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Review article

LOCAL FINANCES IN WESTERN BALKAN COUNTRIES: FOCUS ON OWN -SOURCE REVENUES AND CAPITAL INVESTMENTS

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Abstract

This study examines the fiscal dynamics of local governments' finances in the Western Balkan countries, focusing on their own source revenues and capital investments, made from the municipalities. While spending for capital investment has increased in nominal terms, the share of municipal spending on capital investments has been downwardly unstable over the past 16 years. In addition to central government transfers, several significant factors contribute to the determination of municipal own-source revenues, including central and local public investment, current expenditures, and municipal development index. The study reveals that capital investment depends on its own source revenues or capital transfers from the central government, where local capital expenditure emerges as a robust determinant, exerting a stronger influence on municipal fiscal autonomy compared to central government investments. This finding underscores the importance of local capital expenditure in enhancing fiscal independence at the local level.
This research emphasizes the need for a comprehensive understanding of investment allocation, development indicators, and promoting local revenue mobilization. The findings suggest that enhancing local fiscal autonomy requires a shift in policy focus towards stimulating local capital expenditure and prioritizing human development. By identifying the factors that influence municipal own-source revenues, this study provides valuable insights for local management in strengthening the financial capacities of local governments in the Western Balkan countries.

Keywords: local finances, local owns-source revenues, local capital investment, local governance, local expenditure structure.
JEL: H71, H72, H77, E62, H54

1. Introduction

The Western Balkan Countries have experienced significant transitions in their socio-political landscapes, leading to profound changes in their economic structures and governance frameworks. As these nations strive for economic development and regional integration, there is an increasing need to examine the intricate dynamics of their local government finances. Understanding the fiscal management practices and exploring the role of local governments in driving sustainable development is crucial for ensuring effective governance and equitable socio-economic progress in the region.
The analysis of local government finances in the Western Balkan countries holds substantial significance in the context of fostering transparent and accountable governance, promoting regional stability, and ensuring sustainable development. By delving into the intricacies of revenue generation, expenditure patterns, and investment priorities at the local level, this study aims to contribute to the ongoing discourse on enhancing fiscal autonomy, improving public service delivery, and fostering inclusive growth within the Western Balkans. This research endeavors to comprehensively examine the fiscal dynamics of local government finances in the Western Balkan countries, with a specific focus on understanding the trends in own-source

revenues and capital investments made at the municipal level. The study seeks to offer valuable insights for policymakers, practitioners, and stakeholders involved in the governance and financial management of the Western Balkan countries.
Taking into consideration that local governments in Western Balkans have different responsibilities and due to that different revenue structure in this study we focus on the structure of own revenues, the public revenues as % from the GDP, and public revenues. Taking into consideration that the period of the analysis is 10 to 16 years we can see the growing source revenues of local government in this period due to higher fiscal decentralization and better delivery of public services on a local level, even the last 10 years the structure is same, from 26 % to 33%, were transferred from grants from central budgets is still high (47-60%) in the structure of own revenues. We make a comparison of the growth of capital investments made by the municipalities in Western Balkans countries and they depend on their own source revenues, or central transfers from central budgets, which are also very important on local development and better local infrastructure.
This paper is structured to provide a holistic understanding of the fiscal dynamics of local governments in the Western Balkan countries. The subsequent sections include a comprehensive literature review, an analysis of the trends in local government finances, a discussion of the implications of the findings, and policy recommendations for enhancing fiscal autonomy and promoting sustainable development. The paper concludes with a summary of key insights and recommendations for further research in the field of local government finances in the Western Balkans.

