

STUDY

November, 2024

EVALUATION

OF THE TERRITORIAL AND
ADMINISTRATIVE REFORM
(TAR) OF LOCAL GOVERNMENT
IN ALBANIA



IMPRINT

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This study aims to cover a comprehensive analysis of the financial impact of the territorial administrative reform, from background information to detailed economic and fiscal assessments.

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The opinions, conclusions, and recommendations expressed in this publication do not necessarily reflect those of the "Friedrich Ebert" Foundation.

LIST OF ABBREVIATIONS

ASLSG	Agency for the Support of Local Self-Government
CSO	Civil Society Organizations
EU	European Union
GDP	Gross Domestic Product
LGU	Local Government Unit
SDC	Swiss Agency for Development and Cooperation
TAR	Territorial Administrative Reform
UNDP	United Nations Development Programme

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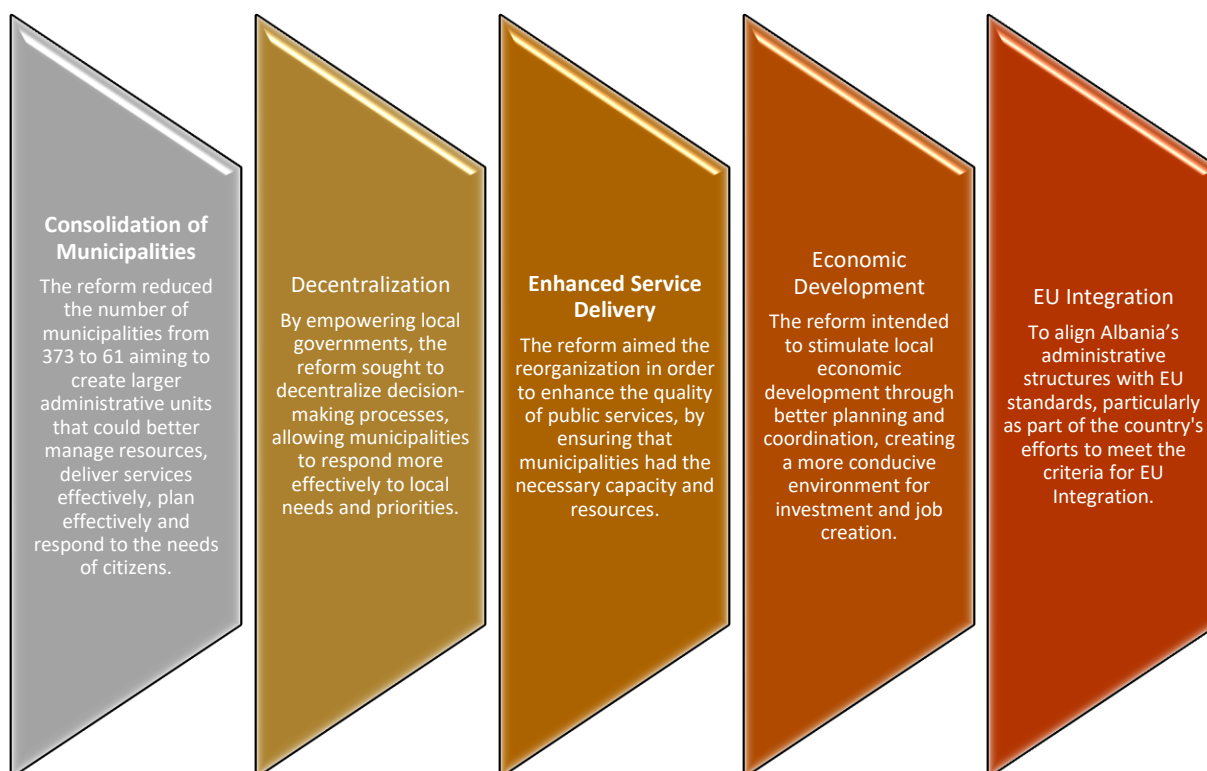
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1. INTRODUCTION

1.1 Overview of Territorial Administrative Reform in Albania

The **Territorial Administrative Reform (TAR)** in Albania, initiated in 2014, represents one of the most important efforts regarding the decentralization. It aimed to address the challenges of an inefficient, fragmented local government structure, which was characterized by a large number of small municipalities and administrative units that struggled with poor service delivery, limited financial capacity and lack of strategic planning. The main goal of the Territorial Administrative Reform was to create a more efficient, sustainable and responsive system of local governance that would enhance public services and strengthen democratic institutions at the local level. The new territorial organization aimed to increase public investment and provide greater opportunities for sustainable economic development.

The objectives of the reform were:



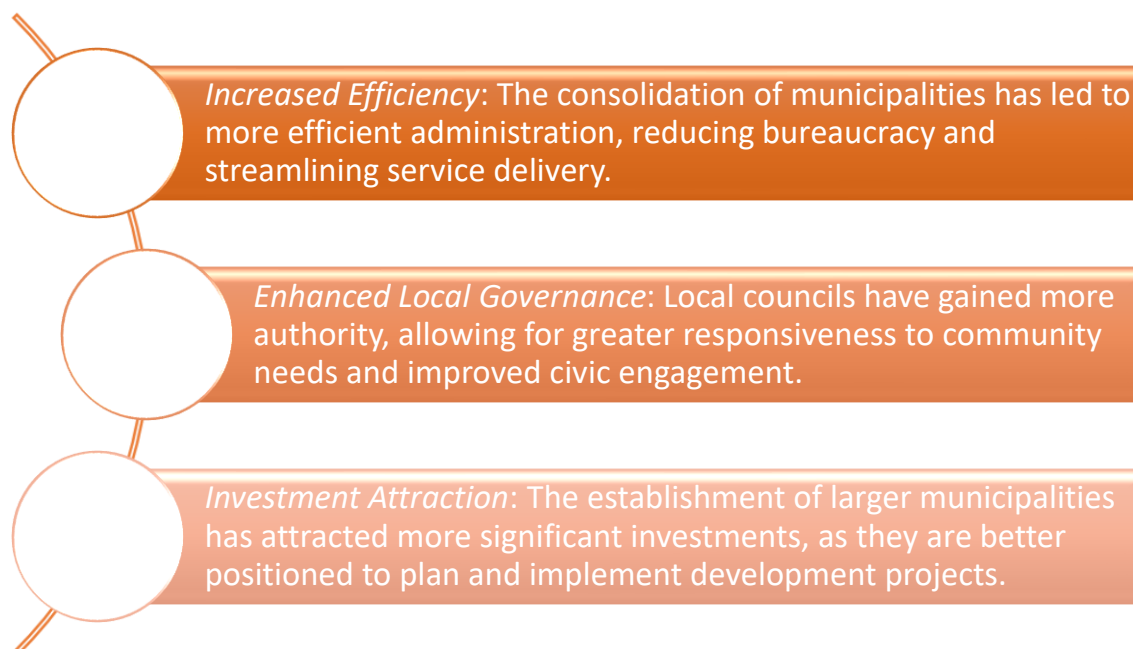
The reform was implemented in several stages, with comprehensive consultations involving local governments, civil society organizations and international experts. In this regard, one of the most important authorities in this process was the Ministry of Interior, which played a central role in driving the reform, supported from the EU and other

international donors. The process included legal amendments, structural changes and capacity-building initiatives in order to ensure that local authorities could manage their new responsibilities effectively. On the other side, the implementation of the reform faced different challenges from cultural to economic ones.



After the implementation of the reform, the Albanian government was mainly focused on addressing emerging challenges and improving the capacity of local governments to handle their expanded roles. In this regard the key priorities were financial sustainability, the effectiveness of decentralization and ensuring that rural areas benefit from improved local governance.

The Outcomes and Impact of the reform consisted in:



According to Agency for the Support of Local Self-Government (2024), the main results of the reform consist in:

- Local budget expenditures as a percentage of GDP have increased from 2.4% in 2015 to 3.2% in 2023.

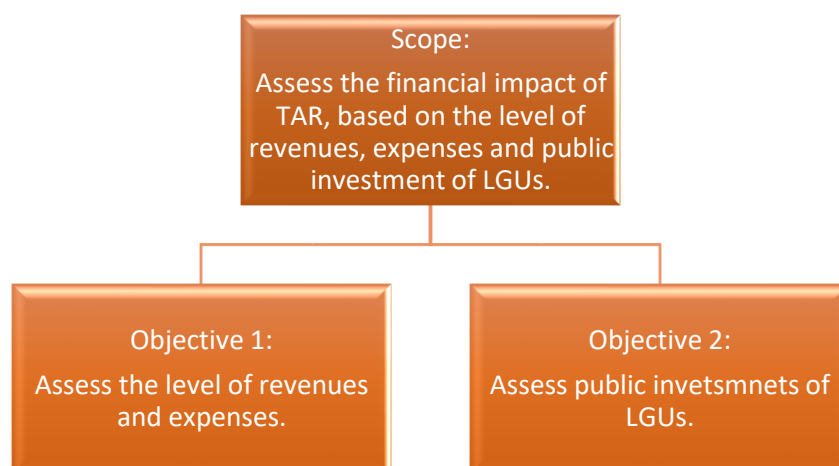
- The contribution to local income has increased from 0.82% of GDP in 2015 to 1.37% in 2023.
- Own revenues: the revenues of the municipalities for 2023 reached 35 billion ALL, which are increased by 166% compared to 2015.
- Wealth tax: increased by 60%, from 3.9 billion ALL in 2015 to 6.18 billion ALL in 2023.
- Government transfers: Unconditional transfers are increase by +40% during the same period.
- Arrears: municipalities have managed to reduce the value from 12 billion ALL in 2015 to around 5 billion ALL in 2023.
- Investments per capita for the period 2015-2023 have increased by 78%, respectively from 3,773 ALL in 2015, to 6,724 ALL in 2023. During 2023, the local government spent 16.56 billion ALL for investments.

1.2 Objectives and Scope of the Study

Territorial and Administrative Reform marked a critical juncture in the country's efforts to modernize its governance structures. Based on the fact that is was directly related to the quality of governance, TAR aimed to improve local governance, enhance service delivery and optimize administrative efficiency. Prior to the reform, Albania was divided into numerous small municipalities that often struggled with limited resources and capacity. In this regard, the reform laid a foundation for more effective local administration, promoting sustainable development and improving the quality of life for citizens. TAR has also addressed a number of other issues such as ***the process of administrative and fiscal decentralization, which need to be analyzed on an ongoing basis.***

In 2022, it was proposed by the Democratic Party of Albania (which represented the opposite) to increase the number of municipalities, where 33 new municipalities would be created by the merge of about 100 administrative units. This reorganization would serve the democratization, transparency and accountability of the local government. Otherwise, the approach of Socialist Party of Albania was focused on reducing the number of municipalities in order to raise their capacities, as well as to be an active actor in the economic development of the country.

In this regard, it is of great importance to assess the financial impact of TAR, based on the level of revenues, expenses and public investment of LGUs. This assessment will serve as a monitoring tool related to the progress of the territorial reform implementation, by analyzing if the expected benefits territorial and administrative reform are achieved, as well as identify any aspect that can be adjusted over time. The assessment will provide findings and recommendations regarding the approach of a new Territorial Administrative Reform, with particular attention to issues that still need to be addressed.



1.3 Methodology and Data Sources

The purpose of the methodology was to assess the efficiency of the implementation of the territorial administrative reform. This evaluation would contribute by assessing changes in municipal efficiency resulting from a structural reform that reduced the number of administrative and local units.

The methodology consists of collecting data from secondary sources, that will serve as a base to examine whether the formed LGUs have benefited financially and earned sufficient budget revenue for efficient self-governance. As a result, is drafted the report that will include findings and recommendations.

2. BACKGROUND OF TERRITORIAL ADMINISTRATIVE REFORM

2.1 Historical Context and Rationale for Reform

The **Territorial Administrative Reform** in Albania was the results of decades of changes in thr political, social and economic aspect. In order to understand the reform's historical context, it is essential to consider Albania's evolution from a centralized communist regime to a democratic, market-oriented society and its efforts to decentralize governance.

- Communist Era and Centralization (1946 - 1991)

Under the communist regime (1946-1991), Albania was one of the most centralized and autarkic countries in Europe, where the state controlled all aspects of life. Taking this in consideration, the local governments had little autonomy, as the decision-making was highly centralized in the hands of the Communist Party. During this period, Albania was divided into large districts (prefectures), which were subdivided into smaller units, which had little power or capacity to serve local populations. In this regard, the concept of decentralization was absent, as the central government had full control over local policy-making and resource distribution.

- Post – Communist Transition (1991 -2000)

In 1991, ffter the collapse of the communist regime, Albania entered a period of political and economic transition toward democracy, where decentralization began to emerge as a key issue. In the early 1990s, the newly established democratic government recognized the need to reform local governance structures in order to have a more responsive, accountable system. The **(1991) Law on Local Self-Government** marked the beginning of decentralization efforts, transferring certain powers to local governments. However, local administrative units remained small and fragmented, facing various difficulties.

