

THE FISCAL DECENTRALIZATION AND LOCAL ECONOMIC DEVELOPMENT, THE CASE OF MACEDONIA

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Rufi Osmani

South East European University, Republic of Macedonia
Contact e-mail: rufi.osmani@seeu.edu.mk

Abstract

The purpose of the paper is to analyze the process of fiscal decentralization and the local economic development (LED) in Macedonia. The progress of the process of fiscal decentralization, the elimination of the regional disparities and local economic development were the main political and institutional reforms in Macedonia after the internal conflict of 2001.

In the first level, the paper analyses the level of fiscal decentralization in Macedonia with countries of Western Balkans (WB) and the countries of EU. In the second level the paper analyses the level of fiscal decentralization and the level of disparities between municipalities and regions and the level of LED in Macedonia.

The findings of the author of this study are consistent with the findings of international and local researchers in this field. The actual level of fiscal decentralization and the ineffective implementation of the law on equal regional development have deepened the local and regional disparities and are the major obstacle for LED in municipalities in Macedonia.

The period of analysis includes (2006-2015), a period sufficient to make competent findings based on the real effects of the implementation of fiscal and regional reforms in Macedonia based on: the law on municipalities, the law on territorial division of municipalities, the law on municipal finance and the law on equal regional development.

The author of this paper shares the conviction that the main responsibility for the inadequate level of LED is consequence of low level of fiscal decentralization. In particular, the deepening of local and regional disparities as responsibility belongs to all Macedonian governments led by the ethnic and political Macedonian majority.

Keywords: the fiscal decentralization, the local economic development (LED), the regional development, the fiscal reforms, Macedonia, WB, UE,

JEL Classification: H1, H2, H3, H4, H72, H76, O1, R58

1. INTRODUCTION

The process of building a democratic political system and functioning of the market economy in the countries of the Western Balkans includes political institutional reforms, fiscal decentralization, active policies of regional development and local economic development taking into account specific political, economic and ethnic composition of the countries.

Political and fiscal decentralization partly realized goals but regional development and local economic development failed to build a functioning local democracy and sustainable fiscal, regional and local development of municipalities and regions, while the process is in the second decade of practical implementation (Osmani 2017).

Fiscal decentralization is an issue and a main concern for developing countries in Western Balkans from 1991s. For developing countries like countries of Western Balkans, fiscal decentralization is supposed to be an alternative of solution of many economic and political problems of the transition period in the local level. However, insufficient level of fiscal decentralization also produces new problems, which are causing additional burden on government efficiency in offering qualitative public goods in local level, improved accountability, transparency, and increased local economic development.

In accordance with the law on equal regional development of Macedonia (LRDM 2008) the equal regional development is the government policy that aims to achieve the balanced and sustainable development based on the model of polycentric development, reduction of disparities between and within municipalities and regions, improving the quality of life of all citizens and increasing the competitiveness of the regions by strengthening their innovation capacity, optimal use and valorization of the natural wealth, human capital and economic characteristics of different regions.

Local Economic development (LED) is the process by which public, business and nongovernmental sector partners work collectively to create better conditions for economic growth and employment of new generations. The aim is to improve the quality of life for all (World Bank Urban Development Unit 2003:4).

Local Economic Development (LED) is the process where the local actors shape and share the future of their territory. We could define it as participatory process that encourages and facilitates partnerships between local stakeholders, enabling the joint design and implementation of decent jobs and sustainable economic activities (Canzanelli 2001:9).

Research conducted by relevant international institutions such as the World Bank, the European Commission and the fiscal authorities of analyzed countries prove that Macedonia based on indicator GDP-per capita is under the average of WB countries for 27% and EU countries are higher than Macedonia for more than 5,5 times. While compared to the public expenditures Macedonia is under WB countries for 15% and reaches only 45% of EU countries.