2. Literature review

A growing body of literature has focused on the complexities of local government finances in the Western Balkan countries. The literature on local government finances in the Western Balkan countries provides valuable insights into the challenges and opportunities associated with fiscal management, decentralization, and sustainable development in the region. Scholars have underscored the importance of strengthening the fiscal capacities of local governments to promote regional development and address socio-economic disparities. Moreover, have emphasized the need for comprehensive fiscal reforms to enhance transparency, accountability, and efficiency in local financial management practices. These studies collectively highlight the evolving nature of local government finances in the region and the imperative of aligning fiscal policies with sustainable development goals.
Decentralization and Local Financial Management in the Western Balkans: A Comparative Analysis by Dr. Elena Popović and Dr. Marko Petrović underscores the complex nature of decentralization processes and local financial management practices in the Western Balkans. Their comparative analysis highlights the need for comprehensive reforms to strengthen the fiscal capacities of local governments and promote equitable development across the region. Furthermore, Prof. Ana Kovač and Dr. Stefan Milošević, in their paper on Revenue Mobilization and Fiscal Autonomy of Local Governments in Southeastern Europe, emphasize the significance of revenue mobilization for enhancing the fiscal autonomy of local governments. Their study sheds light on the factors influencing revenue generation and fiscal independence at the local level, advocating for policy measures that foster sustainable financial management and regional prosperity.
The research conducted by Dr. Ivana Janković and Prof. Nikola Marković, focusing on Intergovernmental Transfers and Local Investments in Infrastructure: Evidence from the Western Balkans, emphasizes the critical role of intergovernmental transfers in supporting local government investments in infrastructure projects. Their findings underscore the importance of strategic utilization of fiscal transfers for promoting sustainable infrastructure development and

improving public service delivery within the region. Moreover, Dr. Jelena Stojanović and Prof. Aleksandar Petrović, in their study on Fiscal Reforms and Local Governance in the Western Balkans: Lessons from EU Integration Processes, highlight the need for comprehensive fiscal reforms to align the practices of local governance with the standards and requirements of the European Union integration processes. Their research emphasizes the role of fiscal policy alignment in fostering effective governance and sustainable development in the Western Balkan countries.
Additionally, Prof. Marija Đorđević and Dr. Stefan Jovanović, in their paper on Local Taxation Policies and Economic Development in the Western Balkans: A Case Study Approach, underline the significance of effective taxation policies in stimulating economic development and fostering sustainable growth in the region. Their study advocates for policy measures that promote a conducive business environment and equitable economic development across the Western Balkan countries.
Collectively, these studies contribute to a comprehensive understanding of the dynamics of local government finances in the Western Balkans, highlighting the challenges and opportunities for promoting sustainable development and equitable regional prosperity.

3. Methodology

The graphs presented in this paper were sourced from two primary sources: the Nalas Observatory and Eurostat. These organizations provide comprehensive data on various aspects of local government finances in the Western Balkans region. Specifically, the graphs depict key indicators such as local government revenues, expenditures, and capital investments over time. The selection of graphs was based on their relevance to the research objectives and their ability to provide insights into the fiscal dynamics of local governments in the Western Balkans. We focused on graphs that captured trends and patterns in local government finances, allowing for a comprehensive analysis of the topic. Each graph was carefully analyzed to identify significant trends, variations, and anomalies in local government finances. We compared the data presented in the graphs with relevant literature and international benchmarks to contextualize our findings. Subsequently, we provided detailed commentary and interpretation of the graphs, highlighting key observations and implications for local government finances in the Western Balkans.
While the graphs themselves were obtained from reputable sources, we ensured methodological rigor in their analysis and interpretation. We conducted thorough validation checks to verify the accuracy and reliability of the data presented in the graphs. Additionally, we applied sound analytical techniques to derive meaningful insights from the visual representations of local government finances.

