	Martinez-Vazquez and Timofeev (2009)
		Production Revenue Index (PRI)	Arithmetic Mean of RDI and EDI	$N(r, e) = \frac{r + e}{2}$	Akai and Sakata (2002)*
		Composition Ratio (CR)	$\frac{RDI}{1 - EDI}$	$C(r, e) = \frac{r}{1 - e}$	Martinez-Vazquez and Timofeev (2009)*
Vertical Fiscal Imbalance (VFI) or Transfer Dependency Measure	Un Combined Indicators	$VFI^I \equiv TD^I$	$\frac{\text{Transfers}}{\text{GG Revenues}}$	$T^I(r, R) = R - r$	Rao and Singh (2002)
		$VFI^{II} \equiv TD^{II}$	$\frac{\text{Transfers}}{\text{GG Expenditures}}$	$T^{II}(r, R; \bar{D}) = (R - r) \frac{1}{\bar{D}}$	Rao and Singh (2002)
		$VFI^{IV} \equiv TD^{IV}$	$\frac{\text{Transfers}}{\text{SNG Revenues}}$	$T^{IV}(r, R;) = \frac{R - r}{R}$	Rodden (2002) Baskaran (2010)
		$VFI^V \equiv TD^V$	$\frac{\text{Transfers}}{\text{SNG Expenditures}}$	$T^V(r, R; \bar{D}) = \frac{R - r}{e \bar{D}}$	Jin and Zou (2002) Eyraud and Lusinyan (2011)

Table 1. Different indicators for measuring fiscal relations.

Source: Generated from the literature, the Author's own schematic representation [16], [19], [20].

$\bar{D}$ is GG the fiscal deficit defined as the ratio of GG expenditure divided by GG revenue.

The VFI has several limitations and therefore does not accurately measure the control of local governments "over their financial resources". Some studies show that "own revenues" do not accurately measure the freedom of local governments over their resources [21]. This shows that there is a need for a more accurate measure to assess the fiscal autonomy of local governments. The measurement of fiscal decentralization can be done in one of these four methods [22], by comparing the ratio of local government revenue to total government revenue. This measure shows the proportion of general government revenue that is generated by local government. The second method is by analyzing the ratio of local government revenue minus grants to total government revenue. This form of measure excludes grants from local government revenue to show the proportion of total government revenue generated solely from local government sources. Third form is the ratio of local government expenditures to general government expenditures. This ratio measure the proportion of general government expenditure allocated to local government. The last form of fiscal decentralization is the ratio of local government expenditures to general government expenditure minus defense expenditure and social security expenditure [22]. This measure subtracts expenditure on defense and social security from general government expenditure to show the proportion of general government expenditure directed to local government, excluding these particular categories of expenditure [23].

These methods provide a way to assess the level of fiscal decentralization in a country, indicating the extent of fiscal autonomy local governments possess. FDI (fundamental fiscal decentralization index) consists of two main elements; (i) fiscal autonomy and (ii) subnational fiscal importance. The fiscal autonomy (FA) of the local government is represented by the ratio of "own revenue for local governments" to local government expenditures [22].

$$FA = \frac{\sum_{i=1}^n OSR_i}{\sum_{i=1}^n E_i},$$

Where OSR_i (Own Source Revenues) represents the own revenue (total subnational revenue minus grants received from the central government) of subnational government i , E_i represents the expenditure incurred by subnational government i , and n is the number of subnational governments. Further, the fiscal importance of subnational governments (FI) is defined as follows [22]:

$$FI = \frac{\sum_{i=1}^n E_i}{TE},$$

Where TE represents the total public sector expenditures from all levels of government within the country. This includes expenditure incurred by the central government and all regional governments, excluding fiscal transfers from one government to another (such as national fiscal transfers to regional governments).