New regional development policies in Macedonia have been supported with the legal obligation for allocation of 1% of GDP as additional financial funds (90-100 million Euros) for each fiscal year with the objective of reducing local and regional disparities. A decade after the implementation of the strategy for equal regional development in Macedonia we have diametrically opposite processes.

Local and regional disparities have deepened considerably by providing the absolute developmental advantage to the country's capital and discriminating in particular the regions with populations of non-majority ethnic communities.

The low level of fiscal decentralization, lack of capital investment and the increase of municipal debts associated with the deepening of regional disparities, the municipalities and regions in Macedonia largely failed to achieve the objectives set out in their strategy for local economic development in the analyzed period (2006-2015).

2. LITERATURE REVIEW

The fiscal decentralization and the local economic development are analyzed by specialized organizations and institutions such as World Bank, the IMF, USAID, and many other

international organizations and national institutions in countries of Western Balkans. In the context of the objectives of this paper the most relevant papers are the following researches:

- Jumandi, M. Pudjiharjo, G. Maski, M. Khusaini "The impact of fiscal decentralization on local economic development in East Java (2013),
 - UNDP" Country Report: An Assessment of Fiscal Decentralization Reform in Macedonia. In Fiscal Decentralization in Transition Economies: Case Studies from the Balkans and Caucasus (2004-2012) (2012),
 - Osmani, R. "The low level of fiscal decentralization and the huge regional disparities : The two main structural problems of Republic of Macedonia (2017),
 - Samistha P." Fiscal decentralization and development: How crucial is Local Politics? (2010),
 - Nalas "Fiscal Decentralization Indicators for South East Europe: 2006-2015 "(2016),
 - World Bank "WB, Sustainable Development Department (ECSSD) SEE-Municipal Finance Review, Local Government Finance in the Western Balkans" (2013),
 - Fondation "Fredrih Ebert "Regional Development in the Republic of Macedonia "(2003).
- The research aims to argue the low level of fiscal decentralization, the huge regional disparities and the insufficient level of local economic development in Macedonia compared with countries of Western Balkans and countries of EU.

3. RESEARCH METHODOLOGY

Through a comparative analysis of the level of fiscal decentralization, regional development and local economic development we intend to argue the main objective of the paper that in these processes of implementing crucial fiscal and development reforms, the government of Macedonia has achieved very poor results compared to the countries of WB and European Union. The research analyzes the different time periods depending on the public information and in a more detailed way; the 2006-2015 period is analyzed in comparative aspect with WB and the EU countries.

The analysis covers these WB countries: The Republic of Albania (AL), Bosnia and Herzegovina (BiH), and The Republic of Bulgaria (BG), The Republic of Macedonia (FYROM), The Republic of Kosovo (KS), Montenegro (MNE), Croatia, Serbia and the average of countries of UE (UE28). The analysis covers eight planning regions of the Republic of Macedonia: Vardar Region, Eastern Region, Southwest Region, Southeast Region, Pelagonia Region, Polog Region, Northeast Region and the Skopje Region.

We use a common statistical methods and descriptive empirical research to conduct a comparative analysis of the fiscal decentralization, regional development and local economic development process in Macedonia in comparison with Western Balkan countries and UE countries.

4. The level of economic and fiscal development in Western Balkans countries (2006-2015)

Despite the fact that Western Balkan countries have permanently implemented economic and political reforms from the 1990s to the present these countries continue to have very low levels of economic development compared to EU countries. Based on indicator GDP per capita in the analyzed period (2006-2015), WB countries recorded a cumulative increase of 37%. Despite this nominal increase these countries by the end of 2015 have reached only 21% of GDP per capita of the EU.