By the late 1990s, Albania's system was not functioning as intended, because local governments were financially weak and unable to address the country's regional development challenges. Taking in consideration the difficulties they were facing, such

as the lack of capacity, inefficient use of resources and weak institutional frameworks for local governance emphasized the need for a deeper reform.

- EU Integration and Reform Momentum (2000 – 2010)

EU accession requires alignment with European standards of governance, particularly in terms of decentralization and local democracy. In this regard, Albania needed to adopt reforms that would strengthen local governance, increase public participation and improve service delivery at the local level.

The **(2008) Law on Local Self-Government** was enacted, which sought to strengthen local government autonomy and decentralize more functions to municipalities and communes. However, despite these legal changes, local governments remained underfunded and fragmented. As a result, they were unable to provide services according to the needs of citizens.

- The 2011 – 2014 Reform

In 2011 was marked an important moment in the Albanian history, as it was granted **EU candidate status**. In order to align with EU requirements, it became clear that territorial administrative reforms were essential for improving public service delivery, reducing regional disparities and creating more effective local governance structures.

Also, the growing public dissatisfaction with the inefficiency of the local government system, especially in rural areas pushed the government's decision for a radical reform. Local governments were considered too small, fragmented, and financially weak to effectively manage resources or implement long-term development strategies. Additionally, municipalities and communes struggled to meet the needs of their citizens.

- The reform of 2014

The need for a reform was recognized by both domestic stakeholders and international partners, including the European Union, which considered it a key step toward modernizing the governance structures, reducing corruption, fostering regional development and aligning with EU standards on local governance.

The Albanian government, with the support of international partners and experts, launched the **Territorial Administrative Reform (TAR)** in 2014. Before the reform, Albania was fragmented in 373 municipalities and communes, that made local governments financially weak, with limited ability to provide adequate public services or attract investments. In addition, there were inefficiencies in the allocation and management of public resources, particularly in rural and remote areas. The reform aimed to address the inefficiencies of the administrative structure by reducing the number of municipalities and communes from 373 to 61, in order to create stronger, more capable local governments that could better manage resources, deliver services and promote local development. The reform also included fiscal decentralization measures to increase the

financial autonomy of local governments, thereby enabling them to have more control over their budgets and improve public service delivery.

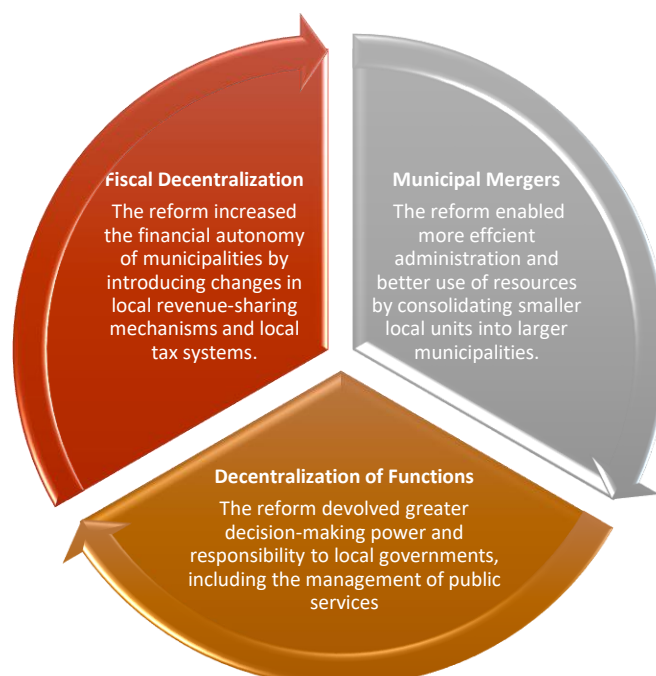
In this regard, the adoption of Law No. 139/2015 "On Local Self-Government", paved the way for the process of decentralization of functions:

1. Administration and management of forests and pastures
2. Administration and management of drainage and irrigation canals
3. Administration and management of preschool education
4. Administration and management of rural roads
5. Administration and management of fire protection and rescue.

2.2 Key Changes Introduced by the Reform

The **Territorial Administrative Reform** reduced the number of local government units by merging smaller municipalities and communes into larger administrative units. As a result, Albania's number of municipalities was reduced from 373 to 61, with 12 counties remaining as administrative and regional units. The reform aimed to foster more effective governance by enabling local authorities to pool resources, share expertise and provide better services to citizens.

Key aspects of the reform included:



2.3 Stakeholders Involved in the Reform Process

The Territorial Administrative Reform in Albania was a complex process that involved different stakeholders, each playing a crucial role during its shaping, implementing and supporting. The stakeholders can be broadly categorized into domestic actors (government institutions, local authorities, and civil society) and international actors (foreign governments, international organizations, and donors). Below is an overview of the key stakeholders involved in the process:

Albanian Government

- Prime Minister and Government Officials set the reform's agenda, mobilized political support and ensured alignment with national development and EU integration goals. The key Ministries involved in the process were:
 - **Ministry of Interior** as the key authority responsible for managing the reform process. Its contribution consisted in coordinating the planning, legal drafting, and implementation of the reform.
 - **Ministry of Finance** was responsible for addressing the fiscal decentralization aspects of the reform and ensuring that financial mechanisms were in place in order to support local governments post-reform.
 - **Ministry of Local Government and Public Administration** played a significant role, especially in managing the institutional aspects of decentralization.
- The Parliament of Albania, that played a crucial role in passing the necessary legislation and amendments required for the reform, such as the Law on Territorial Organization and Administrative Units (2014) that provided the legal framework for the creation of new local government units and the decentralization process.

Local Authorities

- Local Government Units (Municipalities) were the key stakeholders, as the ones directly affected by the reform. Although many of them were initially resistant to the reform due to fears of losing power or control, each municipality played a central role in implementing new governance structures and ensuring service delivery in the redefined administrative units.

Civil Society Organizations (CSOs)

- Civil Society Groups, which conducted research, raised awareness and advocated for more inclusive, transparent and participatory decision-making in the reform

process. Their role was crucial in ensuring that the perspectives of citizens and vulnerable groups were considered during the planning and implementation phases.

- Think Tanks which conducted studies, provided technical expertise and assessed the impact of the reform. Their research helped inform policy recommendations, highlighting both the challenges and opportunities presented by the reform.

International Organization and Donors

- European Union (EU) was a significant external actor, both as a supporter and a driver of the reform, by providing technical assistance, financial support, and guidance throughout the reform process, through various EU-funded projects and initiatives. It had been advocating for territorial and administrative reform as part of Albania's broader efforts to align with EU standards, especially in the areas of governance and decentralization. Especially, the EU Delegation to Albania played a key role in advising the Albanian government and coordinating European assistance in the reform process.
- United Nations Development Programme (UNDP) was another key international partner involved in the reform, which provided technical expertise and supported the Albanian government with capacity-building initiatives for local authorities.
- World Bank provided financial support and technical assistance to Albania in the areas of local government reform, fiscal decentralization and capacity building.
- Other Donors such as the Swiss Agency for Development and Cooperation (SDC), the Norwegian Embassy and USAID, also played important roles, by providing fundings, technical advice and facilitated local-level consultations and training programs to help ensure the successful implementation of the reform.

Political Parties, especially those represented in Parliament, influenced the direction of the reform. Some of them were more supportive of consolidation, while others raised concerns about the impact on local representation and control.

The General Public and Citizens, especially those living in rural areas as they were the ones who would ultimately feel the most the impact of the reform.

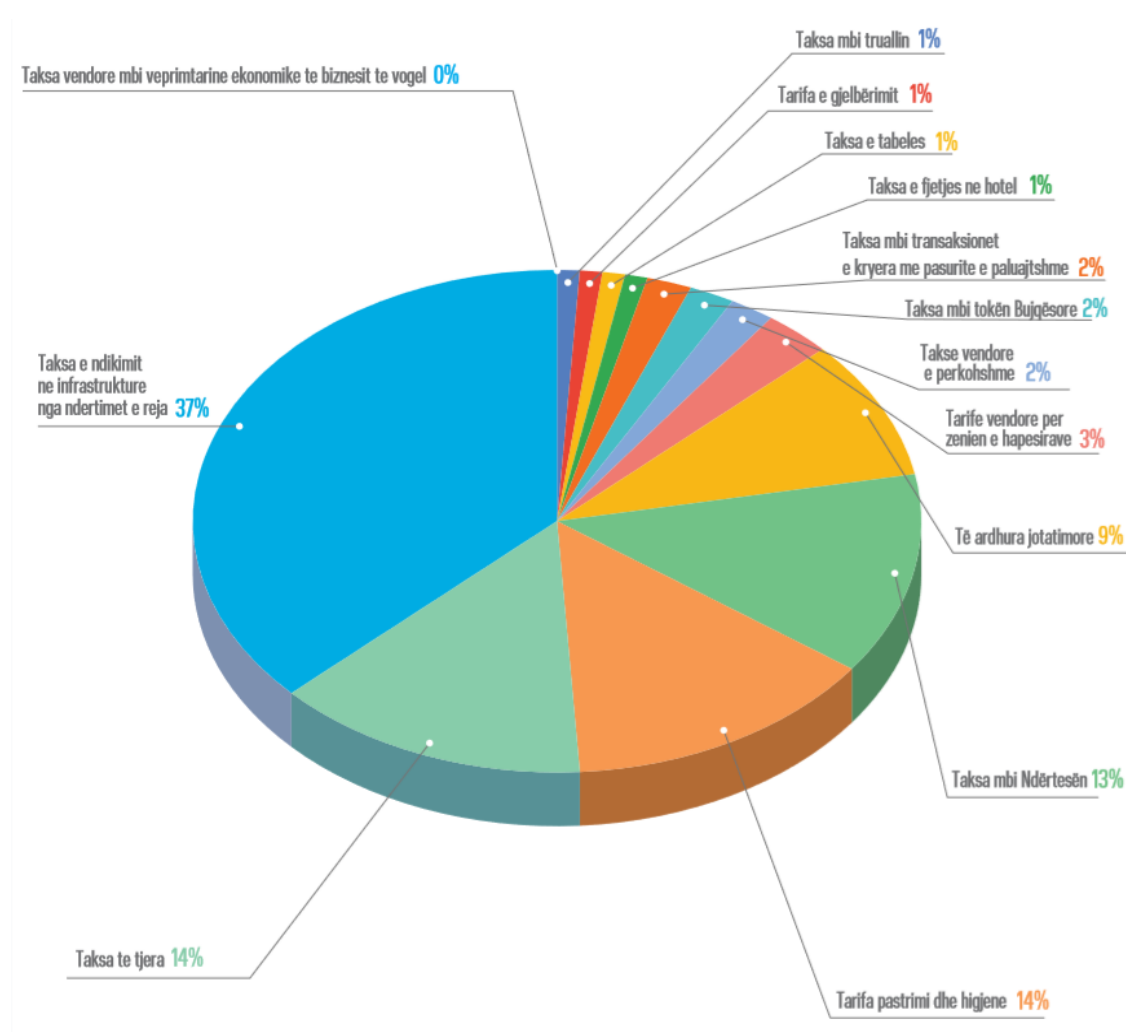
Media, which played an essential role in raising public awareness, informing citizens about the reform's objectives, and fostering public debate about its potential impacts, highlighting both positive aspects and challenges.

3. ECONOMIC IMPLICATIONS OF THE REFORM

3.1 Impact on Local Government Budgets

The Territorial Administrative Reform was focused on creating more efficient local governments, but it also had significant implications for local government finances. The impact on local government budgets has been both positive and challenging, influencing both revenue generation and expenditure management at the local level.