4. Local governments revenues in Western Balkans Countries

Local government revenues in the Western Balkans, as in many other regions, are typically derived from various sources. These sources (Bartle, Kenneth, & Morozov, 2011) may include: 1) Own-Source Revenues such as local taxes and fees and charges and user fees; 2) Intergovernmental Transfers such as transfers from the central government; 3) Grants and aid; 4) Investment income: 5) Borrowing.
The fiscal autonomy of local governments in the Western Balkans can be influenced by various factors, including legal frameworks, decentralization policies, administrative capacity, and the economic context of each country. The specific revenue composition and sources can vary from one country to another within the region. Researchers and policymakers often analyze local government revenues to understand the fiscal capacity of municipalities, assess the

effectiveness of fiscal decentralization policies, and identify opportunities for improving local governance and financial sustainability.
One of the primary indicators illustrating the proportional scale of local government finance is presented in Figure 1, illustrating the revenues of both local governments and the overall public revenues. When we analyze the Western Balkans Countries, Albania, and Kosovo consistently maintain the smallest public sectors, with public revenues comprising 27-27,4% of the GDP. This indicates that the total public revenues generated by the government, including taxes and other sources, make up around 27% to 27.4% of the overall economic output in these countries. The relatively low percentage indicates a limited financial capacity of the government, potentially affecting the scale of public services and infrastructure projects. This may lead to challenges in addressing various societal needs. North Macedonia exhibits comparable public sector sizes of 32,3% of the GDP. This suggests that a significant portion of the country's economic activity is associated with government revenue. The indicator suggests a moderate level of government involvement in economic activities, indicating a reasonable capacity for public service provision and infrastructure development. In contrast, Serbia, Montenegro, and Bosnia and Herzegovina report public sector levels similar to the EU, between 41,2 – 44,3%. This indicates a relatively higher level of government involvement in economic activities and the provision of public services. This may suggest a greater capacity for investment in infrastructure and a potentially broader range of public services. In essence, the indicators highlighted in Figure 1 provide valuable insights into the financial landscapes of the Western Balkans Countries, laying the groundwork for discussions on the broader themes of fiscal dynamics, decentralization, and local governance presented in the paper.

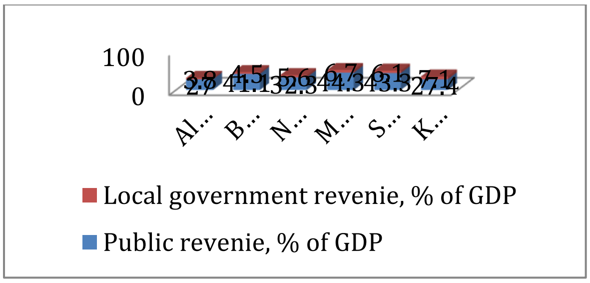

Figure 1 Public Revenue and Local Government Revenue in Western Balkan , 2021
Source: Nalas observatory

In Figure 1, the representation of the share of local government revenue and total public revenue as a percentage of the GDP reveals five main groups, although the boundaries between them are not sharply defined. The first group comprises economies with relatively small public sectors where local governments do not have substantial roles in the social sector, including Albania. The second group includes economies with comparatively small public sectors (public revenues to GDP below 35%) but significant decentralized responsibilities, particularly in education and healthcare; examples include Kosovo, and, to some extent, North Macedonia. The third group encompasses economies with larger public sectors where local government financing is closer to EU averages, such as Montenegro, where local governments play less significant roles in the social sector. The fourth group involves Serbia, characterized by large public sectors but with local governments having delimited responsibilities (Nalas Observatory).
Figure 2 illustrates the local governments' per capita revenues in Euro for the year 2021. The figure serves as a noteworthy indication of the limited financial resources available to most Western Balkans local governments, especially when compared to their European Union (EU) counterparts. On average, WB local governments have approximately seven times less Euro per capita at their disposal than their European peers. The striking observation is that local

governments in Kosovo and North Macedonia fund teachers' wages with per capita revenues of less than 316€. On average, local governments in the Western Balkans have approximately eleven times less Euro per capita compared to their European counterparts.

