Overview of Balanced Regional Development and Fiscal Decentralization: Regional Disparities and Fiscal Decentralization

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Policy Paper:

Overview of Balanced Regional Development and Fiscal Decentralization: Regional Disparities and Fiscal Decentralization

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LIST OF ABBREVIATIONS

GDP	Gross Domestic Product
SSO	State Statistical Office
EU	European Union
LSGU	Local Self-Government Unit
BRD	Balanced Regional Development
RNM	Republic of North Macedonia
USA	United States of America
USAID	United States Agency for International Development

EXECUTIVE SUMMARY

Fiscal decentralization and balanced regional development are closely related instruments and there is a need when making policies for one of these instruments of economic progress to take into account the challenges for the other instrument as well. In the Republic of North Macedonia (RNM), both fiscal decentralization and balanced regional development are Constitutional categories, so the field of research in this document is socio-economic, because in the Constitution of the RNM it is defined as the economic progress of the regions.

RNM, on the one hand, does not have success in the balanced regional development, and on the other hand, there is a need expressed by the Government and other stakeholders for a "new wave of decentralization". So far, researches are prepared about balanced regional development and fiscal decentralization, but those researches are thematic and concern either regional development or decentralization separately as separate phenomena and do not go into the interactions and impact of fiscal decentralization on the balanced regional development in RNM. This analysis aims to fill that research gap because these phenomena in real life do not act separately from each other and certainly have mutual influence. This is important for policy makers to know that in the second generation of fiscal decentralization laws and policies, those policies and laws cannot separate these two instruments as separate instruments for achieving national goals.

Furthermore, bearing in mind that RNM is a candidate country for EU membership, we also take into account the Treaty on the Functioning of the EU, more specifically Article 2 where the EU is promoted through economic, social and territorial cohesion. The measure by which EU measures the progress of cohesion is convergence, i.e., through the reduction of regional differences in the level of development in the EU measured as GDP per capita in relation to the average GDP per capita of the EU.

Therefore, in our research on the measurement of the balanced development of the regions, we follow similar researches from the EU that have both a theoretical and an empirical basis. For RNM, in addition to the relatively high unbalanced in regional development, it is even more worrying that this, measured by the coefficient of variation of GDP per capita for the regions, is increasing in the period from 2011 to 2021. The fact that although the RNM has an established strategic and normative framework and institutional setting, it does not ensure progress in terms of policy implementation and does not contribute to the effective reduction of disparities within and between planning regions and their respective demographic, economic, social and spatial cohesion is worrying. In addition, the weaknesses of the policies for balanced regional development, in addition to the non-compliance with the Law in terms of budget planning for 1% of GDP for balanced regional development, is the lack of capacity for the realization of financial resources, both by the Bureau for Regional Development and by the Centers for the Development of Planning Regions.

Empirical findings for RNM are that planning regions do not converge among themselves towards a stable long-term steady state. Explanatory endogenous factors for the (lack of) convergence of regions in RNM can be: the population density of LGUs within the regions, the share of urban LGUs in the total number of LGUs and the labor market activity of LGUs within the regions. The findings show, for example, that a higher density of LGUs in regions increases regional inequality

by an average of 2%-7%. From our analysis, we conclude that more densely populated regions and those where the labor force is more active in the labor market have slower convergence. On the other hand, greater urbanization drives the economic growth of the regions.

Furthermore, the findings about the endogenous variables are that the less developed-secondary regions lag behind the development of the more developed-primary regions due to the effect of migrations to urban centers and emigration. The magnetic attraction of the more-developed-primary-regions (specific to the Skopje planning region) exacerbates the differences compared to the secondary-less-developed-regions. The effects of agglomeration draw people to the primary centers of productivity growth and higher earnings leaving the more underdeveloped secondary regions without factors of production and without potential. In that sense, the possibility of increasing the potential of secondary regions should be given a chance in order to increase their attractiveness and competitiveness.

In addition, the statistical significance of endogenous factors for the convergence of planning regions in RNM means that convergence is conditioned by endogenous factors for planning regions, so they do not converge to a long-term steady state characterized by a growth rate that depends only on exogenous variables such as the rates of technological progress, trust in institutions and the growth of the labor force, rather it clusters regions to converge towards different rates of long-term steady states and depend on the endogenous factors of the regions themselves appear. Namely, the concentration of capital, investments, human resources, technical infrastructure, social facilities and institutions especially in the city of Skopje violates and threatens the concept of polycentric development of the state, which was a starting assumption for balanced regional development in the state on the first place. This means that there is at least one cluster of secondary-less-developed-regions in which the primary Skopje planning region does not enter.