Figure 1: The structure of local own income



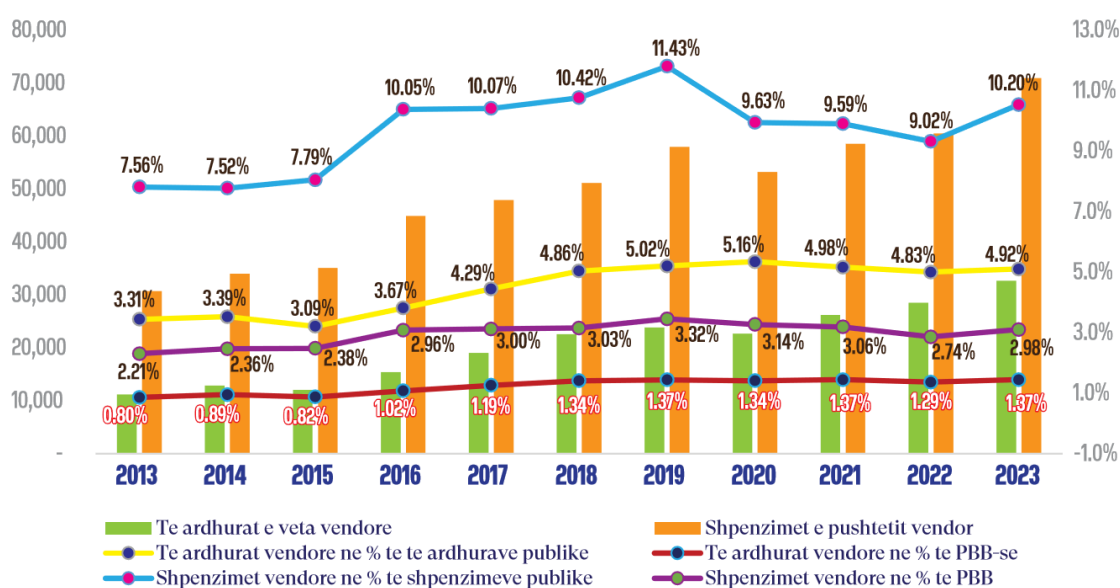
Source: Directorate of Local Finances, Ministry of Finance (2024)

One of the main indicators of local finances is the own income of LGUs. The most important sources at the national level consist in:

- Infrastructure impact tax from new constructions (37%)
- Wealth tax (18%)
- Cleaning fee (13%)
- Non-tax income (9%).

This structure is similar to that of 2022, when the infrastructure impact tax accounted for 33% of revenue, wealth taxes 20% and the cleaning fee 15%.

Figure 2: Own local revenues and local budget expenditures in relation to total public revenues and public expenditures and GDP in years



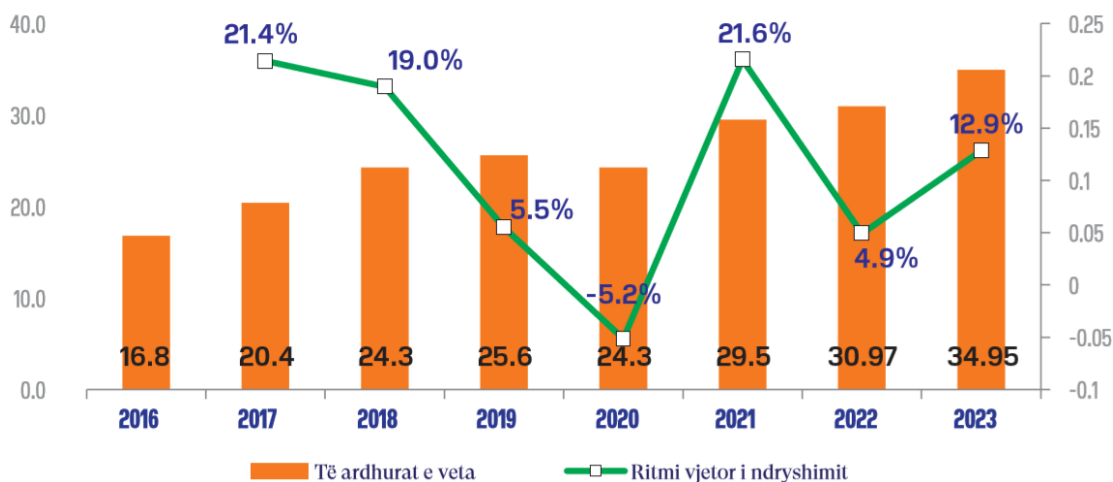
Source: Directorate of Local Finances, Ministry of Finance (2024)

Based on Figure 2, during the last ten years, starting from the average annual rate, the local government's own tax income has a higher annual growth rate (11.9%) than the general public income (7.2%). An important indicator is the ratio of local income to GDP, according to which before the reform, in 2012, domestic revenues were only 0.8% of GDP. In 2016, which represents the first year of the implementation of the reform, they marked an increase of 1.02%. In 2023, local revenues were 1.37% of GDP, showing a significant increase compared to the year before the reform.

Referring specifically to the year 2023, the performance of own income is positive and with an upward trend. In this framework, the local government units realized 34.9

billion ALL of their own income, or 12.9% increase compared to the previous year (30.9 billion ALL); of which local taxes and fees amount to about 31.7 billion ALL (91 percent) and 3.3 billion ALL (9 percent) come from non-tax revenues, exceeding the revenue plan in the initial budget 2023 by about 9% and by about 14% revised budget revenue plan.

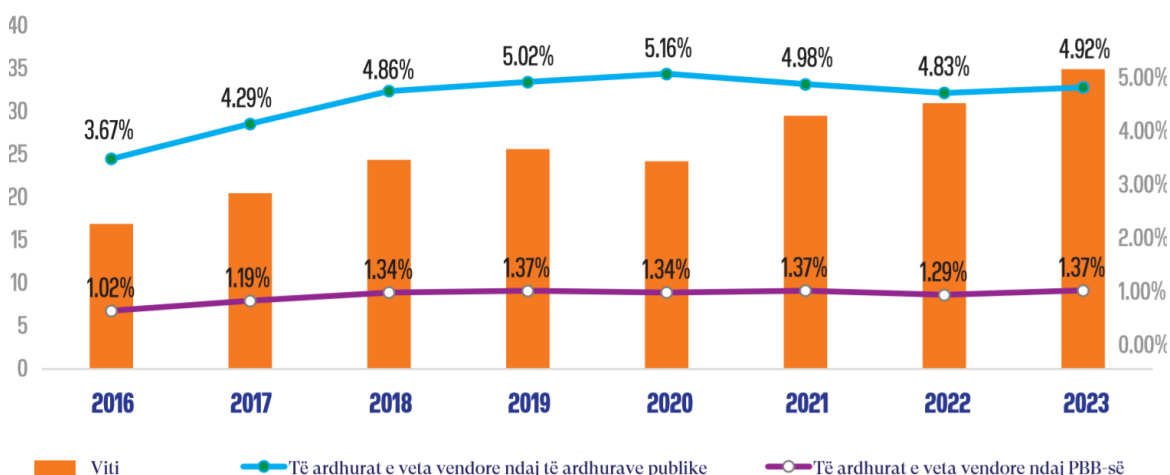
Figure 3: Income from own resources and their change through years



Source: Directorate of Local Finances, Ministry of Finance (2024)

In 2023, the local government collected about ALL 34.9 billion of its own income, from which about ALL 31.7 billion from local taxes and fees and about ALL 3.3 billion from non-tax revenues. According the figure above, the annual growth rate of own income has increased in 2023, during which the local government units have collected 12.9% more own income compared to the previous year. In this context, the positive growth of own income serves as a positive indicator to consolidate the services that the local government provides to the communities.

Figure 4: Local own income to general public income and GDP in years

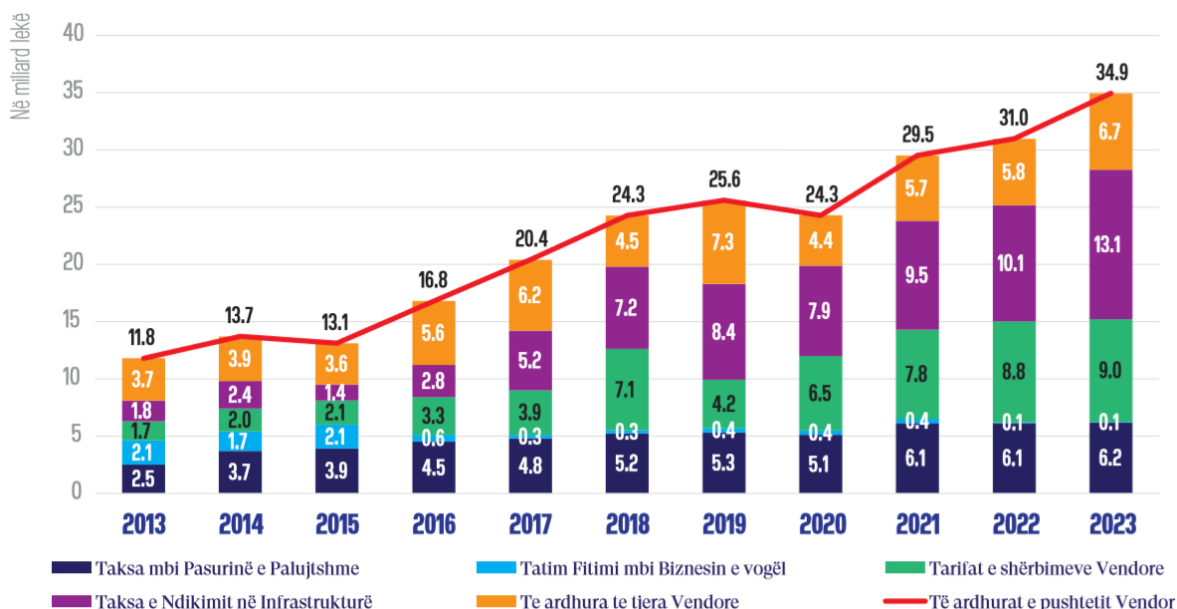


Source: Directorate of Local Finances, Ministry of Finance (2024)

An important aspect of financial management at the local level is the comparison of local revenues with public revenues and gross domestic product. During the year 2023, the local own income reached about 4.92% of the public income and about 1.37% of the GDP. However, most of the increase in revenue came from the increase in the infrastructure impact tax (73% of the increase), the increase in other taxes (hotel, property, other) and the cleaning fee. This concentration of own resources only on some taxes and fees proves the economic dependence on certain sectors. In this context, there is a need for better diversification of resources and better utilization of service fees, in order to offer the respective communities better quality and comprehensive services.

Below is presented in detail the progress of local own income according to the source and it is showed its growth during the 10-year period, 2013-2023. The source with the largest weight in local revenues during 2023 is the infrastructure impact tax with about 13.1% of local revenues. One of the most important sources, both from the point of view of the weight they occupy in the total local income, but also of the sustainability and growing potential as a source of financing, are the income from taxes on real estate. During the year 2023, the local government realized 6.18 billion ALL in property tax revenue, which includes building tax (76%), agricultural land tax (10%), land tax (4%) and property transaction tax real estate (10%).

Figure 5: Local own income by source



Source: Directorate of Local Finances, Ministry of Finance (2024)

Transferta e pakushtëzuar e përgjithshme dhe sektoriale përbën një burim të rëndësishëm për financimin e funksioneve të pushtetit vendor. Gjatë vitit 2023, pushteti vendor ka

përfituar nga buxheti qendror në total rreth 33.87 miliardë lekë në formën e transfertave, të cilat ndahen në:

- 23.98 miliardë lekë ose afërsisht 71% transferta e pakushtëzuar e përgjithshme, e cila shpërndahet përmes formulës
- 9.8 miliardë lekë, ose 29% është në formën e transfertës së pakushtëzuar sektoriale për financimin e funksioneve të transferuara në nivel vendor.

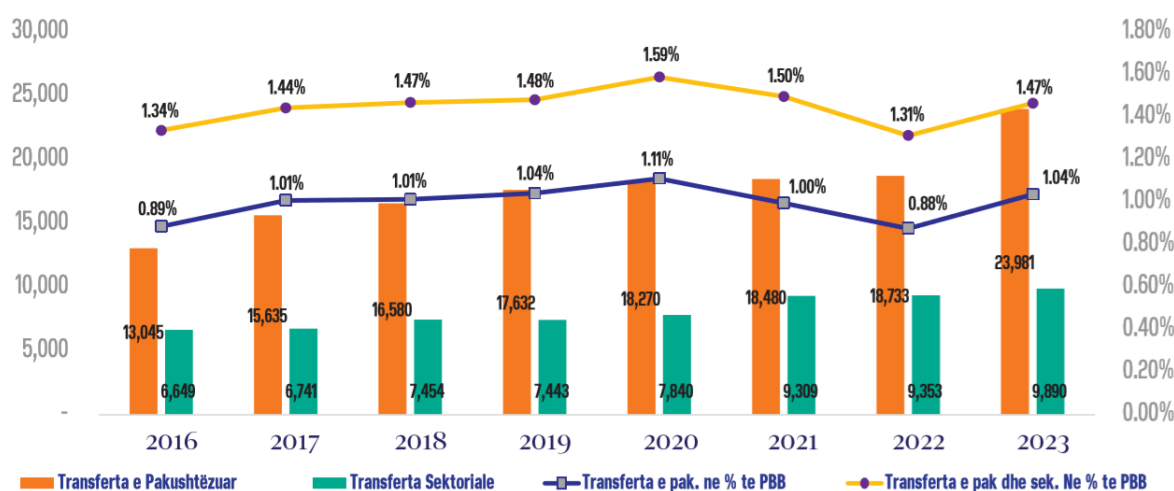
Transferta e pakushtëzuar e përgjithshme për vitin 2023 zë 1.1 % të Produktit të Brendshëm Bruto, duke plotësuar kështu edhe një kusht të rëndësishëm të BE në programin e mbështetjes buxhetore 'BE për Qeverisjen e Mirë (EU4GG), në përmbushjen e treguesve për disbursimin e transhit të katërt, referuar vlerësimit për vitin 2023 për Shqipërinë.