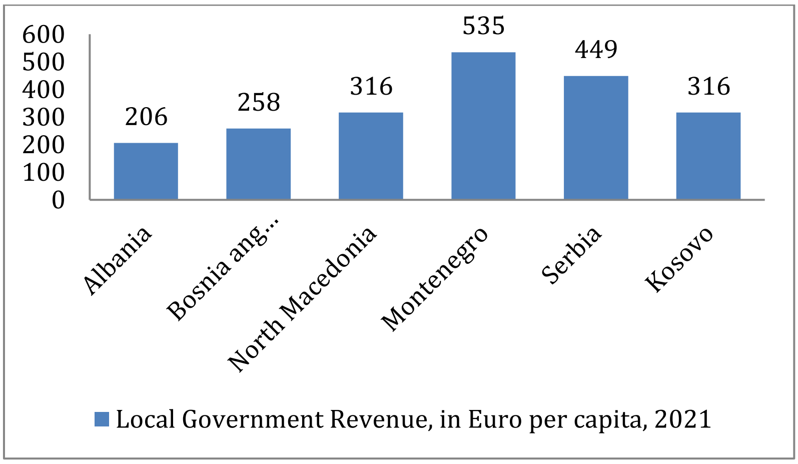

Figure 2 Local Government Revenue, in Euro per capita, 2021
Surce: Nalas observatory

Local government revenues as a percentage of Gross Domestic Product (GDP) is a key indicator that reflects the financial capacity and autonomy of local governments within a country. This metric provides insights into the share of resources that local authorities generate or receive relative to the overall economic output of the nation. Understanding the dynamics of local government revenues as a percentage of GDP is crucial for policymakers, researchers, and analysts as it sheds light on the fiscal health, sustainability, and contributions of local governments to the national economy.

In examining the fiscal landscape of Western Balkans Countries Figure 3 serves as a temporal lens, depicting the evolution of local government revenues as a percentage of GDP across pivotal years—2006, 2009, 2020, and 2021. This visual representation offers a comprehensive insight into the relative financial standing of local governments over the past decade. Notably, an intriguing pattern emerges: approximately half of Western Balkans Countries' economies have witnessed a substantial improvement in the share of local government (LG) revenues concerning GDP. This positive trend is evident in countries such as Kosovo, North Macedonia and Albania. However, a contrasting scenario unfolds in other instances, where local government revenues, relative to GDP, either remain stagnant since 2006 or 2009 (as observed in Serbia) or have experienced a decline (notably in Bosnia and Herzegovina and Montenegro). It is paramount to underscore that the share of LG revenues to GDP for the year 2020 is influenced by a significant economic downturn, contributing to an artificially higher appearance. In delving into these nuances, this analysis aims to unravel the intricate dynamics shaping the financial resilience of local governments in SEE.

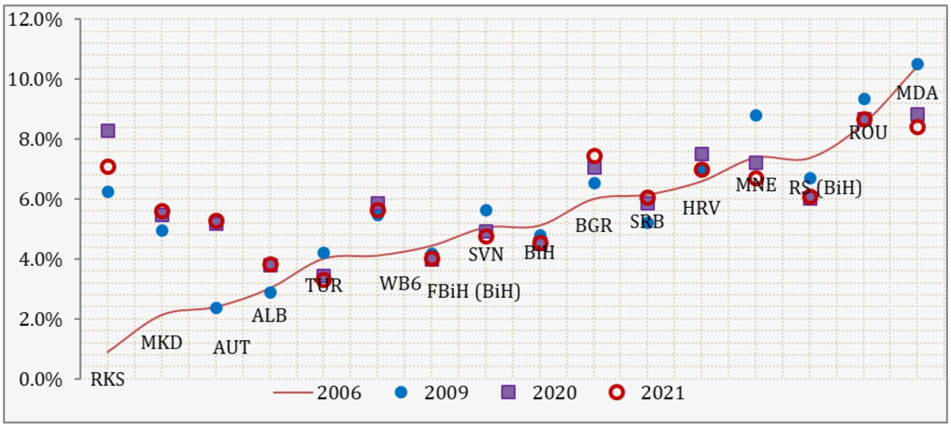

Figure 3 Local government revenue as a share of GDP in 2006, 2009, 2020 and 2021
Source: Eurostat

Maybe the key aspect of local fiscal autonomy, besides the total amount and shares of the local budgets in comparison to the GDP or public sector, is the composition of the revenue base. And the main characteristic of the composition is the level of local decision-making authority over its components i.e., the level of the local fiscal autonomy. Although the general revenue categories may appear clear terminologically, their meaning and composition vary substantially across the region, and, on several occasions, one general revenue component might consist of different revenue items. In the Western Balkans, this scenario is more pronounced – the share of own revenues has been shrinking while the share of sectoral earmarked block grants has increased its weight over time.