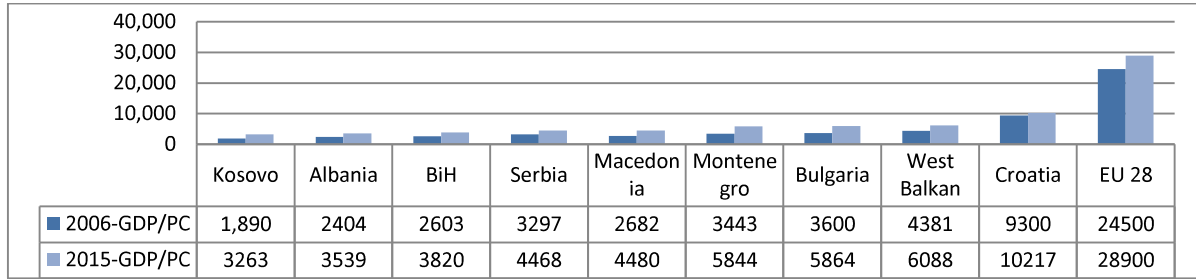


Chart 1: The economic indicator (GDP per capita) of countries of WB, EU (2006-2015) (Author's own calculation)

A more detailed analysis of the individual countries of the WB countries shows very asymmetric trends that are the result of many economic, political and other factors. Kosovo has the lowest level of this indicator with 3,263 euro per capita that represents only 11% of the EU average. Montenegro has achieved growth of 62% that compared with the EU average is only at the symbolic level of 20%.

The most positive trend of Montenegro is the result of success in the implementation of structural reforms in the political, economic and fiscal sphere and the fulfilment of the convergence criteria for membership in NATO and the EU. Positive convergence of this state has impacted positively in elimination of economic and political risks, increase of investment, reduce of unemployment and increase of the standard of living of population (Osmani 2017). Macedonia has increased GDP per capita for 60%, which ranks country to 74% of average of WB countries, while in relation to the EU average country is in the range of 15%. This low level of this basic economic indicator will also reflect the very low fiscal performance and investment of this country compared to other WB countries and the EU countries.

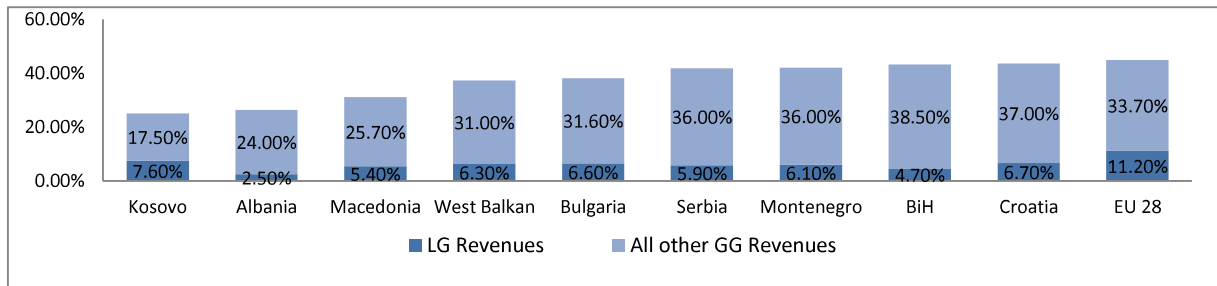


Chart 2. General and Local Government Revenue as a percentage of GDP in 2015 (Author's own calculation)

Chart 2. Argues that the low level of general and local revenues in relation to GDP and compared with the EU average is a consequence of low level of economic development of these countries compared with UE. It is worth mentioning that a country with poor economic performance between countries of WB (Kosovo) has the highest level of local finances as relative percentage (7,6%) despite the average of WB (6,3%), a level that is for 3,6% below the EU average. Albania has the lowest level of local finance (2.5 % of GDP), accompanied by BiH with 4.7% of GDP) and Macedonia with (5.4% of GDP). The data presented in Chart 3 reflect very asymmetric trends in composition of local revenue in countries of WB during the period (2006-2015).