The general and sectoral unconditional transfer is an important source for financing local government functions. During 2023, the local government benefited from the central budget in total about 33.87 billion ALL in the form of transfers, which are divided into:

- 23.98 billion ALL or approximately 71% of the total unconditional transfer, which is distributed through the formula
- 9.8 billion ALL, or 29%, is in the form of unconditional sectoral transfer for the financing of functions transferred to the local level.

The general unconditional transfer for the year 2023 occupies 1.1% of the Gross Domestic Product, thus fulfilling an important condition of the EU in the EU budget support program for Good Governance (EU4GG), in fulfilling the indicators for the disbursement of the tranche fourth, referring to the assessment for the year 2023 for Albania.

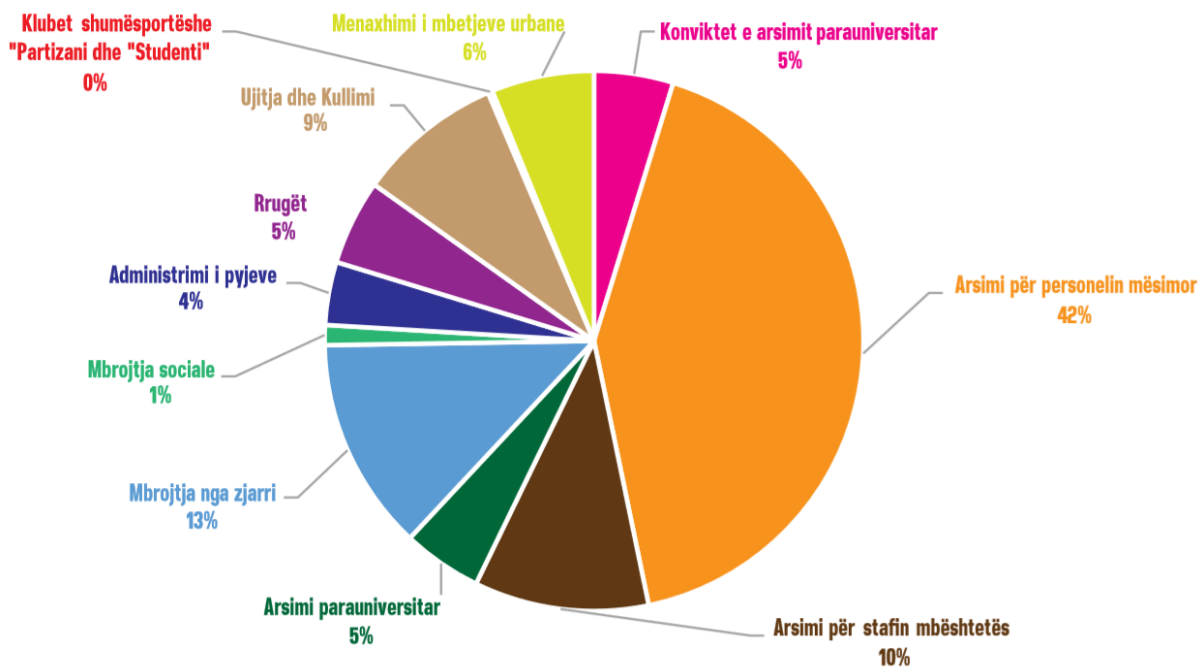
Figure 6: Unconditional and sectoral transfers and against GDP



Source: Directorate of Local Finances, Ministry of Finance (2024)

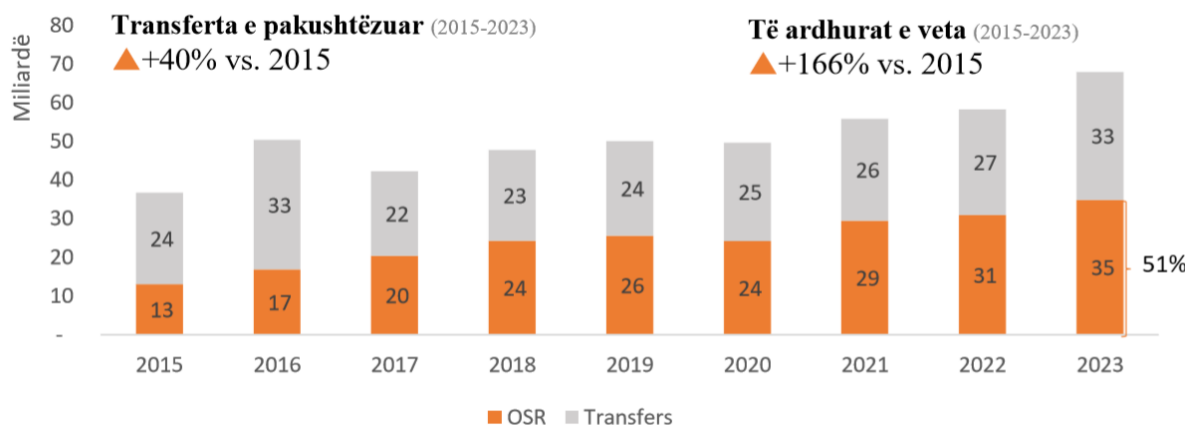
From 2016 onwards, for the functions transferred by law, the municipalities benefit from budget support from the central government in the form of unconditional sectoral transfer, which in 2023 was worth about 9.8 billion ALL or about 537 million ALL compared to a year ago previously or as much as 29% of the total unconditional transfer funds. In relation to the own income of the local self-government units (34.9 billion ALL), the unconditional sectoral transfer is about 33%.

Figure 7: Sectoral transfer allocation 2023 (initial budget)



Source: Directorate of Local Finances, Ministry of Finance (2024)

Figure 8: Progress of own income to unconditional transfer 2015-2023



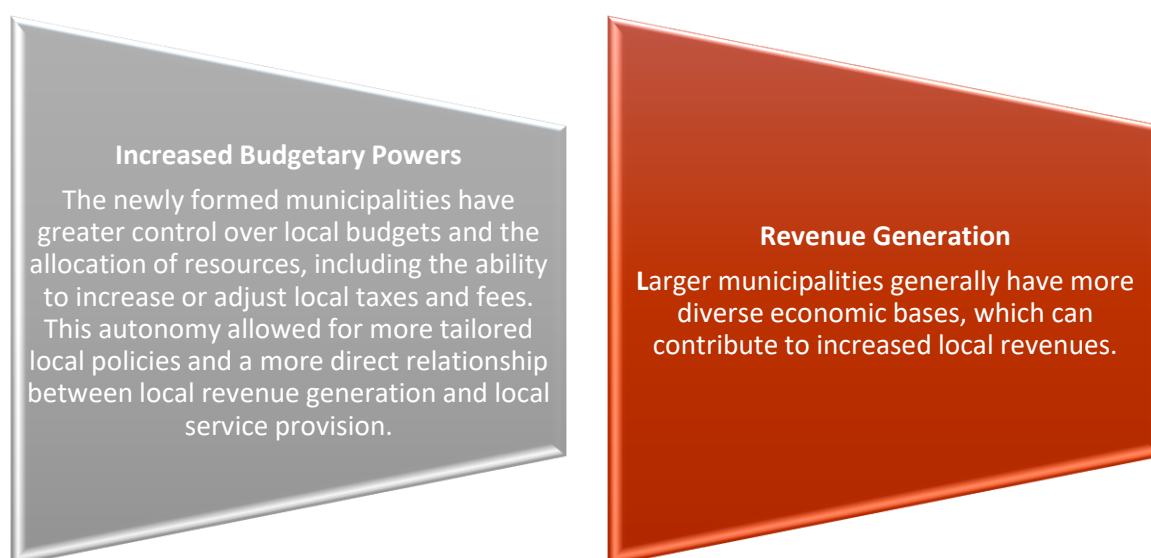
Source: Agency for the Support of Local Self-Government (2024)

Transfers from the central government: In 2015, the own income of Albanian municipalities represented only 36% of their own income against the unconditional

transfer. The gradual increase in the share of own income to transfers in the analyzed period and with the report in 2023 marks an increase of 51%, can be considered as an important step towards strengthening decentralization and increasing financial autonomy for local self-government.

➤ Fiscal Decentralization and Financial Autonomy

One of the key components of the reform was the **increased fiscal decentralization**. By consolidating the municipalities, the reform created larger units with greater fiscal capacity, allowing them to have more control over their budgets and better manage resources. In this regard, the municipalities had greater financial autonomy.



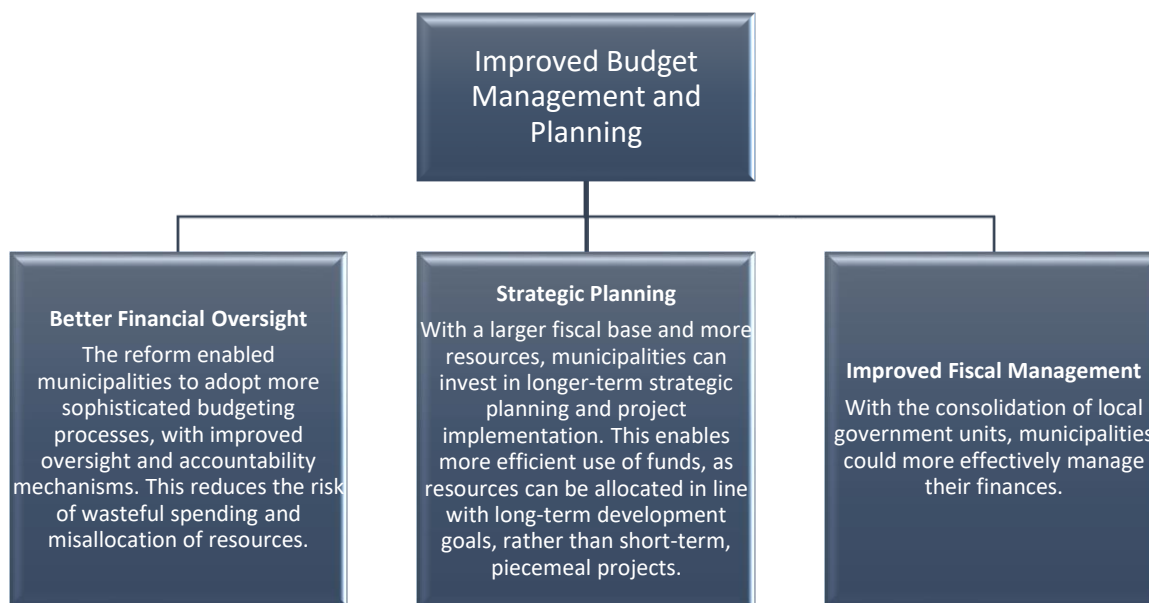
➤ Budgetary Transparency and Public Accountability

The reform aimed to **improve budgetary transparency** and **public accountability** at the local level, encouraging better governance and more effective use of local funds.



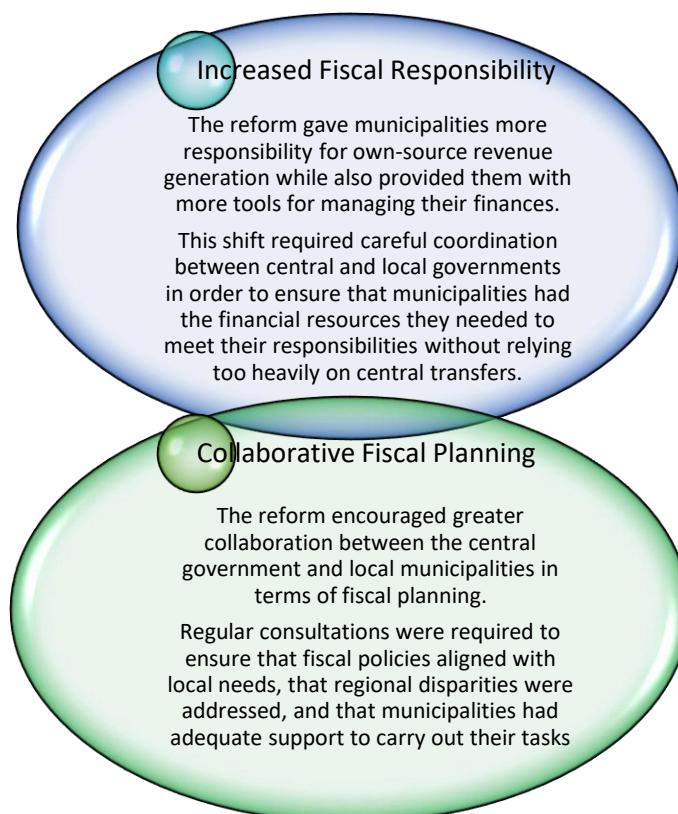
➤ Improved Budget Management and Planning

Larger municipalities typically benefit from improved budget management and financial planning, which is crucial for efficiency in public spending.