That is why it is necessary in the criteria for the allocation of funds from the central government (regardless of whether in the system of fiscal decentralization or in the system of balanced regional development) to take into account those LGUs that are in regions that have a lower population density and in which the workforce does not participate enough in the labor market and where the population is predominantly rural.

In the RNM, the same economic benefits cannot be expected from fiscal decentralization as in more developed economies, and therefore it should be designed in such a way as to take into account the relevant specifics of the country, the degree of development of democracy and good governance. Furthermore, it should be taken into account that in the RNM decentralization after 2001 was used more as an instrument for calming ethnic tensions rather than as an instrument for achieving economic efficiency and good governance. Therefore, after more than 20 years, fiscal decentralization should be seen more as an instrument for achieving socioeconomic goals rather than as an instrument for calming ethnic unrest.

Fiscal decentralization and the transfer of responsibilities may negatively affect the balanced development of the regions. There are certain categories such as economies of scale and externalities that lead to spillover effects from one LGU to other LGUs. For such competences, one should either approach asymmetric decentralization or consider the transfer of competences to the planning regions. For example, the social risk of poverty, unemployment and other social risks, waste management would be better managed at the level of regions than by LGUs. Another

example is the population density of LGUs where more densely populated LGUs may enjoy positive effects from economies of scale compared to LGUs similar in territory but with a smaller number of inhabitants within a planning region. Here, the measure of increasing the income of the population will not affect balanced development because those regions with fewer inhabitants per m2 in their LGUs have lower income perhaps simply due to lack of population and therefore have lower economic activity.

How do the endogenous variables of fiscal decentralization affect the balanced development of regions? To answer this question through an empirical analysis, as endogenous measures of fiscal decentralization, we take LGU revenues (own revenues and shared personal income tax but excluding VAT transfers) in the respective regions and those LGU expenditures in the respective regions from the program presentation of expenditures for which we can assume with considerable certainty that LGUs decide independently from the central government on providing services to citizens (urban planning, local economic development and communal activities). We take these variables either as nominal values, or as a share of total or per capita in order to empirically evaluate which of their transformations has a statistically significant effect on the balanced development of the regions. We measure the balanced development of regions through: coefficient of variation, or the weighted coefficient of variation or the Gini coefficient.

The findings of the empirical analysis show that:

- In RNM, a 1% decrease in the number of inhabitants in the region leads on average to a 2% increase in inequality in the planning regions (measured as the weighted coefficient of variation or as the GINI coefficient).
- 1% increased revenues at LGUs are correlated with a 7% to 7.6% reduction in regional inequality, but if we also take into account the number of population in the regions, then the impact, per capita, can be up to 12.6% in reducing inequality of GDP per capita for planning regions. So demographic trends have high effects in the evenness of development in the regions.
- An increase in the share of LGUs' own revenues in their total revenues is correlated with increased regional inequality. This means that the lower economic power in the LGUs themselves reflects the economic reality of the less developed regions, because even if the effort to collect own revenues in the LGUs increases, then the inequality in the regions would increase due to the fact that the economic activity of the population is either lower or on average, the potentials of that less developed region are exhausted, i.e., no matter how much they increase the effort to collect revenues, LGUs in those regions would still lag behind the more developed regions due to the low potentials for economic activity. In that case, the role of the central government is, through the instruments of regional development, to sustainably influence the less developed regions to increase their economic potential rather than to solve the challenge with instruments for reducing poverty, for example.
- In other words, the collection of own revenues by LGUs is a good indicator of how far revenue can be expected from the tax base for the local government, but it is also implicitly an indicator of the level of the limited economic potential of the poorer regions where there is a relatively higher tax effort among LGU. In that case, the central government should work on increasing the economic potential of the less developed

regions so that they can converge towards the long-term steady state of the more developed regions.

- If we measure good governance through the budget implementation at LGUs (realized revenues compared to planned revenues), the effect is such that a higher budget implementation at LGUs is correlated with an increase in the degree of inequality in the regions. This finding must be seen from at least three aspects. First, the budget realization here is of the total revenues of LGUs, which on average in RNM have low fiscal autonomy, so the impact of transfers is such that they may influence the increase of inequality in the regions (in fact, the block grants from fiscal decentralization are designed in that way to finance existing facilities rather than service development of the transferred competency). Second, those primary regions where LGUs have sufficient economic power leave behind those secondary regions where LGUs have less attractive economic potential. Third, in the context of the findings from above, budget implementation has limited power to be correlated with higher development because the effect of the economic (non)attractiveness of less developed regions has a higher negative effect than the possibility of a positive effect even with full budget implementation of LGUs because secondary regions have lower economic potential. Therefore, the focus of the government policies should be more towards the economic development of the regions than towards the economic growth of the regions.