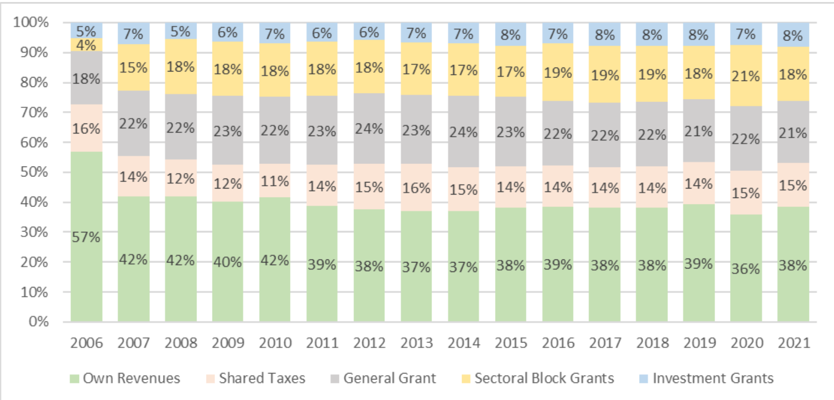

Figure 4 Evolution and Composition of LG finance in the Western Balkans, % of total
Source: Eurostat

The composition of municipal revenues is a key indicator for fiscal autonomy no matter what the size of the local public sector is. Its main components comprise local taxes, service fees, property management revenues, and other, smaller revenue categories such as fines and fees. The accounting and reporting of local revenues differ substantially across the region. For some of the countries, a detailed breakdown of own revenues is available whereas for some other countries, the data is reported only on two or three categories. Except for Kosovo, the share of own revenues to total local government revenues has declined by 3-12% in the Western Balkans Countries over the past decade and a half. Figure 5 shows the share of own revenue to total LG revenue in Western Balkans economies, for 2006, 2009, 2019, 2020, and 2021. On average, the share of own revenues in the WB6, in 2021 constitutes 38% of total local revenues down from 57% in 2006. Between 2006 and 2021, the share of own revenue to total revenue has increased only in Kosovo while in Bosnia and Herzegovina, it has remained the same, and in Serbia, it has increased by a more than 1%.

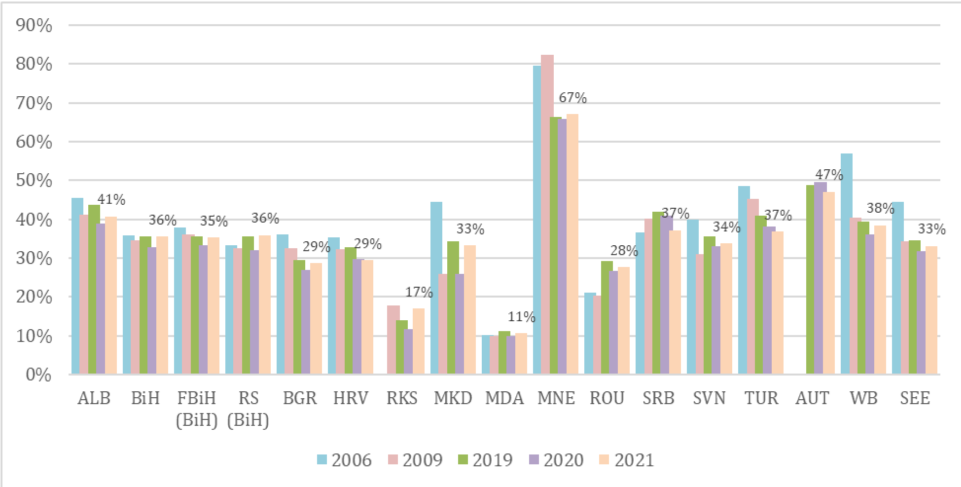

Figure 5 Share of own revenue to total local revenue, 2006, 2009, 2019, 2020 and 2021. Source: Eurostat