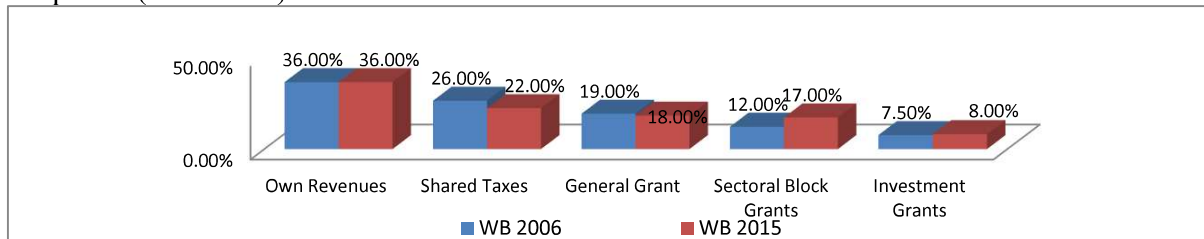


Chart 3. The trend and composition of Local Revenue WB countries (2006-2015) (Author's own calculation)

Own municipal revenues that are managed with full autonomy by municipal authorities have the same level of 36% from 2006-2015. Investment grants that are very important for municipal and regional development and in particular in terms of local economic development have marked a symbolic increase of 0.5% in the analyzed period (2006-2015). The increase of 5% of grants dedicated for salaries in the public sector of education and is entirely fixed expenditures that have no impact on local economic development.

Capital investment in the Education sector remains a central government competence as a consequence investment funds for the education sector are not the competence of the municipal authorities. The data presented in Table 1 present very asymmetric trends in different WB countries and reflect the deterioration in the structure of expenditures in local governments in Kosovo and Macedonia by increasing the participation of the expenses for the education sector in the case of Kosovo to 58% and in the case of Macedonia to 49 %.

Countries	Investments	Wages and Benefits	Goods and Services	Grants and Transfers	Other
Kosovo	28.30%	58.20%	9.00%	2.20%	2.30%
Albania	44.00%	29.00%	27.00%	0.00%	0.00%
BiH	11.00%	34.00%	22.00%	16.00%	18.00%
Macedonia	20.00%	49.00%	25.00%	5.00%	1.00%
Serbia	13.00%	21.00%	27.00%	26.00%	12.00%
Montenegro	17.00%	22.00%	9.00%	16.00%	36.00%
Bulgaria	36.00%	32.00%	23.00%	4.00%	4.00%
Croatia	17.00%	10.00%	26.00%	45.00%	2.00%
West Balkan	24.00%	32.00%	23.00%	12.00%	10.00%
EU 28	11.00%	33.00%	26.00%	6.00%	23.00%

Table 1: The trend and composition of Local Expenditure in Western Balkan countries (2015)
(Author's own calculation)

It should be pointed out that only in the case of Kosovo and Macedonia wages in primary and secondary education in public sector are part of municipal budget expenditures, while in other countries of the WB and the EU these expenditures are covered by the central government. In the structure of local expenditures in the investment component, Albania leads by 44% followed by Bulgaria by 36% and Kosovo by 28%. Macedonia has registered the level of 20% which is 4% lower than the WB average.

Chart 4. argues that the low level of Public Investment by Level of Government as % of GDP is the main reason why countries of West Balkans continue to be at the bottom compared with countries of EU. Despite the fact that Kosovo as the most underdeveloped country in WB has the highest level of investment at the local and central level in relative terms, a situation of this nature should be seen with reserve and is due to the low level of GDP in absolute terms and the lower level of public debt compared to the Maastricht criteria and compared to other WB countries.