More details are given in the findings and recommendations of this document in the section of the empirical analysis and in the section of the analysis of the Proposal document of the working group for the expansion of the decentralization process dated 2019 and Information on the continued process of institutional decentralization prepared by the Ministry of Local Self-Government dated 2019.

In this document, several recommendations are proposed, which we list taxatively here, but more details about the recommendations can be found in the main text of the document below:

- To make a detailed analysis of the achievements of decentralization so far.
- Each subsequent generation of decentralization in RNM must also take into account the impact it would have on balanced regional development.
- To make an analysis for the introduction of asymmetric and/or the introduction of competences to the planning regions, which would make them the second level of local government. More specifically, deconcentration or asymmetric decentralization and/or a change in territorial organization by introducing cities and municipalities, introducing a two-level local government with LGUs and regions or simply consolidating LGUs according to the "old" division of 34 LGUs.
- Fiscal decentralization should be seen as a socio-economic instrument and not as an instrument for ethnic consolidation.
- To make a detailed analysis of the failure to achieve balanced development of the regions.
- Decentralization cannot be seen separately from balanced regional development.
- The focus should be on economic development, not economic growth.
- To make an evaluation of the factors that are taken as measures for the degree of development of the regions.

- The Skopje Planning Region as a whole in a certain period of time may have to contribute to the distribution to other planning regions respecting the Robin Hood principle. This could be a transitory decision until a "reasonable balanced regional development" is reached (reasonable balance is also subject to analysis and evaluation) between Skopje planning region and the rest of the planning regions).
- As for the VAT transfer, the City of Skopje should be analyzed fragmented at the level of LGUs that have greater potential compared to those LGUs that do not have enough potential, so the VAT transfer for the City of Skopje should also take that fact into account.

INTRODUCTION AND ACTIVITY OBJECTIVE

The Republic of North Macedonia (RNM) strives to be a prosperous, independent and inclusive democratic society. The USAID Project for Strengthening Resource Mobilization Activity, 2021-2026 helps the governmental institutions of North Macedonia raise and independently manage the resources needed to finance the services that citizens require. Facing difficulties in collecting revenues and executing budgets, 81 units of the local self-government of North Macedonia are ready for this challenge, and it is in the interest of North Macedonia to take advantage of the opportunity offered by the USAID Project for Strengthening Resource Mobilization Activity (hereinafter "The Project").

The project team enables participatory and sustainable transformation, helping the local governments of North Macedonia to generate, access and effectively manage their own revenues and other external revenues needed to finance social services and programs that provide benefits to the citizens.

The project works with local self-government units, the Government of the Republic of North Macedonia (GRNM) and key stakeholders on: 1) improvement of the quality of municipal systems for collecting fees and taxes; 2) increasing the capacity of local self-government units (LSGUs) to access external resources from central government funds or international organizations and/or capital markets and banks; 3) improvement of LSGUs' ability to plan, manage and collect revenues from the public sector in accordance with the regulation of North Macedonia; and 4) improvement of the decentralization process.

The topics covered in this document are aimed towards balanced regional development and how fiscal decentralization as an important pillar of the decentralization process in the RNM affects balanced regional development. Both concepts, fiscal decentralization and balanced regional development are constitutional categories. Article 57 of the Constitution states that the Republic encourages economic progress and provides for a more balanced regional development, as well as faster development of economically underdeveloped areas. Decentralization, on the other hand is regulated in Chapter V of the Constitution by defining municipalities as units of local self-government. With reference to the fiscal part, municipalities are financed from their own sources of revenues determined by law and with funds from the Republic. Furthermore, the Constitution stipulates that in the local self-government units citizens participate directly and through representatives in the decision-making on issues of local importance, especially in the areas of urban planning, communal activities, culture, sports, social and child protection, pre-school education, primary education, basic health care and in other areas established by law.

On one hand, the RNM does not have great success with reference to balanced regional development, and the Government of RNM also feels the need for a "new wave of decentralization", which we will discuss into more detail later in the text. So far, researches have been done on balanced regional development and fiscal decentralization, but those researches are thematic and concern either regional development or decentralization separately as two distinct phenomena and do not go into the interactions and the impact of fiscal decentralization on the balanced regional development of the RNM. This analysis aims to fill that gap for such researches.