The Fiscal Decentralization Index (FDI) is based on the approach of "fiscal autonomy and importance" and is the geometric mean of measures of both elements [22].

$$FDI = \sqrt{FA * FI} = \sqrt{\frac{\sum_{i=1}^n OSR_i}{\sum_{i=1}^n E_i} * \frac{\sum_{i=1}^n E_i}{TE}}$$

The results of the Fiscal Decentralization Index (FDI) can provide three situation as a "relative fiscal decentralization" were FDI is between 50 to 100, "relative fiscal centralization" were FDI is 0 to 50, "perfect fiscal centralization" were $FDI=0$, a situation what can be described as expenditures are fully financed by the national government fiscal transfers (when OSR is zero) and the last situation were $FDI = 100$, it can be described as perfect fiscal decentralization, where public expenditure is fully financed by local governments (when $OSR = TE$). The last two cases are two extreme cases that are only theoretically possible.

3. METHODOLOGY

To achieve the objective of this study is important to compare the fiscal decentralization index of Albania with other countries in Southeast Europe and beyond. To analyze the fiscal decentralization are used four variables such as [16], [24], [25] *Revenue Decentralization Index (RDI)*, which is an indicator that is generated from the ratio of SNGTR/GGTR, local revenue to total state budget revenue for the period 2014-2023 [8], *Production Revenue Index (PRI)*, which is the arithmetic measure of RDI and EDI, $(r + e)/2$, where the two main components are revenue from local government and expenditure for local budget for the period 2014-2023, *Transfers to TR Index (VFI₄)*, is an indicator that comes as a result of Transfers/SNGTR, so transfer (Grant) to revenue from local government for the period 2014-2023 and *Transfers to TC Index (VFI₅)*, is an indicator that comes as a result of Transfers/TC, so Transfer (Grant) to Local Budget Expenditures for the period 2014-2023[5].

These indicators were selected from the methodology identified in the literature review with the argument that the PRI provides a better balance and is more useful for comparative analyses between countries with different fiscal structures, and also that the VFI⁴ and VFI⁵ measure dependency exclusively for local governments, being more useful for decentralization policies [26].

Regarding this, the following research questions were developed the following hypothesis:

H1: Does the Revenue Decentralization Index positively impact the increase in the Fiscal Decentralization Index of Local Government?

H2: Does the Production Revenue Index positively impact the increase in the Fiscal Decentralization Index of Local Government?

H3: Does the Transfers to Revenue variable positively impact the increase in the Fiscal Decentralization Index of Local Government?

H4: Does the Transfers to Expenditure variable positively impact the increase in the Fiscal Decentralization Index of Local Government?

This paper employs the statistical method of simple and multiple regression to achieve its objectives. Additionally, secondary data, data analysis, and various graphical representations were also utilized. The paper aims to identify a statistically significant correlation between the independent variables such as; Fiscal Importance, Fiscal Autonomy, Decentralization Index, Revenue Autonomy, Transfers to Revenue Variable, Transfers to Expenditure Variable, and the dependent variable of the Local Government Fiscal Decentralization Index. Additionally, it seeks to empirically test the research questions (hypotheses) posed.

The selection made in this paper presents data for both central and local government over 10 years, from 2014 to 2023, without any lack of data for each year within this timeframe.

Variables	Number of observations per variable
RDI, PRI, VFI ₄ , VFI ₅	Fiscal indicators, Central and local government
Total	Data for 10 years (2014 - 2023)

Table 2. Descriptive Statistics

Table 2 outlines the descriptive statistics and the number of observations available for each variable over a period of 10 years, from 2014 to 2023 [5].

4. FISCAL DECENTRALIZATION INDEX AND COMPARISON WITH OTHER COUNTRIES

Fiscal decentralization is a cornerstone of effective governance, enabling local governments to have greater control over their financial resources and decision-making processes. The intricacy of fiscal decentralization presents a comprehensive index that measures the extent to which fiscal powers and responsibilities are devolved to subnational entities in different countries [27]. By examining this index, we gain valuable insights into the efficiency, equity, and accountability of public finance management at the local level [28]. Furthermore, this chapter offers a comparative analysis with other countries, highlighting best practices and identifying areas for improvement. This exploration analyzed the situation of fiscal decentralization of Albania compared with other OECD countries [29].