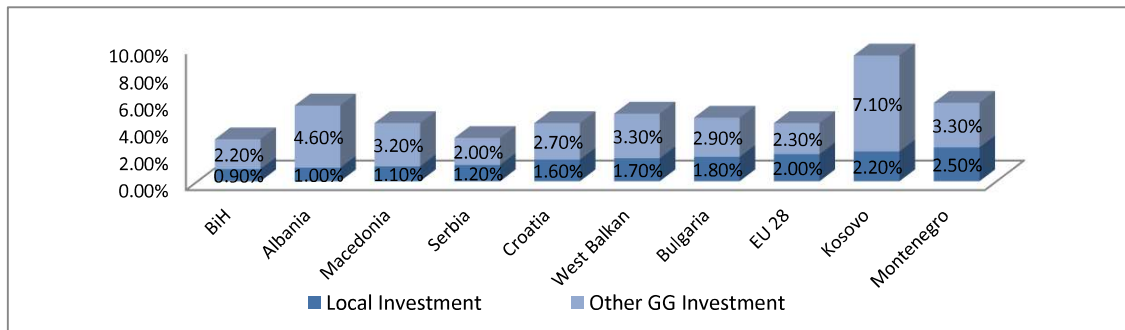


Chart 4. Total Public Investment by Level of Government as shares of GDP (average 2006-2015) (Author's own calculation)

The lowest levels of local public investments in the WB countries share Macedonia by 1.1%, Albania by 1.0% and B&H by 0.9%. This low level of public capital investment argues the failure of government policies to advance the process of decentralization, to reduce the huge regional disparities between urban and rural municipalities and presents the failure of policies for local economic development.

5. The process of Fiscal decentralization in Macedonia (2002-2016)

The internal ethnic conflict in Macedonia in 2001 produced the change of Macedonian Constitution and advanced the rights of minorities in particular the political rights of the Albanian community as the second largest community in the country.

Source of finance	Before 2002	After 2002
1. Local taxes	Local	Local
Property taxes	0,1%	01,%-0,2%
The tax of turnover of property	3%	2%-4%
The tax on property: First generation, Second generation, Third generation,	0%,3%,5%	0%, 2%3%, 4%5%
2.Local taxes		
Communal taxes	Local (fix tariffs)	Local with margins
Administrative taxes	Central	Local with margins
3.Tax income	Central	Marginally local
Tax on personal income(PIT)	-	(3% of 100%)
Tax on additional value (VAT)	-	(3% 4,5% of 100%)
4.Grants from the government of RM	No	Block grants for education, capital grants,
5.Debts	Central	Local
6.Other local income	Local	Local
7.Other income	Central	Local – Central

Table 2: Sources of local public finance before and after 2002 in Macedonia (Author's own calculation)

Table 2 presents a comparative analysis of the sources of funding for local authorities before and after 2002 and shows an additional growth of 3% of the tax on personal income and 3-4,5% of Vat meaning a nominal increase of only 12-15% in real public finance for municipalities in Macedonia (Osmani 2014).

Years	Own Revenues	Shared Taxes	General Grant	Sectoral Block Grants	Investment Grants
2006	44.00%	18.00%	11.00%	26.00%	1.00%
2007	40.00%	14.00%	8.00%	36.00%	2.00%
2008	29.00%	9.00%	5.00%	56.00%	1.00%
2009	26.00%	7.00%	6.00%	61.00%	0.00%
2010	31.00%	6.00%	5.00%	57.00%	1.00%
2011	35.00%	6.00%	5.00%	54.00%	1.00%
2012	35.00%	6.00%	5.00%	54.00%	1.00%
2013	34.00%	6.00%	5.00%	54.00%	1.00%
2014	31.00%	6.00%	6.00%	56.00%	1.00%
2015	33.00%	6.00%	6.00%	53.00%	2.00%

Table 3: Trends and composition of Local Government Revenues in R. Macedonia (2006-2015) (Author's own calculation)

Table 3 argues asymmetrical trends of different types of local revenues in the analyzed period (2006-2015). This asymmetric level is identified in one side with the decrease of 11% of own revenues, which has had a direct negative effect on investment and the increase of education sector wages for 27%, which are exclusively fixed expenditures.