➤ Intergovernmental Relations and Fiscal Decentralization

By increasing the fiscal capacity of local governments, the reform aimed to shift the balance of power and financial responsibility from central to local governments.



3.2 Financial Restructuring at the Local Level

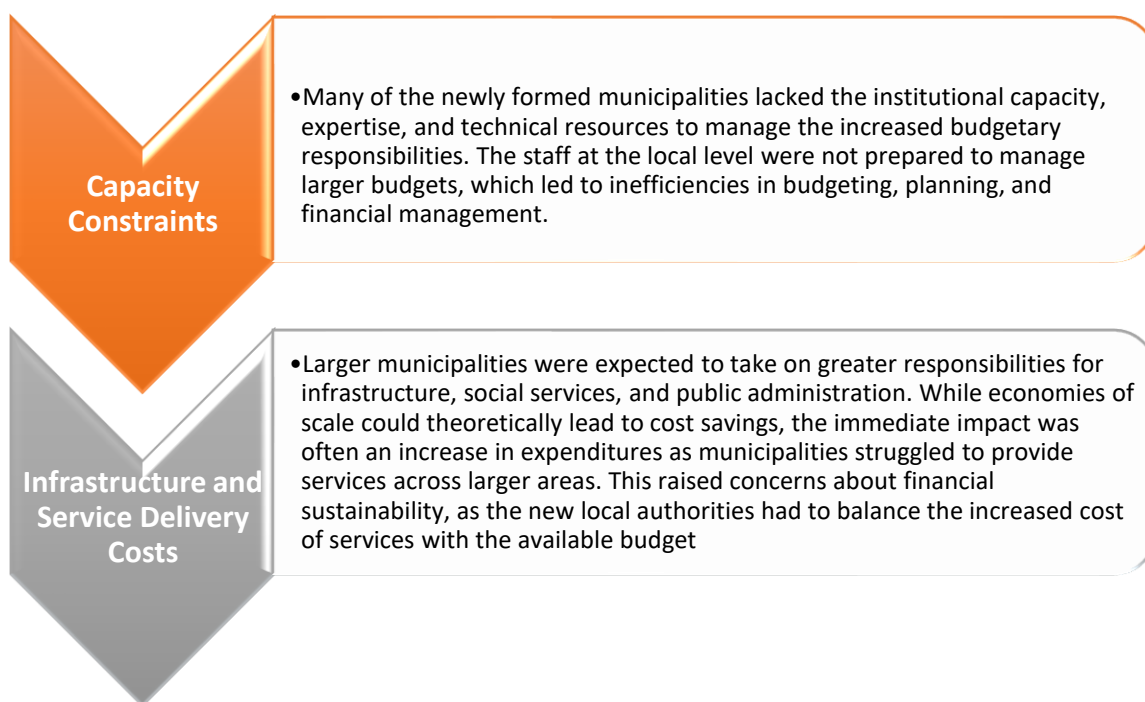
- Redistribution of Financial resources

The reform brought changes in the redistribution of financial resources from the central government to local governments. The central government's financial transfers were adjusted to ensure that newly consolidated municipalities would receive adequate funding.



- Challenges with Fiscal Capacity of Newly Consolidated Municipalities

Although the reform aimed to create larger and more capable local governments, the fiscal capacity of many newly consolidated municipalities was a significant challenge. In many cases, the merging of smaller municipalities into larger ones did not automatically result in stronger financial management or increased revenue collection. Several issues arose:



➤ Changes in Local Revenue and Expenditure Patterns

Tax Base Expansion:

- The larger municipalities, particularly those in urban areas, as a result of a broader tax base, were able to increase revenue through local taxes and fees. This helped them to cover the increased costs of local services post-reform.

Increased Service Delivery Costs

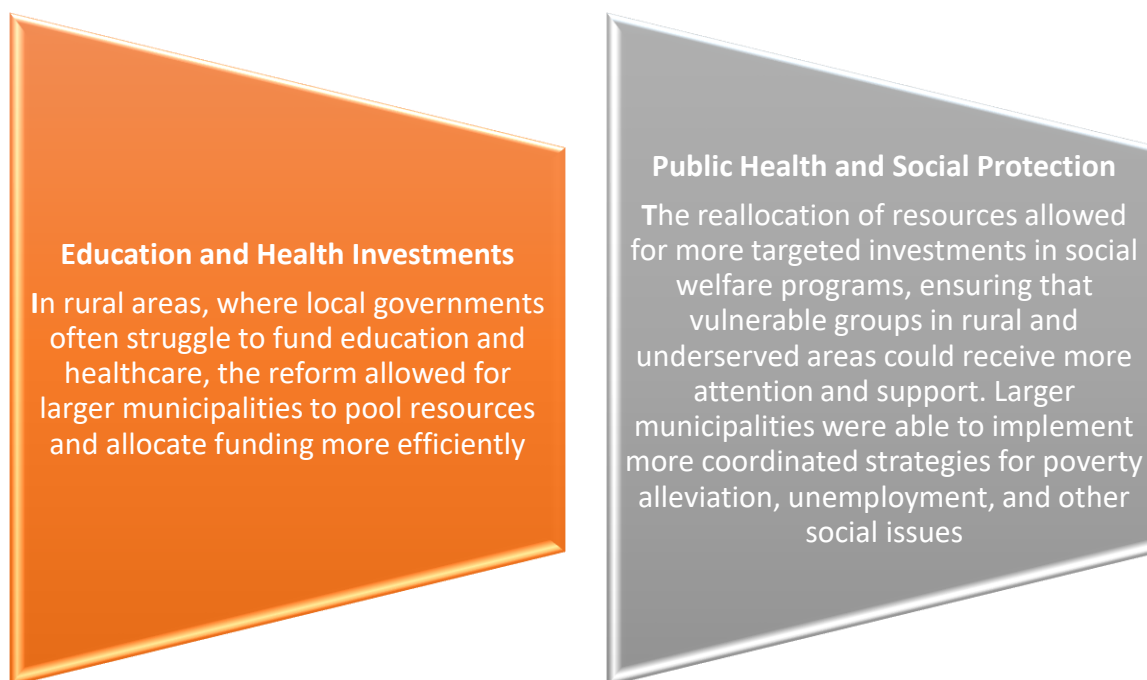
- The increased size of municipalities often led to higher administrative costs, according to which larger areas meant more infrastructure maintenance, social services, and public works projects. These increased responsibilities came with higher spending needs, especially for municipalities that previously lacked the resources or infrastructure to manage such tasks effectively.

Better Investment Attraction

- Larger, more financially stable municipalities are more attractive to investors. This can enhance the municipality's revenue potential by increasing economic activity and job creation. The ability to manage larger-scale investments and development projects also contributes to better public spending outcomes.

➤ Improved Resources Allocation for Social Services

The reform aimed to create local governments that could better manage social services, including education, healthcare and social protection programs. By consolidating smaller units, the government could allocate resources more effectively to improve social service delivery across regions.



➤ Revenues Generation Risks

The reform sought to increase the financial autonomy of local governments by providing them with a broader tax base. Larger municipalities were expected to be better positioned to generate revenue from local taxes, fees and services. However, several financial risks emerged in the context of local revenue generation:

- **Dependence on Central Government Transfers:** not all municipalities had the same potential for revenue generation. Urban areas with more economic activity and a larger tax base could generate more revenue, while rural municipalities with fewer businesses, lower property values and smaller populations faced difficulties in mobilizing adequate local resources. This disparity forced some municipalities being heavily reliant on central government transfers to meet their fiscal needs. If these transfers were reduced or not adequately distributed, local governments could face budgetary shortfalls, making it difficult to maintain service delivery or finance investment projects.
- **Local Tax Collection Efficiency:** Although larger municipalities had more administrative resources to improve tax collection, many still faced challenges in effectively collecting taxes, particularly in rural areas where there was often low compliance and weak tax administration. The inability to improve tax compliance rates and manage revenues efficiently led to the risk of uncollected taxes, further exacerbating budget deficits.

3.3 Fiscal Capacity of Newly Consolidated Municipalities

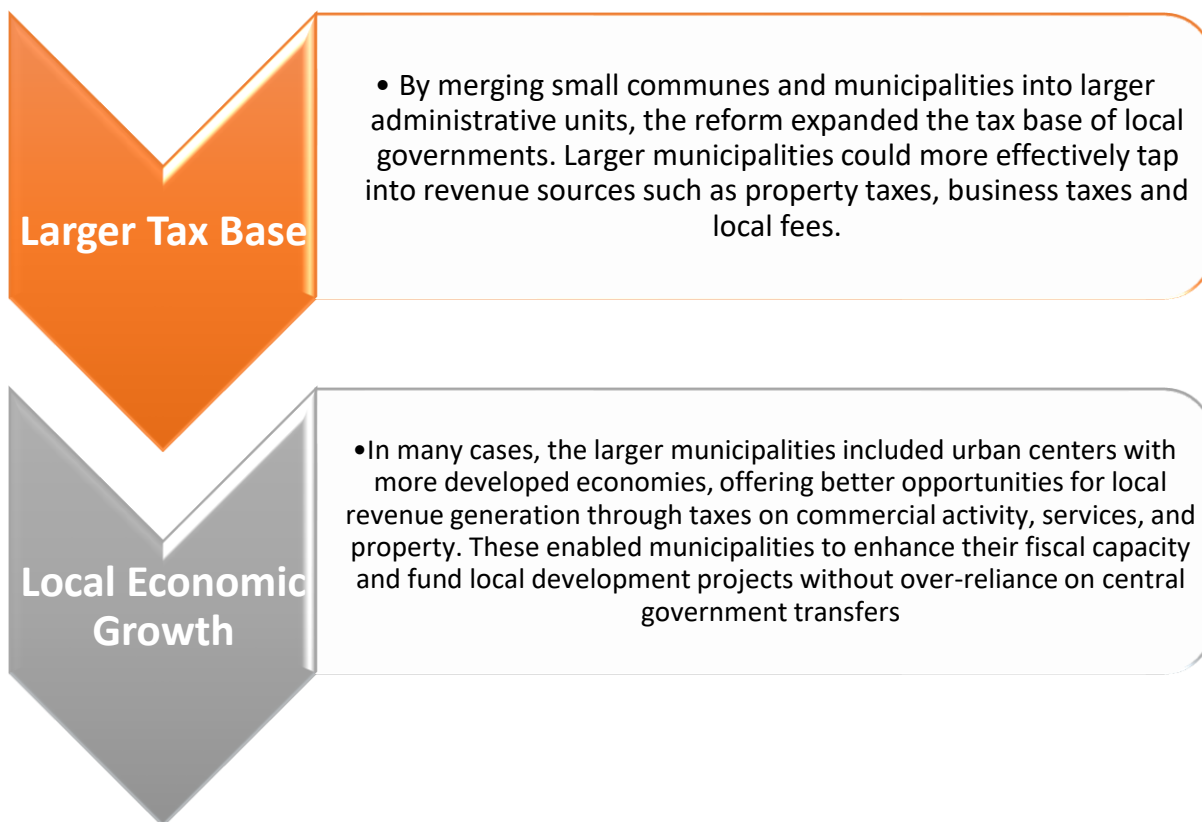
A key aspect of the reform was the fiscal capacity of the newly consolidated municipalities, which refers to their ability to generate and manage financial resources effectively to provide public goods and services. The fiscal capacity of these larger municipalities became a central concern, as the restructuring process created both opportunities and challenges in terms of revenue generation, fiscal management, and financial autonomy.

The fiscal capacity of newly consolidated municipalities in Albania after the Territorial Administrative Reform saw both significant improvements and notable challenges. On the positive side, the reform provided municipalities with a larger tax base, increased fiscal autonomy and better capacity for revenue collection, contributing to enhanced financial independence. However, many municipalities, especially in rural or underdeveloped areas, still required fiscal equalization transfers to ensure adequate resources for service delivery and regional development.

Despite these advances, newly consolidated municipalities faced challenges in managing their expanded responsibilities, requiring ongoing investments in capacity building, fiscal planning and debt management. The success of the reform in enhancing fiscal capacity ultimately depends on the continued support for local governments to improve governance, financial management, and service delivery, ensuring that the benefits of decentralization and fiscal autonomy are fully realized.