No	Description	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
1	Total state budget revenue	366,721	379,206	407,021	430,397	449,909	460,349	425,905	510,572	572,790	643,678
2	Local government revenue (from taxes)	12,447	11,700	14,951	18,447	21,863	23,102	21,975	25,426	27,638	31,686
3	Property tax	3,700	3,900	4,500	4,700	5,200	5,300	5,124	6,116	6,138	6,181
4	Local taxes	7,547	5,766	9,852	13,451	16,347	17,447	16,467	18,925	21,428	25,446
5	Simplified profit tax for small businesses	1,200	2,034	599	296	316	355	384	385	72	60
6	Transfers (grant)	12,335	19,694	22,376	24,034	25,075	26,110	27,789	28,086	33,871	33,871
7	Total of state budget expenditure	438,849	437,408	433,697	461,410	476,147	491,897	536,279	592,801	651,015	674,855
8	Expenditures of local budget	32,985	34,066	43,580	46,487	49,615	56,227	51,626	56,826	58,696	68,841
9	GDP	1,395,303	1,434,308	1,472,480	1,550,644	1,636,730	1,691,903	1,644,077	1,856,172	2,138,339	2,311,673

Table 3. Some Central and Local Fiscal Indicators (in million ALL)

Source: Ministry of Finance, (authors' own calculations) [5], [6].

The budgetary (fiscal) revenue has generally increased from year to year, and in 2023 it was 75% higher than in 2014. Moreover, the local government revenue has increased, and when comparing the year 2023 with 2014 we note that the revenue has increased by more than double.

For the fiscal decentralization analysis, we have taken into consideration the indicators provided in the literature section [30]. These indicators have been used by other authors across different countries in Europe and around the world. In the researched material, we did not find data and analyses for Albania on the raised issue, therefore everything was processed by the authors. The indicators extracted from the data provided by different sources (cited in the material) are presented in Table 4.

No	Description	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
1	FA TR / TC % (Fiscal Autonomy of Local Government)	38	34	34	40	44	41	43	45	47	46
2	FI = Fiscal Importance LC / LG	8	8	10	10	10	11	10	10	9	10
	FA*Fi	304	272	340	400	440	451	430	450	423	460
3	Square Root of (FA * FI) (FDI Fiscal Decentralization Index)	17.4	16.5	18.4	20	21	21.2	20.7	21.2	20.5	21.4
4	RDI Revenue Decentralization Index (SNGTR / GGTR)	0.034	0.031	0.037	0.043	0.049	0.050	0.052	0.050	0.048	0.049
5	EDI Expenditure Decentralization Index (SNGTC / GGTC)	0.075	0.078	0.100	0.101	0.104	0.114	0.096	0.096	0.090	0.102

6	Revenue Autonomy (RAI) SNGTR per capita / SNGTR	0.38	0.34	0.34	0.40	0.44	0.41	0.43	0.45	0.47	0.46
7	PRI Production Revenue Index (Arithmetic mean of RDI and EDI, $(r + e) / 2$)	28,940	28,733	36,741	41,691	46,671	51,216	47,788	53,839	56,986	66,107
8	Composition Ratio (CR) RDI / (1 - EDI)	0.037	0.033	0.041	0.048	0.054	0.057	0.057	0.055	0.053	0.055
9	VFI ₁ (Transfers/GGTR)	0.034	0.052	0.055	0.056	0.056	0.057	0.065	0.055	0.059	0.053
10	VFI ₂ (Transfers/GGTC)	0.028	0.045	0.052	0.052	0.053	0.053	0.052	0.047	0.052	0.050
11	VFI ₄ (Transfers/SNGTR)	0.991	1.683	1.497	1.303	1.147	1.130	1.265	1.105	1.226	1.069
12	VFI ₅ (Transfers/TC)	0.374	0.578	0.513	0.517	0.505	0.464	0.538	0.494	0.577	0.492
13	GG deficit (as part of expenditures) (GGTC - GGTR) / GGTC	0.164	0.133	0.062	0.067	0.055	0.064	0.206	0.139	0.120	0.046

Table 4. Some decentralization indicators for the 2014-2023 period for Albania

Source: The data have been processed by the authors according to Table 3 [5], [6].