On the other hand, RNM is a candidate country for EU membership, hoping to be able to start using EU cohesion funds in the future. The objective of the European Cohesion Policy is defined in the Treaty on the Functioning of the EU[1], more specifically according to Article 2, the EU should promote economic, social and territorial cohesion. These foundations are further regulated in more detail in Title XVIII on economic, social and territorial cohesion. In particular, Article 174 of the agreement defines the goal of the EU, namely: *"In particular, the Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favored regions. Among the regions concerned, particular attention shall be paid to rural areas, areas affected by industrial transition, and regions which suffer from severe and permanent natural or demographic handicaps such as the northernmost regions with very low population density and island, cross-border and mountain regions."*

The measure by which the Union evaluates the progress of cohesion is convergence. Namely, although the cohesion policy aims at purely economic convergence, in the EU the reduction of regional differences in the development level is mainly measured as the convergence of regional levels of GDP per capita in relation to the average of EU GDP.

Hence, there is the need to analyze the impact of fiscal decentralization onto the balanced regional development in the RNM as well. The field of research is socio-economic because in the Constitution of the RNM, it is defined as the economic progress of the regions. Within the Constitution, decentralization provides municipalities with functions in areas (spatial planning, culture, sports, social and child protection, education, health care) that are important for the spatial and socioeconomic development of the state and are directly related to the factors of economic growth and development (space, people, capital: human, infrastructural and social) i.e. the economic progress, as stated in the Constitution. Hence, fiscal decentralization and balanced regional development are closely related and when making policies for one of these instruments of economic progress, it is required to take into account findings and challenges for the other instrument as well.

On the other hand, we would like to take into account, as far as the resources for this analysis allow, the ambitions of the Government of the RNM for a "new wave" of decentralization through the analysis of the *Proposal document of the working group for the expansion of the decentralization process* and the *Information on the continued process of institutional decentralization* by the Ministry of Local Self-Government. Although these documents are dated 4 years ago, we will proceed with their analysis and make a selection of competences from these documents according to predetermined criteria. The goal is to understand the extent of the expansion of decentralization for selected competences so that a fiscal assessment of those expanded competences can be made, as well as of their possible impact towards a more balanced regional development. Details regarding this activity are provided in chapter 4.

Therefore, the purpose of the activity of this document is *to assess the impact of fiscal decentralization on balanced regional development and to assess the impact of the expansion of the decentralization process (the fiscal part) on the balanced regional development.*

The implementation of the activity includes:

- desk research,
- quantitative and qualitative analysis,

[1] See more: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:12012E/TXT.

- through quantitative data for LSGUs and planning regions and
- through data collected from conversations with line ministries

in order to give certain expert assessment regarding the impact of fiscal decentralization on the balanced regional development so far and to give an evaluation of the fiscal scope of the selected competences from the *Proposed document of the working group for expanding the decentralization process and the Information on the continued process of institutional decentralization* by the Ministry of Local Self-Government and how they would influence balanced regional development.

Fiscal data on the revenues of LSGUs in RNM are provided by the Treasury Office of the Ministry of Finance. The data on the regions are provided by the State Statistics Office (SSO) and the SSO's MakStat database. The other sources of data and information are based on other sources, analyses, documents and studies of the CEA, the project and publicly available information related to and connected to the research subject.

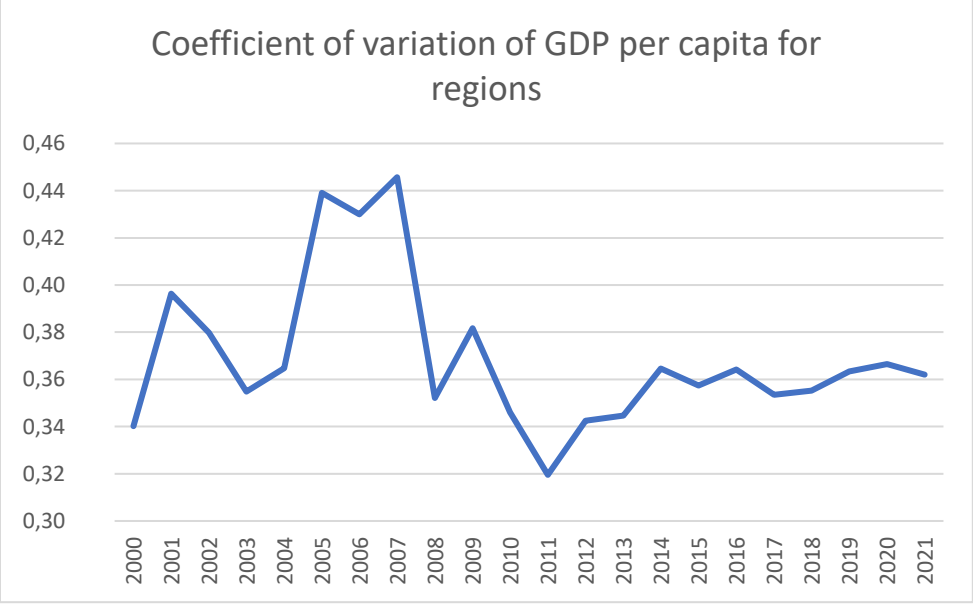
The first part of this document analyzes the balanced regional development, while the second part refers to fiscal decentralization as an introduction to the third part which empirically investigates the impact of fiscal decentralization on balanced regional development. The empirical research is followed by an analysis of the data emphasizing the findings and the corresponding recommendations. The fourth part of this document covers the analysis of the Proposed document of the working group for expanding the decentralization process and the Information on the continued process of institutional decentralization by the Ministry of Local Self-Government and how they would influence balanced regional development.