Years	Property Tax	Communal Fees and Charges	Non tax revenue	Asset revenue (in million denars)	Self-financing	Other loans	Asset revenue
2006	6.00%	53.00%	9.00%	0.00%	28.00%	1.00%	3.00%
2007	8.00%	53.00%	7.00%	0.00%	25.00%	4.00%	3.00%
2008	9.00%	64.00%	4.00%	1.00%	17.00%	3.00%	2.00%
2009	11.00%	51.00%	4.00%	10.00%	16.00%	5.00%	3.00%
2010	10.00%	50.00%	4.00%	6.00%	12.00%	3.00%	15.00%
2011	10.00%	51.00%	5.00%	2.00%	10.00%	5.00%	17.00%
2012	8.00%	43.00%	5.00%	1.00%	9.00%	6.00%	28.00%
2013	10.00%	42.00%	9.00%	1.00%	9.00%	7.00%	22.00%
2014	13.00%	46.00%	4.00%	1.00%	10.00%	7.00%	19.00%
2015	12.00%	45.00%	3.00%	4.00%	9.00%	5.00%	22.00%

Table 4: Trend and composition of LGR by types of revenue in Macedonia (2006-2015) (Author's own calculation)

The revenue trend by type presented in Table 4 is similar to the previous table with the difference that the increase in property tax revenues is the result of the discovery of new taxpayers as individuals and companies based on the market value of their properties. Revenues from the sale of assets are additional revenues from 2012 by sale of construction land with a proportion of 80% for the municipal budget and 20% for the central budget.

Years	Investment	Wages Benefits	Goods and services	Grants and Transfers
2006	33.00%	16.00%	47.00%	3.00%
2007	28.00%	28.00%	41.00%	4.00%
2008	21.00%	48.00%	27.00%	4.00%
2009	19.00%	50.00%	27.00%	3.00%
2010	21.00%	50.00%	26.00%	3.00%
2011	25.00%	48.00%	24.00%	3.00%
2012	25.00%	46.00%	25.00%	4.00%
2013	21.00%	49.00%	25.00%	5.00%
2014	20.00%	50.00%	26.00%	4.00%
2015	20.00%	49.00%	25.00%	5.00%

Table 5: The trend and composition of Local Expenditure in Macedonia (2006&2015) (Author's own calculation)

As a result of the transfer of wage expenditures and the maintenance of school facilities within municipal budgets since 2008, we have very negative changes in the structure of municipal expenditures. This negative change in the expenditure structure presented in the table 5 is identified with these trends: reduction of investments by 40%, increase of wage costs by 206% and decrease of goods and services by 47%. The above trends argue the undeveloped structure of local expenditure as a result of structural problems of fiscal decentralization. While we have increased local public money in the analyzed period (2006-2015), these funds are mainly used to cover fixed expenditures and have no positive effect on investment and local economic development.

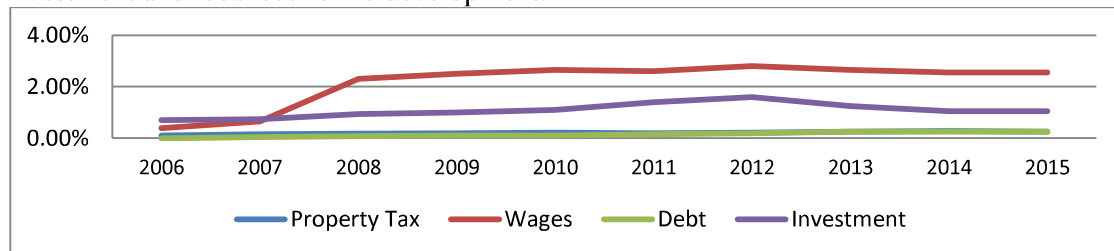


Chart 5. Investment, Wages, Debt & Property Tax as Shares of GDP in Macedonia (2006-2015) (Author's own calculation)

Graph No.5 presents very asymmetrical trends and argues the failure of the fiscal decentralization process in Macedonia in the analyzed period. Fiscal property tax revenues in relation to GDP have increased by 40%, capital investments have increased by 30% and the

level of municipal debt has increased by 20%, while wage expenditures have increased over 550%.