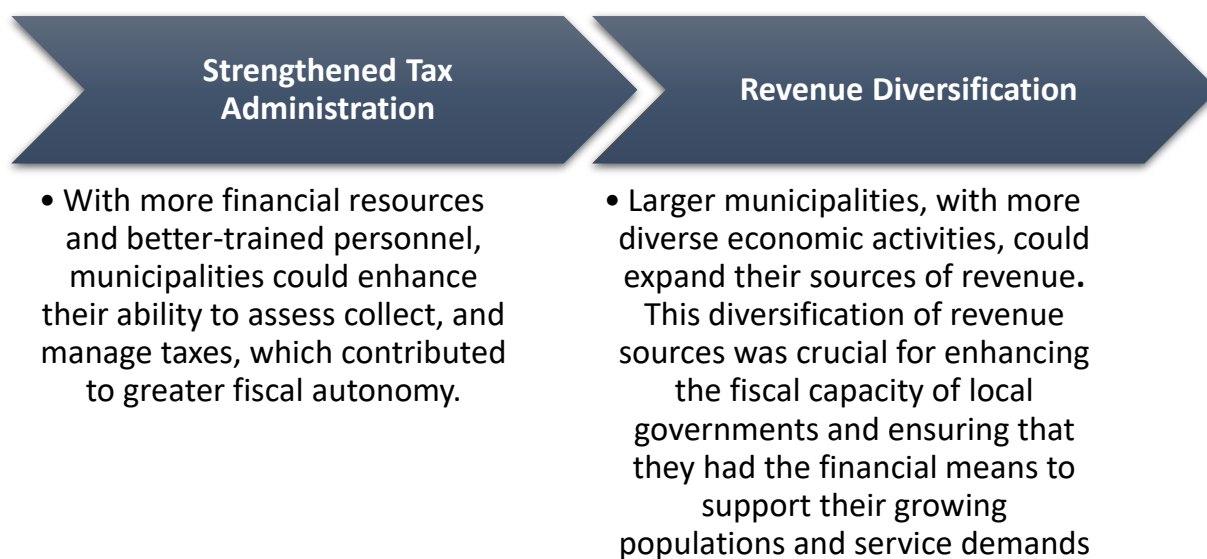
➤ Increased Fiscal Autonomy

One of the main objectives of the territorial reform was to give local governments more fiscal autonomy. Prior to the reform, many of the smaller municipalities had limited fiscal capacity due to a narrow tax base and insufficient administrative resources. The consolidation of municipalities aimed to improve their ability to generate revenue, thereby allowing them to become less dependent on central government transfers and more self-sustaining.



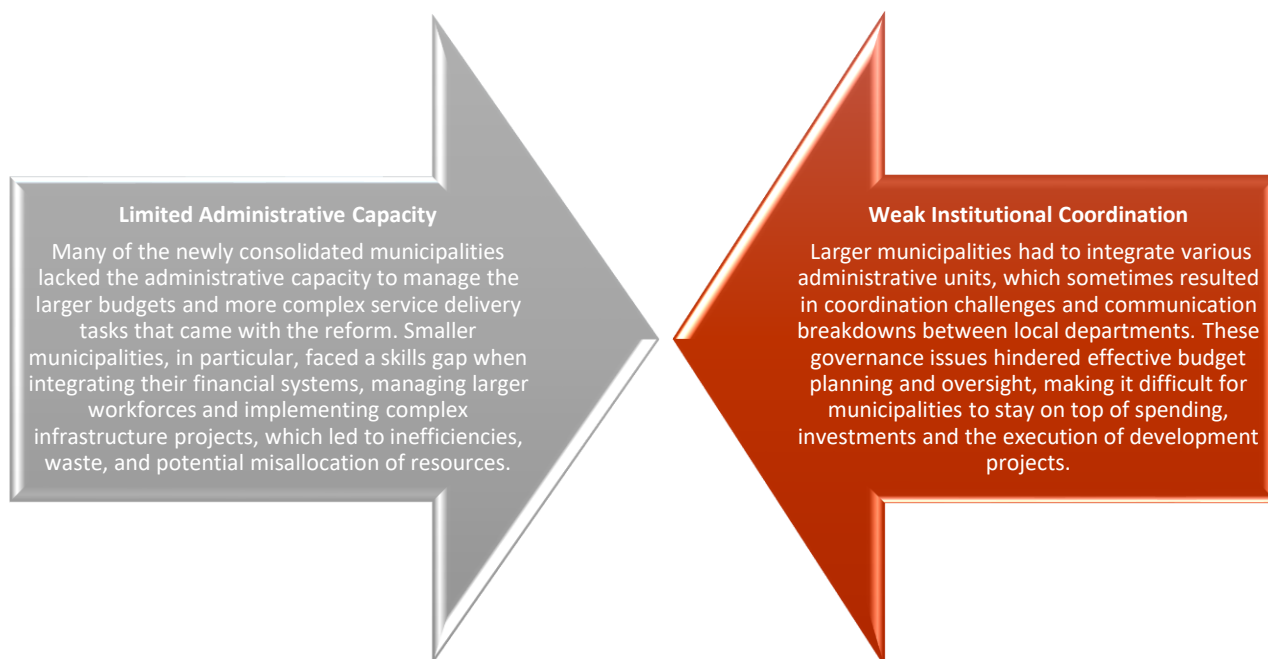
➤ Improved Local Revenue Mobilization

The reform aimed to improve the efficiency of local revenue mobilization, which was a significant challenge for many of the smaller municipalities prior to consolidation. The creation of larger municipalities, provided more resources and tools to collect taxes and fees more efficiently.



➤ Risk related to Capacity and Governance

Although the territorial consolidation aimed to enhance the capacity of local governments, many municipalities still faced challenges in managing their expanded roles effectively, which increased the risks of mismanagement and inefficiencies.

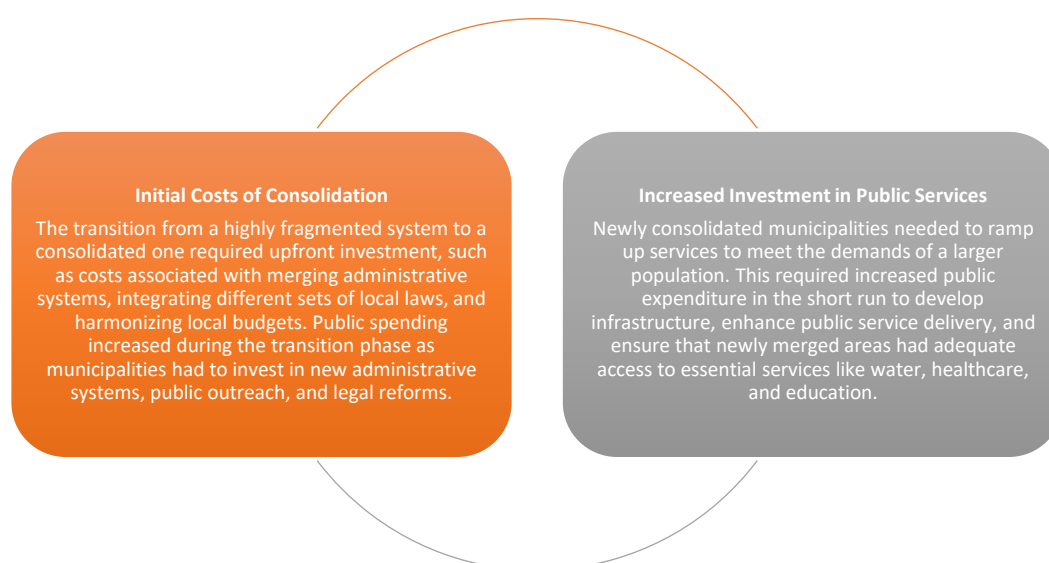


4. IMPACT ON PUBLIC EXPENDITURE

The impact on public expenditure has been both positive and negative, especially in terms of how resources are allocated, spent, and managed across different regions. Below are presented some issues in which the Territorial Administrative Reform influenced public expenditure:

➤ Short-Term Increase in Public Expenditure

While the long-term goals of the reform were to reduce public spending inefficiencies and improve service delivery, the short-term effect of the reform was often an increase in public expenditure due to the following:



➤ Reduced Administrative Costs and Efficiency Gains

One of the most immediate impacts of the reform was the reduction of administrative costs and the creation of efficiencies in public spending.

- **Lower Administrative Overhead:** The consolidation into 61 larger municipalities reduced the need for multiple administrative bodies across the country. This allowed the government to reduce expenditures on salaries, administrative services and overhead costs.

- **Economies of Scale:** Larger municipalities are better positioned to benefit from economies of scale. The main goal of territorial reforms is to reduce production costs by using economies of scale, scope and density in the provision of public goods and services. (Bourdin & Torre, 2021; Hofmann & Rother, 2019; Lima & Silveira Neto, 2018; Matějová, Nemeč, Křápek & Klimovský, 2017; Soukopová, Nemeč, Matejová & Struk, 2014; Turley, McDonagh, McNena & Grzedzinski, 2018). By merging small communes and municipalities, larger municipalities can achieve **economies of scale**, which lead to cost savings in several areas:
 - ✓ **Shared Resources:** With a larger population base and a more extensive tax base, municipalities can share resources, such as administrative services, technical expertise and infrastructure across a broader area. This eliminates the need for smaller, redundant administrative offices and allows for more efficient service delivery.
 - ✓ **Reduced Duplication:** The consolidation of small municipalities reduced administrative duplication. Prior to the reform, each commune or small municipality had its own administrative structure, including mayors, councilors, and administrative staff. By merging these units, the need for multiple layers of administration was eliminated, reducing personnel costs and the potential for overlapping functions.

A more recent trend is that of local governments that also seek economies of scale in specific services through joint production through inter-municipal cooperation". (Blank & Niaounakis, 2021, p. 4).

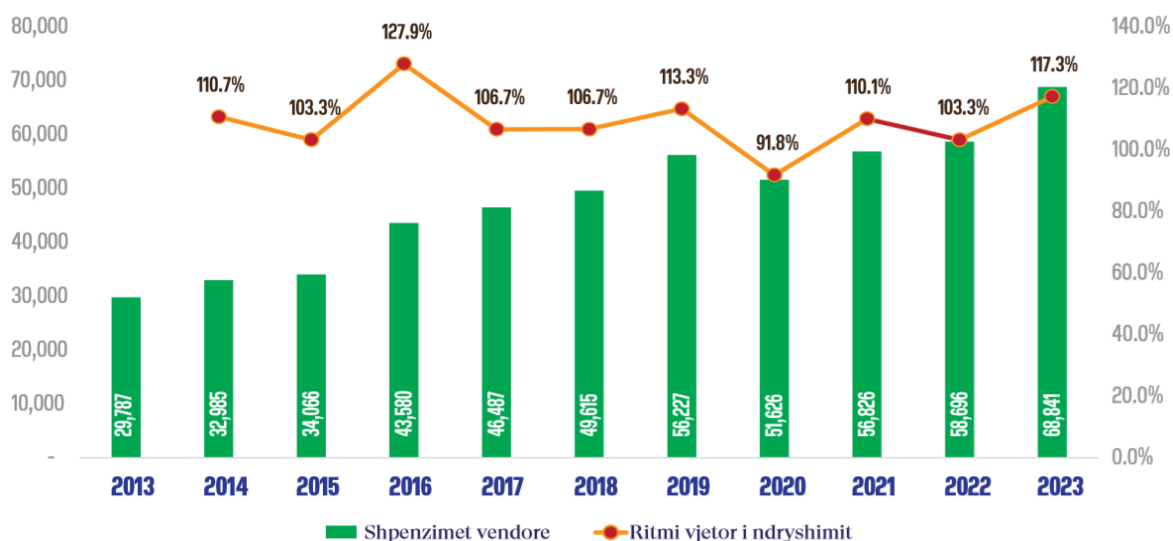
- **Improved Public Service Delivery:** The consolidation of resources meant that municipalities could manage services over larger populations, achieving better cost efficiency through centralization. Larger units could also attract higher-quality staff and expertise, further improving the quality of service delivery without a proportional increase in spending.
- **Centralized Decision-Making:** Larger municipalities are generally more efficient in decision-making. Instead of multiple, often competing, local administrations, a centralized leadership in larger municipalities can make decisions more quickly and implement policies in a more coordinated manner, reducing the time and resources spent on bureaucratic procedures.

➤ Expenditure Pressures and Service Delivery

While fiscal capacity increased in many municipalities, the pressure on public spending also grew as municipalities took on more responsibilities. The reform aimed to improve service delivery in newly consolidated areas, which often involved significant **expenditure increases**.