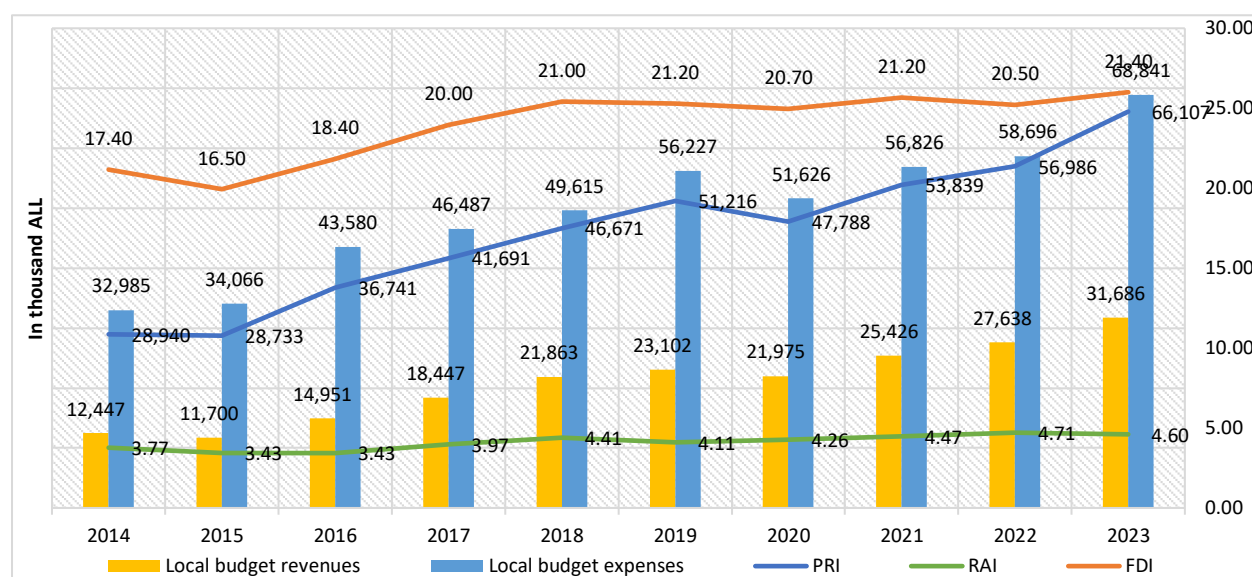


Fig. 3. Revenue and expenditure indicators (PRI, RAI, and FDI)

Source: Data from the Ministry of Finance, calculations, and processing by the authors [5], [6].

No.	Country	Fiscal Autonomy (FA)	Fiscal Importance (FI)	Fiscal Decentralization Index (FDI)	FDI 2014-2021
1	Austria	44.90	14.5	25.54	-0.06
2	Czech Republic	33.36	27.6	30.32	0.59
3	Denmark	40.03	63.2	50.30	-0.64
4	Greece	48.77	6.9	18.31	0.93
5	Hungary	38.06	11.5	20.91	-4.71
6	Slovak Republic	39.17	16.7	25.54	1.33
7	Slovenia	39.65	18.1	26.77	-0.81
	Min	33.4	6.9	18.31	
	Max	48	63.2	50.3	
	Average	40.60	22.6	28.2	

Table 5. Some Decentralization Indicators for 7 European Countries

Source: OECD [8].

The coefficient of fiscal autonomy in Albania for the years 2014-2023 varies from 38 in 2014 to 45 in 2021 and 46 in 2023. Compared to other countries these indicators are lower. If we compare Albania's fiscal autonomy for 2021 and 2023 with that of a group of countries presented above, we conclude the following:

Regarding FA (Fiscal Autonomy) the maximum for the OECD is 48, whereas the minimum is 33.4. The minimum is held by the Czech Republic, and the highest is by country Austria. Albania (for 2014-2021) would rank near at minimum Fiscal Autonomy Indicator if included in Table 5. However, Albania has a slight improvement for the years 2022 and 2023. Also, on **FI (Fiscal Importance)** minimum is 6.9, while the maximum is 63.2. The minimum is held by Greece, and the maximum by Denmark. If we included Albania in 2021 and 2023, it would rank at position in the end but before Greece. **FDI (Fiscal Decentralization Index)** varies from 18.31 to 50.3, with an average of 28.2. Albania has increased its score from 17.4 in 2014 to 21.2 in 2021 and 21.4 in 2023. In this indicator, Albania would rank at position of third place from the end, but before Hungary and Greece.