The decrease in the share of own revenue to total revenue is linked to both the elimination or reduction of local governments' tax powers on the one hand and the decentralization of additional social sector functions that are mostly financed by sectoral block grants, on the other. In Albania, the government eliminated almost entirely the local tax on small business turnovers/profits in 2016, and its yield in 2021 was 1% of its own revenues as opposed to 20% in 2012. Similarly, the share of revenues from municipal assets has been decreasing in Bosnia and Herzegovina, and Montenegro. On the other hand, local governments in Albania received new functional responsibilities as of 2016, including in particular the payment of wages for pedagogical staff in preschool education.

5. Local Government Capital Investments

Local government capital investments refer to the expenditures made by local authorities to acquire, upgrade, or maintain physical assets that contribute to the long-term development and improvement of a community's infrastructure and public services. These investments are distinct from day-to-day operational expenses and are typically directed toward projects that have a lasting impact on the locality.

The infrastructure requirements in Western Balkans Countries necessitate an augmentation of expenditure, implying that a higher proportion of municipalities' income should be allocated to capital infrastructure. Substantial enhancements to local public sector infrastructure are indispensable for elevating the quality and accessibility of services. This holds paramount significance in improving the quality of life and future prospects for citizens in the Western Balkans (WB), and concurrently, it addresses territorial development disparities within both the region and the European Union (EU).

Despite a nominal increase in spending for capital investment, the proportion of municipal spending allocated to such investments has shown a consistent decline over the past 16 years. This suggests that, in absolute terms, more funds have been earmarked for long-term projects such as infrastructure development. The share of municipal spending for capital investments in Western Balkans Countries has dwindled from 29% in 2006 to 25%, marking a downward trajectory. Despite the increase in nominal spending, the proportion of municipal budgets dedicated to capital investments has steadily decreased. In other words, the relative importance of capital investment within municipal budgets has diminished over time. Following the global financial and economic crisis of 2008-2009, this share continued to decline in the subsequent decade, reaching its lowest level at 22% in 2018. While the average impact of the COVID-19 crisis on the share of spending for investments appears limited, the performance of individual Western Balkans economies varies significantly, as depicted in Figure 7 below. The proportion of municipal spending for capital investments reflects the priority given to long-term projects that contribute to infrastructure development, economic growth, and community well-being. A decline in the share of spending on capital investments may signal challenges in fostering economic development and building resilience, as such investments are crucial for the sustainable growth of municipalities. Capital investments are often linked to the quality of public services and the overall standard of living in a region. A decreasing share may impact the ability to enhance and maintain essential services. The decline in the share of spending for capital investments may indicate limitations in the financial capacity of local governments to address long-term development needs, potentially impacting their ability to respond to evolving challenges.