6. The local economic development in Macedonia for period (2006-2015)

Some research on decentralization in many transition countries like countries of Western Balkans shows that insufficient level of decentralization has not been able to bring in a better economic condition, even the view that decentralization appears only a matter of inter-governmental relations without positive effect for local economic development. It has also been revealed by the World Bank (1997) that decentralization may also have a negative impact on local and regional economic development. This could happen if the local government is not able to capture what the needs of local people and local characteristics of each region or each municipality. A phenomenon of this nature is confirmed in the case of Macedonia, where after 15 years there is an increase in disparities between urban and rural municipalities and further deepening regional disparities (Osmani 2014).

Local Economic Development (LED) is developed by and for local people. A good LED process is participatory and inclusive – public, private, civil society, and marginalized groups work together to develop locally based solutions. Local Leadership – Development strategies are developed at the local level (e.g., district, etc.), city or region itself, not imposed from higher levels of government or donors. LED is values-based – the values of local people (i.e. what is important to them) drive the process and the solutions (UN-Habitat 2013).

Developing an LED Strategy based on World Bank requires that a municipality does an analysis of the existing situation, look at opportunities for growth and decide on the best strategies to achieve their goals. The following are some key strategies that a municipality can put in place to meet its goals:

- Developing the infrastructure of the municipality to make it easier for businesses to operate (i.e. houses, transport, roads, water and electricity etc). This is mainly addressed in the IDP of the municipality. It contributes to providing better living conditions it also creates an environment that promotes economic growth.
- Promoting tourism, which currently is one of the biggest growth industries in South Africa. This includes developing local tourist sites and facilities, improving security and ensuring that all residents are welcoming of tourists.
- The municipalities tender and procurement policies must favour small contractors and emerging businesses. Where these companies cannot provide the required services, steps must be taken to get larger companies to enter into joint ventures with smaller partners.
- Marketing the municipality, its infrastructure and people to local and international businesses. This can be combined with service centers that provide assistance and information to businesses that wants to start operations in the municipality.

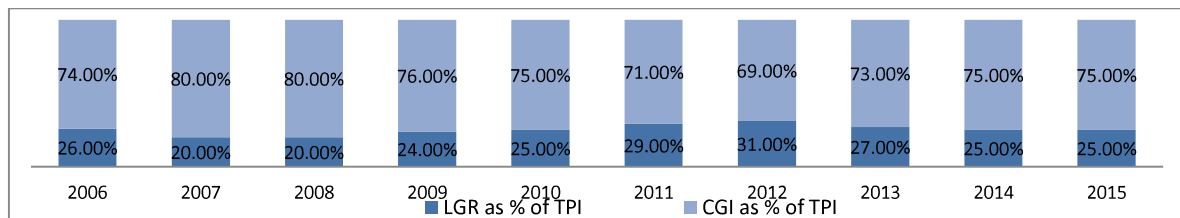


Chart 6. Public Investment by Level of Government as a share of GDP in Macedonia 2006-2015

(Author's own calculation)

Graph No.6 argues that public capital investments maintain in the same proportion in favour of the central government by discriminating local government in Macedonia. The fact that in the end of 2015 we have the same situation with that of 2006 and over 75% of the capital

investments are managed by the central government and only 25% are managed by all municipalities in Macedonia shows the lack of political will of central authorities to decentralize public investment funds as the main precondition for equal regional development and LED within municipalities.