All these comparisons with other countries and the extremes show that Albania ranks among the lowest. This means that the central government shall transfer more powers to the local government in the future. If we compare the FDI with the evaluation groups by size, it falls into the group above 0 and below 50, which means that "when a country's situation is $0 < \text{FDI} < 50$, it can be described as having relative fiscal centralization." Therefore, in Albania, given the level of this decentralization index, it can be considered as having relative fiscal centralization, indicating more centralization than decentralization.

5. EMPIRICAL EVALUATION OF MODEL

Based on the literature review, data collection, and analysis, we tested the statistical significance of independent variables and the correlation of these variables with the dependent variable Fiscal Decentralization Index.

5.1 Data generation and hypothesis testing

The data used for hypothesis testing were accessed and generated by the Government's Financial Information System for 10 years 2014-2023, for some central and local fiscal indicators, among which we list: Total State Budget Revenue, Local Government Revenue, Property Tax, Local Tax, Simplified Small Business Profit Tax, Transfer (Grant), Total State Budget Expenditure, Local Budget Expenditure and GDP in million ALL.

The accessed data or indicators were used to calculate the indicators or variables as presented earlier in this paper, in order to measure the independent variables which, as the case may be, are RDI, PRI, VFI₄, VFI₅, which are included in this work. The data available were the fiscal data of the central and local government for the last 10 years. Even though the time interval of available data was much larger, the selection was random and the final selection was limited to 10 years, i.e. for the period 2014-2023.

The available data were analyzed using the SPSS program, from which we derived conclusions. The regression analysis was performed to test the hypotheses aiming to examine the extent to which the independent variables affect the Local Government Fiscal Decentralization Index. Each independent variable included in this study was tested for its significant impact, determining whether there is a statistically significant correlation and whether this impact on the dependent variable is positive or negative, thus confirming connections established in the literature. To address these questions, an empirical analysis was conducted with the outputs generated using SPSS.

The Index of Fiscal Decentralization of Local Government is the central focus of our study and therefore serves as the dependent variable in the model, i.e., the explained variable. The paper also includes additional variables that act as explanatory variables or, in other words, independent variables.

Data processing and analysis commence with the interpretation of internal consistency, or in other words, the internal consistency of the model. This aspect of the analysis is tested by the factor known as Cronbach's ALPHA. The result is shown in Table 6. The variables all show a good internal consistency,

as the value generated for each of the 4 independent variables presents a value greater than the critical value of Cronbach's ALPHA which is equal to .71.

Reliability Statistics

Cronbach's Alpha	Number of Items
.75	4

Table 6. Internal Consistency of the Model, Cronbach's ALPHA

The second step of the analysis involves testing the correlation between the variables included in the model. Table 7 shows the correlation among the independent variables. The table indicates that the correlations between positive variables or one negative variable as applicable, are weak. The sign of correlation (positive or negative) simply reflects the correlation that the variables have with each other; a positive correlation suggests that, as one of the factors increases or let us say improves, the other factor also increases or improves its indicator but not in total to the same extent. The improvement of one factor compared to the other is presented in percentages as can be seen in the table below. Conversely, a negative correlation means that as one of the factors increases or improves, the other factor decreases or worsens its indicator but not in total to the same extent. The improvement of one factor compared to the other is presented in percentage also in Table 7 below. All correlation values among the variables included in our model are below the critical Pearson Correlation value, at 0.7, indicating that there are no significant correlation issues affecting our model.

Correlations

		RDI	PRI	VFI₄	VFI₅
RDI	Pearson Correlation	1	.866**	-.549	.114
	Sig. (2-tailed)		.001	.100	.753
	N	10	10	10	10
PRI	Pearson Correlation	.866**	1	-.495	.179
	Sig. (2-tailed)	.001		.146	.622
	N	10	10	10	10
VFI₄	Pearson Correlation	-.549	-.495	1	.684*
	Sig. (2-tailed)	.100	.146		.029
	N	10	10	10	10
VFI₅	Pearson Correlation	.114	.179	.684*	1
	Sig. (2-tailed)	.753	.622	.029	
	N	10	10	10	10

*. Correlation is significant at the 0.05 level (2-tailed).