Figure 9: Local government expenditures and annual growth rate

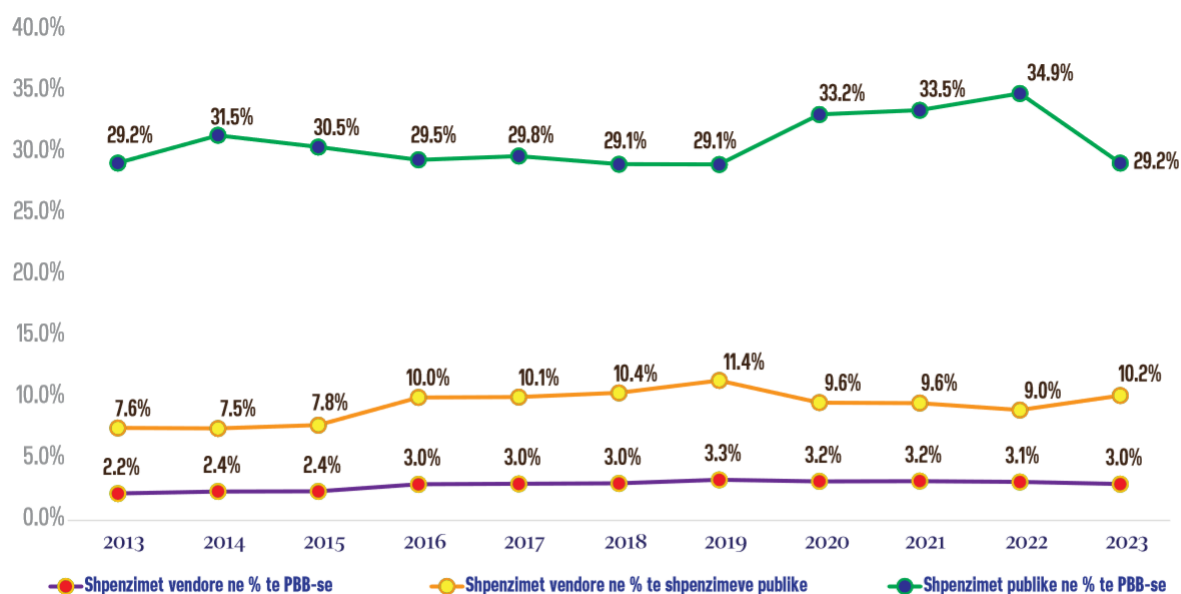


Source: Directorate of Local Finances, Ministry of Finance (2024)

Based on the figure above, a stable growth rate is observed, indicating the consolidation of the local budget, which is an indicator of the financial stability of the local self-government units. The expenses of local government units with funding sources (own revenues, general and sectoral unconditional transfer and separate taxes) during 2023 have reached 68.8 billion ALL, 17% or 10.1 billion ALL more than in 2022. From 2015 to 2023, actual local government spending has seen a significant increase of 101%, showing positive innovation in funding and support for local development. This increase shows a strengthening of the local budget, reflecting a stable growth feature that underlines the financial stability of local units. This approach of increased spending is related to the increased need for financing and new investments, signaling the units' commitment to improving public services and fulfilling strategic objectives.

At the end of 2023, local budget expenditures reached 2.98% of the Gross Domestic Product and 10.2% of general public expenditures. Compared to the previous year, during the year 2023 local government expenses have increased slightly in relation to GDP (0.23%). Referring to the share of local expenses to public ones, they are presented with an increase of 1% more, i.e. from 9% in 2022 to 10.2% in 2023.

Figure 10: The weight of local expenditures to GDP and general public expenditures



Source: Directorate of Local Finances, Ministry of Finance (2024)

This ratio is one of the most important indicators, because it expresses the role of the local government and the degree of its fiscal decentralization. The improvement of these ratios requires the addition of financial mechanisms that encourage the increase of the capacity of local self-government units in providing public services.

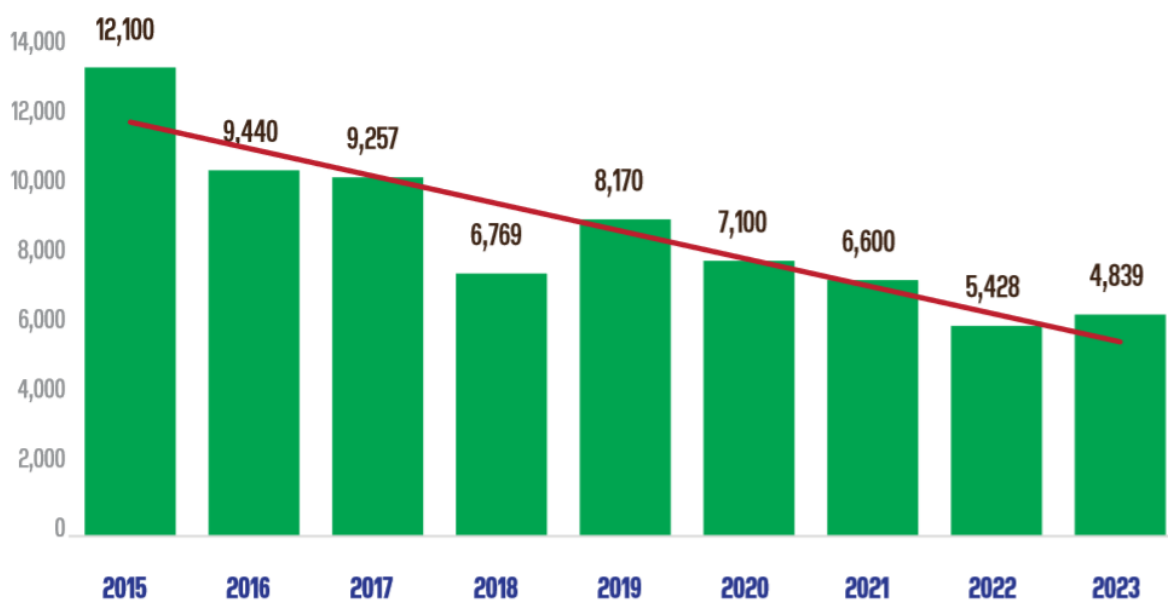
➤ Financial Sustainability and Debt Management

With an improved fiscal capacity, larger municipalities had greater access to credit and could engage in local borrowing to finance infrastructure and development projects. This raised significant concerns about the financial sustainability of local governments, particularly in terms of their ability to manage long-term debt and ensure the efficient use of funds.

- **Access to Credit:** Larger municipalities were better positioned to engage with banks or international financial institutions to borrow funds for capital projects, allowing them to invest in major infrastructure projects such as road construction, public transport and urban development. While this was a positive development, it also meant that municipalities had to carefully manage their debt levels to avoid fiscal instability.
- **Debt Management:** Smaller municipalities, which were more financially vulnerable before the reform, often relied on central government transfers to meet their obligations. Post-reform, newly merged municipalities faced increased debt responsibilities and were expected to take on new financial burdens for regional development projects and infrastructure. In some cases, this led to concerns about their ability to manage debt effectively without adequate financial oversight and support.
- **Debt Sustainability:** Newly consolidated municipalities need to adopt debt management practices to ensure that borrowing won't become a burden on future budgets.
- **Access to EU and International Funds:** Larger municipalities, with more robust administrative structures, were better positioned to access international funds, including EU grants and loans for development projects. This increased their ability to invest in infrastructure and regional development, which was essential for long-term financial sustainability.

By analyzing the arrears for the period 2015-2023, it is showed a significant improvement in their reduction by local self-government units. These arrears in 2023 are three times less compared to 2015, from about 12 billion ALL to about 4.8 billion ALL with a margin of 7 billion less, improving fiscal stability in the municipality. Municipalities have managed to reduce financial obligations since the beginning of the reform and reduce the level of debt from 940 million ALL in 2015 to 101 million ALL in 2023. Also, the value of the stock of arrears has decreased by about 3 billion ALL, compared to the stock of the obligation at the end of the third quarter of 2023, and has decreased by about 0.59 billion ALL, compared to the stock of the obligation at the end of 2022, which was 5.4 billion ALL.

Figure 11: Arrears of the local government



Burimi: Drejtoria e Financave Vendore, Ministria e Financave (2024)

5. IMPACT ON LOCAL DEVELOPMENT AND INVESTMENT

A key focus of the reform was its potential impact on local development and investment. By consolidating smaller municipalities, the reform sought to enhance the capacity of local governments to plan and implement development strategies, attract investment, and better utilize resources for regional growth. The impact of the Territorial Administrative Reform on local development and investment can be seen through various aspects:

➤ Improved Local Government Capacity to Promote Development

One of the primary goals of the reform was to enhance the administrative and financial capacity of local governments to manage development initiatives. By consolidating small municipalities into larger ones, Albania aimed to create local governments that could more effectively plan and implement long-term development strategies.

Larger Administrative Units with Greater Resources

Larger municipalities, with more diversified tax bases and greater financial capacity, are better positioned and equipped to plan and implement development projects.

More Professionalized Governance:

Larger municipalities could employ more qualified staff, adopt better project management practices and improve their ability to design and manage development programs.

Enhanced Strategic Planning

With larger populations and more complex administrative structures, municipalities were able to adopt more comprehensive development plans. These plans could focus on long-term growth, integrating both economic and social aspects such as infrastructure, education, healthcare and social welfare, which in turn fostered more holistic and sustainable development

➤ Attracting Investment and Improving Infrastructure

A key aspect of local development is the ability to attract both domestic and foreign investment. The reform aimed to increase the attractiveness of Albanian municipalities for investors by enhancing local governance and improving infrastructure.



Improved Investment Climate

Larger municipalities have a broader range of economic activities, including industrial, commercial and service sectors, which provide a more diversified base for investment.

With more developed financial management and governance systems, these municipalities were better able to create an attractive investment climate, offering investors improved administrative services, clearer regulations, and better infrastructure.

6. CHANGES IN INVESTMENT PATTERNS AT THE LOCAL LEVEL

One of the key outcomes of the reform was its impact on investment patterns at the local level, as it changed how resources were allocated, how investments were prioritized and how local governments engaged with the private sector, international donors, and central government funding. The following explores the changes in investment patterns at the local level in Albania after the Territorial Administrative Reform.

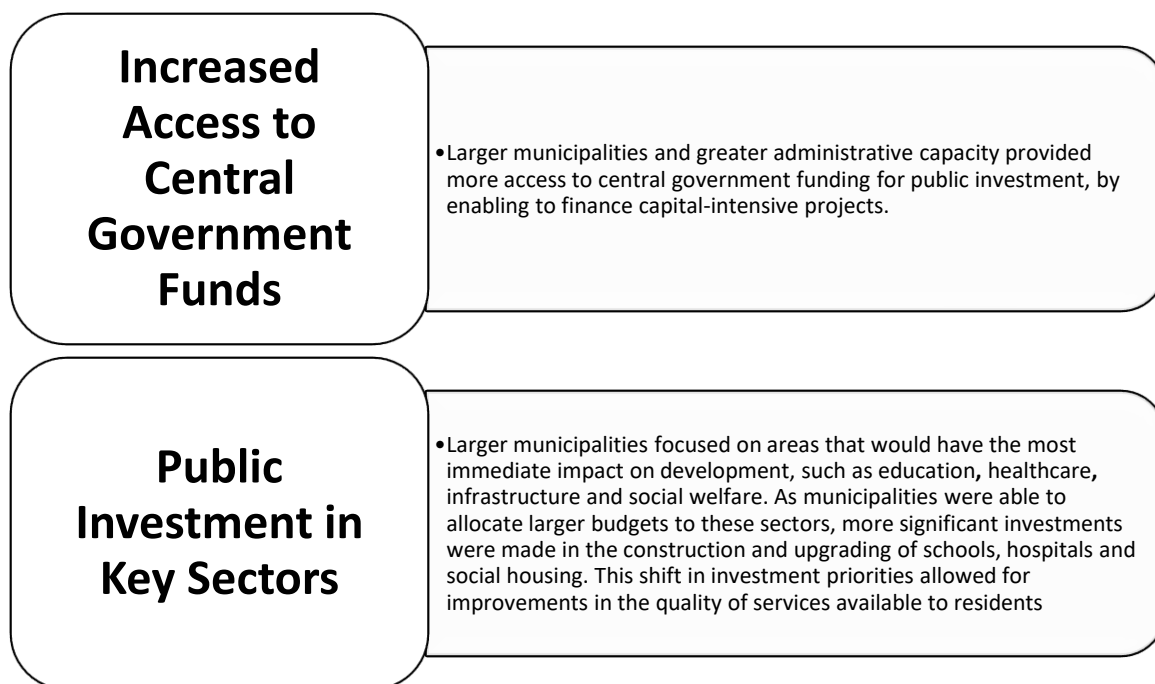
➤ Shift Toward Larger – Scale, Regional Investments Projects

Prior to the reform, small municipalities had limited fiscal capacity and often struggled to attract significant investment. The consolidation of municipalities into larger units allowed for the coordination of larger-scale regional investment projects that could have a broader impact across entire municipalities or regions, rather than being confined to smaller, individual areas.