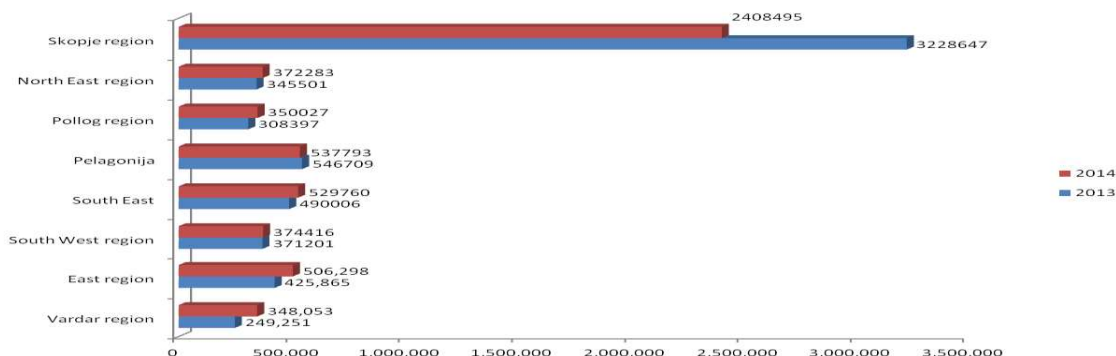


Chart 7. Capital Expenditure Policy by regions in Macedonia (2013-2014) (Author's own calculation)

In order to advance the process of decentralization and reduction of regional disparities during 2007 in Macedonia a Law on equal regional development was adopted. Adoption of the law took into consideration the main findings and recommendations published in the publication of Friedrich Ebert "Regional development in Macedonia".

According to the law on equal regional development in Macedonia 8 planning regions were constituted: Vardar Region, Eastern Region, Southwest Region, Southeast Region, Pelagonia Region, Polog Region, North-eastern Region and the Skopje Region (LERD 2007). Establishment of eight planning regions is based on combination of the territorial division of municipalities under the Constitution of Macedonia of 1974 (34 municipalities) and the territorial division of 2007 (87 municipalities) (Osmani 2017).

Graph 7 argues the deep discrimination between the regions in the management of capital investment policies for the period (2013, 2014). In the Skopje region (the capital of Macedonia) were invested 55% of the public capital funds while in the other seven regions were invested only 45% of the public capital funds. Polog Region is the most discriminated region with only 5.5% of the capital investments despite the fact that 16% of the population lives in this region and has the highest level of unemployment of 30% at the country level.

7. CONCLUSION AND RECOMMENDATIONS

- The fiscal decentralization process in the Western Balkans countries has recognized serious failures in the realization of financial and fiscal sustainability of the local governments of the WB countries in relation to the fiscal sustainability of local authorities of EU countries.
- The process of decentralization in Macedonia partly realized goals to build a functioning local democracy, sustainable financial and fiscal level of municipalities, equal development of regions and local economic development.
- Partial effects of political and fiscal decentralization in Macedonia's case imposed the need for establishment of 8 planning regions, the adoption of a balanced strategy for regional development and local economic development,
- Results from these fiscal and development reforms and the support of municipalities for businesses are symbolic and the majority of municipalities failed with their policy of local economic development.

- The papers argue that the situation in 2015 is the same as one decade ago (2006) , up to 75% of the public capital investments (PCI) are managed by the central government, less than 25% of PCI are managed by all municipalities in Macedonia.
- The low level of public capital investment on the local level argues the failure of government policies to advance the process of decentralization, to reduce the huge regional disparities between urban and rural municipalities and to advance the local economic development.
- Fiscal volatility at underdeveloped municipalities and in particular at rural municipalities imposes the need to increase delegated revenues (VAT and personal income tax) by 3%-4,5%, as is currently to 10-15%%, which would provide a normal level of fiscal autonomy not influenced by the central government (Osmani 2017).
- Research recommends that public investment funds of 1% of GDP (90-100 million euros) based on LERD in conformity with mechanism of balancing between municipalities to be directly transferred to underdeveloped municipalities based on indicator “the average level of capital investment per capita in Macedonia” (Osmani 2017).

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