Table 7. Correlation between Variables

Following the correlation analysis, the validity testing of the model was performed. The necessary data to be available in this last second step before building the regression are presented in Table 8. The table shows that the value of the R² coefficient is .984 or when converted to a percentage, it is approximately 98.4%. This means that 98.4% of the variability of the model constructed in this study can be explained by the 4 selected variables included in this study. It should be noted that, based on the value produced by SPSS, the explanatory power of this model from these selected variables is significantly strong.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.984a	.969	.930	.46542

Predictors: (Constant), VFI₅, PRI, RDI, VFI₄

Table 8. Model summary

The final step of the empirical analysis involves assessing the multiple linear regression equation. This equation is assessed using the statistical software SPSS, and the results of this assessment are shown in Table 9.

Model	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	.750	.182		5.955	.000
RDI	.772	.431	1.206	4.725	.000
1 PRI	.836	.000	.836	1.478	.006
VFI ₄	-.221	.212	-.422	-2.802	.002
VFI ₅	-.612	.136	-.198	-1.915	.005

a. Dependent Variable: Fiscal Decentralization Index

Table 9. Output's Table

Model equation:

$$Y = \beta_0 + \beta_1 \text{RDI} + \beta_2 \text{PRI} + \beta_3 \text{VFI}_4 + \beta_4 \text{VFI}_5 + e$$

Coefficients (β):

- $\beta_0 = 0.750$
- $\beta_1 = 0.772$ (Coefficient for RDI)
- $\beta_2 = 0.836$ (Coefficient for PRI)
- $\beta_3 = -0.221$ (Coefficient for VFI₄)
- $\beta_4 = -0.612$ (Coefficient for VFI₅)

$$Y = 0.750 + 0.772 \text{RDI} + 0.836 \text{PRI} - 0.221 \text{VFI}_4 - 0.612 \text{VFI}_5$$

This model expresses how the Fiscal Decentralization Index of the Subnational Government (Y) is predicted by the Revenue Decentralization Indicator (RDI), Production Revenue Indicator (PRI), Transfers to Revenue Indicator (VFI₄), and Transfers to Expenditure Indicator (VFI₅), along with an error term (e). The coefficients (β) indicate the strength and direction of the relationship between each independent variable and the dependent variable Y.

5.2 Interpretation of Variables

From the regression analysis, it is found that if all the independent variables of the model are held constant, then $Y = 0.750$. This reasoning also applies to the interpretation of other variables as follows:

- If all other independent variables are held constant and $RDI = 1$, then $Y = 0.772 * RDI$. This means that if $RDI = 1$, then $Y = 0.772$.
- If all other independent variables are held constant and $PRI = 1$, then $Y = 0.836 * PRI$. This means that if $PRI = 1$, then $Y = 0.836$.
- If all other independent variables are held constant and $VFI_4 = 1$, then $Y = -0.221 * VFI_4$. This means that if $VFI_4 = 1$, then $Y = -0.221$.
- If all other independent variables are held constant and $VFI_5 = 1$, then $Y = -0.612 * VFI_5$. This means that if $VFI_5 = 1$, then $Y = -0.612$.

These interpretations provide insights into how each independent variable influences the dependent variable Y (Fiscal Decentralization Index of Subnational Government) when the other variables in the model are held constant at different values.