➤ Increased Public Investment and Access to Central Government Funds

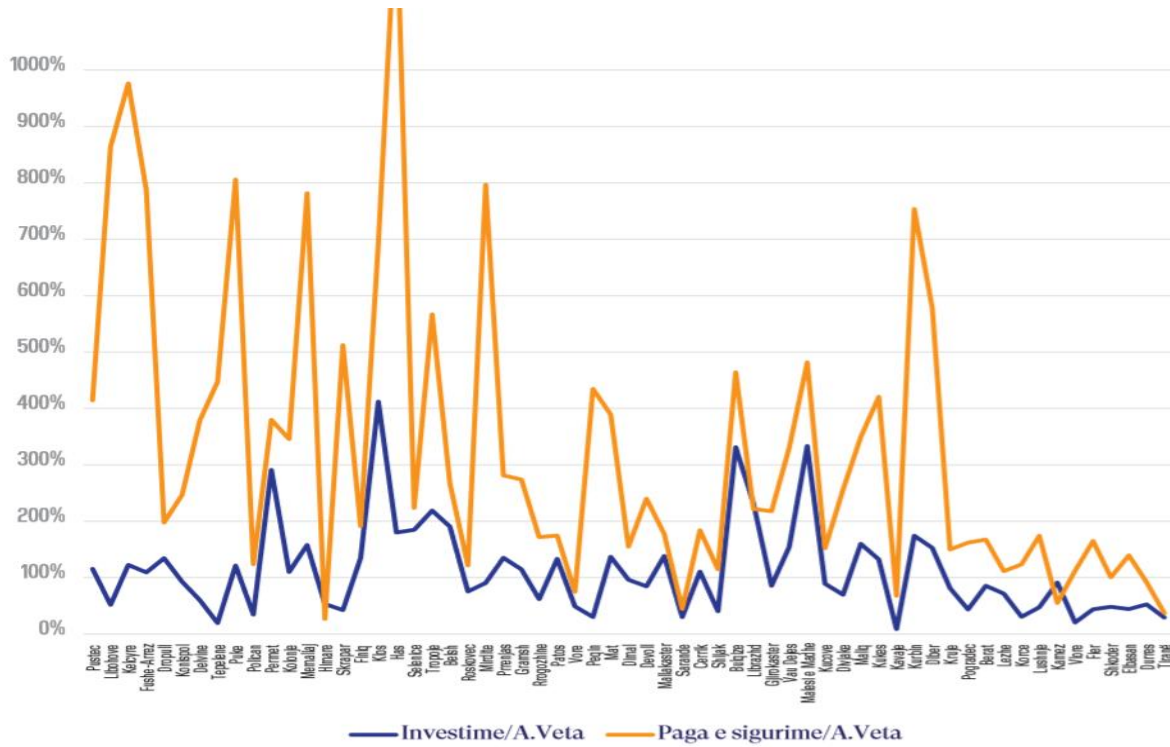
One of the primary objectives of the reform was to enable municipalities to better manage and allocate public resources. As local governments gained more fiscal autonomy and administrative capacity, they were better positioned to make larger investments in different projects.



One of the objectives of the territorial reform and fiscal decentralization is to create conditions for LGUs that are more financially capable and have an impact on local economic development. For 2023, investment expenditures accounted for about 24.1% of total local expenditures. Compared to a year ago, it is found that investment expenses have increased by over ALL 4.6 billion or 39% and the relative weight of investments in the budget structure has increased by 4%. The increase in the quality of financial management at the local level is also reflected in the level of realization of capital expenditures. In thi regard, local self-government units have realized 17.3%, or over 10.1 billion ALL more expenditures compared to 2022, among of which ALL 4.6 billion is dedicated to more investments.

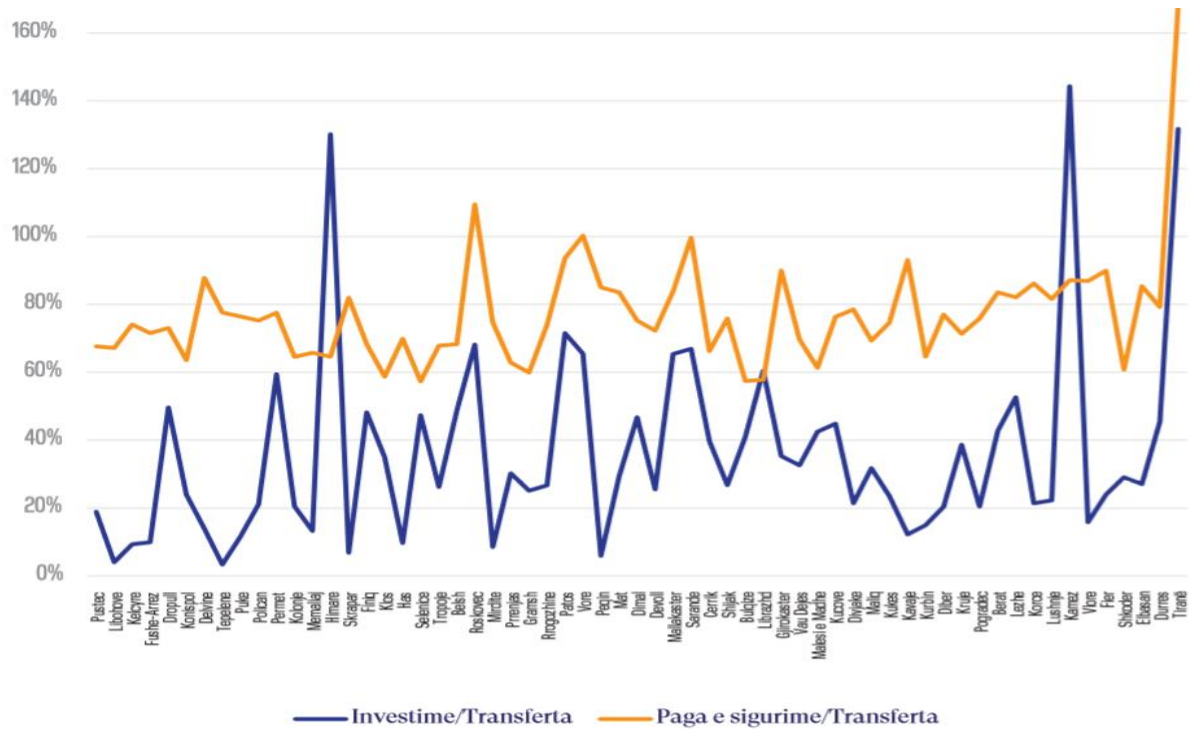
As regards the own income, capital expenditures in 2023 reached 47%. LGUs should increase the financing of investments through their own revenues, as a key indicator of the importance of local government for economic development and the efficiency of financial management. Personnel expenses against own income during 2023 account for about 84%, while against unconditional transfer and the sector account for about 89%.

Figure 12: Capital and personnel expenses against own income



Source: Directorate of Local Finances, Ministry of Finance (2024)

Figure 13: Capital and personnel expenditures against unconditional sectoral transfer



Source: Directorate of Local Finances, Ministry of Finance (2024)

➤ Diversification of Investments Sources

Larger municipalities were in a stronger position to attract external funding (loans, grants, funds, etc.), as the reform allowed local governments to access a wider range of funding sources, beyond central government transfers. In this regard, larger municipalities, with enhanced governance capacity, became more competitive in accessing international funds

EU and International Funding

- The EU accession process has provided Albania with access to significant funding for local development. After the reform, larger municipalities became more competitive in securing EU funds. As these municipalities had improved governance and administrative structures, they were better equipped to apply and manage complex projects and access international funding for regional development. This enhanced access to EU funds boosted investment in local infrastructure, environmental projects, and other development initiatives

Foreign Direct Investment (FDI)

- The larger municipalities, especially urban centers and those with economic potential, were better positioned to attract foreign direct investment (FDI). The consolidation allowed these municipalities to offer a more attractive investment environment by improving business infrastructure, local governance and financial services

➤ Changes in Investment Distribution Across Regions

The reform had a profound effect on how investments were distributed across Albania. Larger municipalities with more developed economic bases, such as urban centers, began to attract a larger share of investment, while rural or economically disadvantaged areas faced challenges in attracting sufficient investment.

Urban-Centric Investment Growth

- Larger cities (urban centers), saw an increase in implementing different projects focused on infrastructure, tourism, etc. The consolidation allowed for more streamlined urban planning and infrastructure investments, making these areas more attractive to both domestic and foreign investors

Disparities in Rural Investment

- Despite efforts to promote balanced regional development, rural areas still faced challenges in attracting investment. While larger municipalities were intended to reduce regional disparities, many rural regions with lower economic activity continued to lag behind in terms of both public and private investment. The reform helped centralize resources in larger municipalities, but smaller rural areas with lower population densities still struggled to secure the same level of attention and investment as urban areas

➤ Challenges in Aligning Investment Priorities

Although larger municipalities had more resources to invest in development projects, aligning investment priorities across different regions and sectors presented challenges. Larger municipalities were tasked with coordinating investments across urban, rural and peri-urban areas, each of which had distinct needs and capacities.

- **Balancing Urban and Rural Development:** The reform created new challenges in balancing the demands of urban and rural areas. Urban municipalities, with higher populations and stronger economic bases, were able to attract more investment, while rural areas sometimes struggled to secure the resources needed for development. Ensuring that investment was equitable across regions remained a key concern, despite the reform's goal of reducing regional disparities. In this regard, the central government could allocate more funds to areas with lower revenue generation capacity, ensuring that disadvantaged regions had the resources to invest in infrastructure and local services, thereby fostering more balanced development across the country.

- **Coordination Between Central and Local Governments:** Aligning the investment priorities of local governments with national development goals was another challenge. While larger municipalities had more control over local investments, ensuring that these investments contributed to broader national objectives—such as inclusive growth and social welfare—required close coordination with central government agencies.

7. CONCLUSION AND RECOMMENDATIONS

In conclusion, the **Territorial Administrative Reform** in Albania represents a critical step in local governance and financial management improvement. It was a multi-faceted process involving a diverse array of stakeholders, from government institutions to international donors, local authorities, civil society and the public. The involvement of these diverse groups was crucial to ensuring the reform was inclusive and effective, addressing the needs of local communities while aligning with broader national and international goals for governance, regional development and EU integration aspiration.

TAR represented a critical attempt to address deep-rooted inefficiencies in local governance, strengthen democratic processes and ensure more equitable development across the country. By consolidating administrative units and enhancing the capacity of local governments, the reform aimed to create a more sustainable and responsive governance structure, which was considered as vital for the political and economic future of Albania.

The Territorial Administrative Reform had a profound impact on local government budgets, resulting in both opportunities and challenges. In this regard, the consolidation of municipalities allowed for economies of scale, reduced administrative duplication and improved coordination of public services. Larger municipalities could better manage their finances, generate revenue, and attract investment, all of which contributed to more effective and efficient use of public resources. Having said that, the Territorial Administrative Reform in Albania resulted in several key efficiency gains in public spending.

The reform also involved increased expenditures in areas such as infrastructure development, social services, capacity building and regional development. The reallocation of resources and the implementation of fiscal equalization mechanisms have been essential in ensuring a fairer distribution of public funds, but *challenges remain in balancing the needs of urban and rural areas and maintaining fiscal sustainability.*

While the reform increased fiscal autonomy, it also highlighted the need for improved financial planning, transparency and capacity-building at the local level to ensure the long-term sustainability and effectiveness of local governance. The reform's success in this area ultimately depends on *continuous support for local authorities, particularly in strengthening financial management systems and ensuring equitable resource distribution across the country.*

The Territorial Administrative Reform introduced a series of financial risks that local governments had to navigate carefully. These risks included challenges related to revenue

generation, debt sustainability, expenditure management, administrative capacity and regional fiscal imbalances. To mitigate these risks, local governments must adopt appropriate fiscal planning, improve tax collection systems, ensure effective public investment management and enhance transparency and accountability. Strengthening the capacity of local governments to manage their new responsibilities will be crucial in ensuring the long-term success of the reform and the financial stability of municipalities. Furthermore, continued support from the central government in the form of fiscal equalization mechanisms and capacity-building programs will help balance regional disparities and support local governments in managing their finances more effectively. Also, with better governance and access to investment, municipalities can develop and implement sustainable growth models that focus on green development, renewable energy, and environmental conservation.

The territorial consolidation created opportunities for enhanced regional cooperation in addressing cross-municipal issues, such as environmental management, transportation and tourism. Previously, smaller municipalities often operated in isolation, which limited their ability to leverage regional synergies. The larger municipalities were better able to coordinate their efforts and pool resources for common regional goals. In this regard, larger municipalities could undertake joint projects with neighboring municipalities to tackle regional issues more efficiently. This will allow for the reallocation of resources toward regional priorities such as environmental protection, sustainable tourism, etc., according to which will benefit multiple communities within a larger geographical area.

While challenges remained in the early years of implementation, the reform has laid the groundwork for more sustainable, accountable, efficient local governance in Albania and the country's EU aspirations.

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