Chapter 15
Public Choice and Financing Local Government Fiscal Reform in Albania

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ABSTRACT

The Albanian government has been decentralizing decision making. Central to decentralization is a system of intergovernmental revenue transfers, especially unconditional transfers. This study examines in what ways market conditions and policy options affect the central government and local government relationship. It analyzes unconditional intergovernmental revenue transfers between the central government and local governments to better understand Albanian fiscal decentralization. While the unconditional intergovernmental transfers during the time of this study were found to be stable, the fragmentation of local government units and the evolving role of the regions, could complicate decentralization. The lack of a clear path to local government debt and borrowing, coupled with the system of intergovernmental transfers, has resulted in few viable policy options for balancing local government budgets. A more diversified local revenue structure, coupled with the ability to borrow on the open market, could allow larger and better growth-enhancing public investments without additional budgetary pressures.

INTRODUCTION

Albania became an independent country after the dissolution of the Ottoman Empire, but was occupied by Italy in 1939 followed by Germany's occupation during World War II. The Republic of Albania was established as a centralized state, with a unitary parliamentary republic established in 1991 after 46 years of Communist control. Although little authority was given to Albanian local governments during the Communist rule, the local governments shouldered high levels of fiscal and social responsibility. Albania has a population of 2.8 million and about 50% live in urban areas (INSTAT, 2011). Approximately 20% of the population is below 15 years old, about 70% is between 15-64 years old, and 10% of the population is 65 years old and above.

Table 1 displays the population of each Albanian county, the population density and the geographic size of the county in order to provide context for understanding the challenges in local fiscal autonomy.

Albania is in transition from a centrally planned economy to a market economy. The transition is largely successful, but there have been periodic shocks to the Albanian economy. For example, there was a national pyramid scheme in 1997. The pyramid scheme, while not supported by the government, was heavily promoted on state television. This gave the impression that the central government endorsed the funds which were involved in the pyramid scheme (NY Times, 1/97). As a result, thousands of Albanians sold homes and livestock to invest in the scheme funds. The personal and subsequent governmental financial liabilities resulting from that illegal activity amounted to almost 50% of the Albania's GDP. The decline of GDP at that time demonstrated the importance of institutional and financial sector reform (Jarvis, 1999; Mussari & Cepiku, 2007). Although recent macroeconomic growth in terms of GDP has been more favorable, the challenge remains for Albania to consistently achieve economic stability and growth.

During the early years of Albania's transition to a market economy, the focus was mainly on reforms at the central government institutional level in order to build democratic institutions and, at the central government economic level, to build basic economic reforms. However, beginning with the laws passed in 2000 and more recent laws on local governance, the focus is on the relationship between the central government and the local governments as evidenced by devolving more fiscal responsibility to local governments. The new laws established the central government's economic approach as one of devolving responsibility for public services to the lowest governmental level. That strategy included reforms in financing of local governments by the Albanian national government. Since the passage of various laws, the government of the Republic of Albania also has been working toward decentralizing local government decision-making, including fiscal decision making. A major part of that decentralization includes intergovernmental revenue transfers.

Table 1. Population by region

Counties/Regions	Population	Area (km2)	Density/km2
Berat	145.178	1.798	81
Diber	138.45	2.586	54
Durres	275.471	766	360
Elbasan	303.12	12.3	199.95
Fier	318.102	12.3	199.95
Girokaster	73.627	2.884	26
Korce	226.282	3.711	61
Kukes	86.555	2.374	36
Lezhe	138.349	1.62	85
Shkoder	221.459	3.562	62
Tirana	789.129	1.652	478
Vlore	183.002	2.706	68
Totals	**2.898.782**	**28.749**	**101**

Thousands
Source: (INSTAT Albania 2013 in Marku, 2015)

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