5.3 Testing of Research Questions (Hypotheses)

- **H1:** Looking at the significance (SIG) of the observed variables in relation to each other, we find that sig. $RDI = 0.000$, which is less than the 5% level of significance of the critical level. This shows that the hypothesis is correct. Question: “Does the Revenue Decentralization Indicator positively affect the increase of the Local Government Fiscal Decentralization Index?” is fully supported, so this hypothesis stands.
- **H2:** Looking at the significance (SIG) of the observed variables in relation to each other, we find that sig. $PRI = 0.006$, which is less than the 5% level of significance of the critical level. This shows that the hypothesis is correct. Question: “Does the Production Revenue Indicator positively affect the increase of the Local Government Fiscal Decentralization Index?” is fully supported, so this hypothesis stands.
- **H3:** Looking at the significance (SIG) of the observed variables in relation to each other, we find that sig. $VFI_4 = 0.002$, which is less than the 5% level of significance of the critical level. This shows that the hypothesis is correct. However, the resulting value before the unstandardized coefficient B5 is negative, which leads us to the conclusion that the hypothesis is true and the variable’s influence on our independent variable is verified, but the question: “Does the Variable of Transfers to Revenue positively affect the increase of the Local Government Fiscal Decentralization Index?” is only partially supported. This hypothesis really holds, but the correlation is negative, i.e., the increase in transfers to TR decreases the Local Fiscal Decentralization Index.
- **H4:** Looking at the significance (SIG) of the observed variables in relation to each other, we find that sig. $VFI_5 = 0.005$, which is less than the 5% level of significance of the critical level. This shows that the hypothesis is correct. However, the resulting value before the unstandardized coefficient B6 is negative, which leads us to the conclusion that the hypothesis is true and the variable’s influence on our independent variable is verified, but the question: “Does the variable of Transfers to Expenditures positively affect the increase of the Fiscal Decentralization Index of Local Government?” is only partially supported. This hypothesis really holds, but the correlation is negative, i.e., the increase in transfers to Expenditures decreases the Local Fiscal Decentralization Index.

All four research questions (hypotheses) in this paper are statistically significant. However, the impact they have on our dependent variable, the Local Government Fiscal Decentralization Index, is different:

- a) For the first two hypotheses, RDI and PRI, the results show a statistically significant positive relationship with the Fiscal Decentralization Index of the Local Government. This means that the Revenue Decentralization Indicator and the Production Revenue Indicator have a positive impact on increasing this index. This finding confirms their positive role in fiscal decentralization.
- b) For the last two variables, VFI₄ and VFI₅, the results show a statistically significant negative relationship with the Fiscal Decentralization Index of the Local Government. This means that Transfers to TR and Transfers to TC have a negative impact on increasing this index. This conclusion indicates that an increase in these variables leads to a decrease in the Fiscal Decentralization Index of the Local Government, which is contrary to the initial hypotheses.

Thus, the change in the direction of the impact of these variables presents an interesting and important finding for understanding the dynamics of fiscal decentralization in the context of Local Government.

6. CONCLUSIONS

The decentralization of power began earlier, dating back to the establishment of the Albanian state in 1912, and has gone through several phases. Albania started the fiscal decentralization process in 2001 by transferring a portion of taxes to local authorities. The most recent phase occurred after 2015, which also saw a reorganization of territories, reducing the number of municipalities and communes from 373 to just 61 municipalities. Fiscal decentralization has undergone continuous improvements, both in delegating certain taxes and in the right to modify them.

The analysis of decentralization indicators shows that Albania is among the last countries in Southeast Europe to transition from a centralized economy and has not yet fully integrated into the decentralization process. We can say that this process has many shortcomings, including the lack of consideration of business stakeholders' opinions. The decentralization indicators are so low that there is very little difference from a centralized system. This places Albania among the countries with the highest "Relative Fiscal Centralism".

The four research questions (hypotheses) raised in this paper regarding the relationship between the Fiscal Decentralization Index and (i) Revenue Decentralization Indicator, (ii) Production Revenue Indicator, (iii) Transfers to Revenue Variable, and (iv) Transfers to Expenditures Variable have been confirmed as a strong relation with a combination between positive and negative impact.

For the first two hypotheses, the positive relationship they have is confirmed. Therefore, both RDI and PRI variables have a positive impact on increasing the Local Government Fiscal Decentralization Index. For the last two variables, a negative relationship is confirmed with our dependent variable. Thus, both VFI₄ and VFI₅ variables have a negative impact on increasing the Local Government Fiscal Decentralization Index. In other words, their increase leads to a decrease in the Local Government Fiscal Decentralization Index. This is different from the assumptions made in the research questions or hypotheses at the beginning of the paper.

It is recommended that during discussions on local taxes and fiscal packages, interested businesses should be part of these discussions. If these businesses are not involved in discussion and decision-making, then tax increases may not lead to revenue growth, but rather to their decline. Additionally, fiscal autonomy should be increased to expand autonomy in collecting and administering local taxes and tariffs, while simultaneously increasing the number of local government taxes, aiming for their weight in local revenue and expenditures to dominate transfers from the state budget.

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