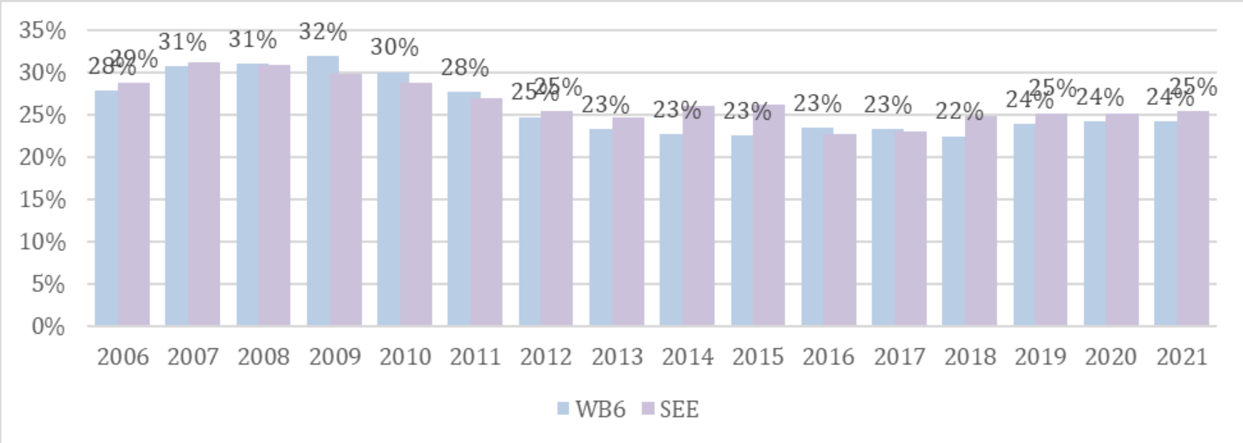

Figure 6 Evolution of the average share of Capital Investments in LG expenditures in SEE and WB6, 2006-2021, % of total
Source: Eurostat

The proportion of municipal expenditure allocated to capital investments exhibits substantial volatility in the Western Balkans (WB) and Southeastern Europe (SEE). Figure 8 illustrates the fluctuation in the share of municipal spending dedicated to capital investment relative to total municipal spending in SEE economies spanning the years 2006-2021. The share of spending on capital investments has undergone notable changes annually, particularly in the aftermath of the global financial crisis of 2008-2009, affecting all SEE and WB economies. Capital investment spending is characterized by greater volatility and adaptability. In several instances, local governments opt to decrease capital investment spending as necessary to reallocate funds to other categories, responding to external shocks such as the COVID-19 pandemic.
The proportion of spending on capital investments reflects the commitment of local governments to infrastructure development. This includes projects such as roads, bridges, utilities, and public facilities that contribute to the long-term development and well-being of the community. Capital investments are often linked to economic growth. Allocating funds to infrastructure projects stimulates economic activity, creates jobs, and enhances the overall economic health of the region. Capital investments contribute to the quality and accessibility of public services. Adequate spending in this area ensures that communities have well-maintained facilities, reliable utilities, and efficient public services. Infrastructure projects, funded through capital investments, have a direct impact on the well-being of the community. This includes

improved living conditions, enhanced mobility, and increased access to essential services. The balance between capital investments and other spending categories reflects the fiscal sustainability of local governments. Efficient allocation of resources ensures that municipalities can address both immediate needs and long-term development goals without compromising financial stability. The volatility and adaptability of capital investment spending indicate the ability of local governments to respond to unforeseen events or external shocks. This flexibility is crucial for managing crises, such as natural disasters or pandemics, without jeopardizing essential services.

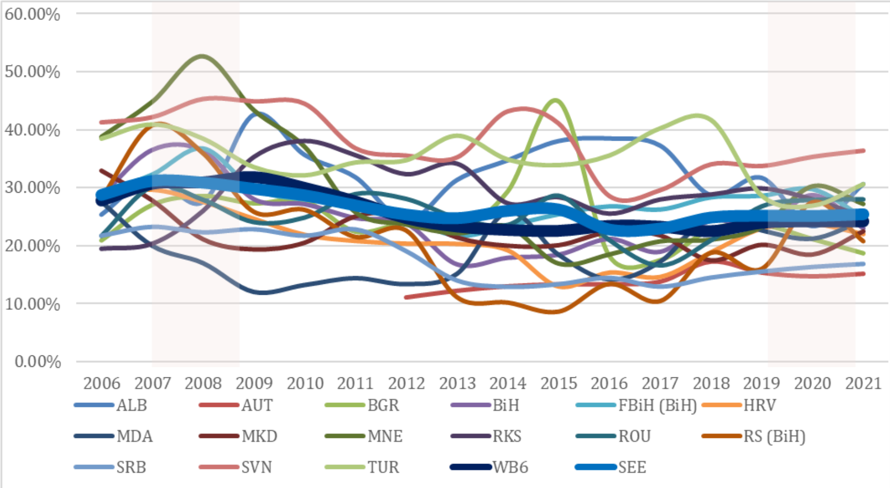

Figure 7 Evolution of the share of Capital Investments in LG expenditures in SEE and WB6, 2006-2021, % of total
Source: Eurostat

6. Recommendation

The findings of this study carry significant implications for policy development and implementation at both the local and national levels in the Western Balkan countries. The analysis underscores the importance of fostering transparent and accountable governance frameworks, strengthening institutional capacities, and promoting participatory decision-making processes in local financial management. Furthermore, the study's findings highlight the need for policy coherence and coordination between central and local authorities to ensure effective intergovernmental fiscal relations and sustainable development planning.
Based on the study's findings, several key recommendations are proposed to enhance the fiscal autonomy of local governments and promote effective investment allocation in the Western Balkan countries. These recommendations include the implementation of supportive fiscal decentralization reforms, the adoption of inclusive and transparent budgeting processes, the enhancement of revenue mobilization through efficient tax administration, and the strengthening of intergovernmental collaboration for equitable resource distribution. Moreover, the recommendations emphasize the importance of prioritizing strategic investment in human capital development, sustainable infrastructure projects, and local economic empowerment initiatives to foster long-term socio-economic growth and regional stability.
Building on the insights gained from this study, several avenues for future research in the field of local government finances in the Western Balkans are identified. These include exploring the dynamics of public-private partnerships in local infrastructure development, assessing the impacts of digitalization and technological advancements on local fiscal management, and investigating the role of community engagement and social inclusion in shaping effective public service delivery and governance outcomes. Additionally, further research is recommended to

evaluate the implications of EU integration processes and policy harmonization on local government finances and to assess the long-term sustainability of local development initiatives in the context of evolving global challenges and opportunities.

The composition of municipal revenues is a key indicator for fiscal autonomy no matter what the size of the local public sector is. Its main components comprise local taxes, service fees, property management revenues, and other, smaller revenue categories such as fines and fees. The accounting and reporting of local revenues differ substantially across the region. For some of the countries, a detailed breakdown of own revenues is available whereas for some other countries, the data is reported only on two or three categories.

Being EU members, LGs in these economies can benefit from substantial investment funding as opposed to the WB economies. In per capita terms LG spending for capital investment seems to be similar in Bulgaria and Montenegro, two economies where LGs have significantly different competencies.

7. Conclusion

This study provides a comprehensive analysis of the fiscal dynamics and financial management practices of local governments in the Western Balkan countries, offering valuable insights into the factors shaping local government revenues, capital investments, and fiscal autonomy within the region.

The study underscores the multifaceted nature of local government finances, highlighting the interplay between revenue generation, expenditure allocation, and regional development dynamics in the Western Balkans. Additionally, the research findings emphasize the critical role of effective fiscal governance, transparent financial management, and strategic investment planning in promoting sustainable development and fostering inclusive growth at the local level.

Throughout the study, the main arguments and implications underscore the importance of fostering fiscal decentralization, enhancing revenue mobilization, and strengthening intergovernmental fiscal relations to support the financial sustainability and autonomy of local governments in Western Balkan countries. The research highlights the need for policy coherence, institutional capacity-building, and participatory governance mechanisms to facilitate effective resource allocation, infrastructure development, and service delivery at the local level. Moreover, the study emphasizes the significance of aligning local financial management practices with sustainable development goals and promoting a conducive policy environment for fostering socio-economic progress and regional stability.

In conclusion, this study serves as a timely contribution to the discourse on local financial management and policy formulation in the Western Balkan countries. By providing a comprehensive analysis of the fiscal dynamics and investment priorities at the local level, the study offers valuable insights for policymakers, practitioners, and stakeholders to formulate evidence-based strategies that promote fiscal sustainability, equitable development, and effective governance. The findings of this research underscore the imperative of fostering inclusive and participatory approaches to local financial management and policy formulation, fostering a conducive environment for sustainable development and prosperity in the Western Balkans.

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