1. BALANCED REGIONAL DEVELOPMENT

Article 57 of the Constitution of the RNM indicates that the Republic encourages economic progress and takes care of more balanced spatial and regional development, as well as faster development of economically underdeveloped areas. So, the balanced regional development provides the economic aim towards encouraging the economic progress in economically underdeveloped areas.

However, although the RNM has the established strategic and normative framework and institutional setting, it does not ensure progress in terms of policy implementation and does not contribute to the effective reduction of disparities in and between planning regions and their appropriate demographic, economic, social and spatial cohesion[2].

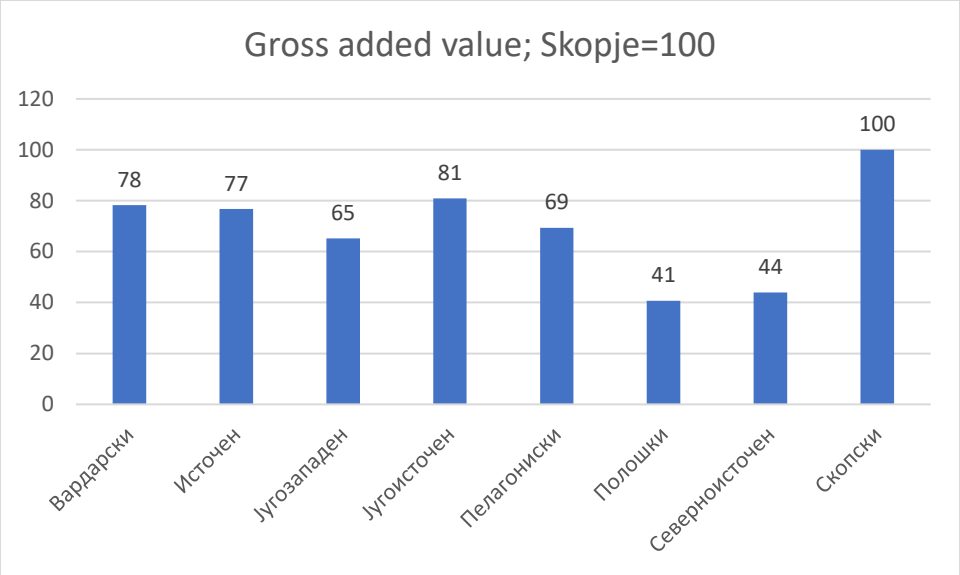
Research also shows that despite the relatively high inequality in the regional development of the RNM, it is even more worrying that this inequality has increased over the last years as measured with the coefficient of variation of GDP per capita for regions (illustrated in the following Graph 1). As presented in Graph 1, from 2011 to 2021 the variation increases i.e. the inequality measured as GDP per capita grows over time.



Graph 1. Coefficient of variation -CV

At the same time, the inequality is especially noticeable when comparing the Skopje Planning Region with the rest of the regions (see Graph 2). What we can conclude is that the least developed regions (Polog and Northeastern) measured as gross added value per capita do not even reach half of that of the Skopje Planning Region.

[2] See more: SAO (2022): "Final performance audit report: Balanced regional development with special emphasis on demography"



Graph 2. Gross added value of the planning regions for 2021. Skopje=100.
Source: State Statistical Office. Author's calculations

The weaknesses of the policies for balanced regional development, in addition to the non-compliance with the Law in terms of budget planning for 1% of GDP for BRD, is the lack of capacities for distribution of financial resources, both on the part of the Bureau for Regional Development and the Centers for the development of planning regions[3].

1.1. BETA-CONVERGENCE

We will analyze the convergence of planning regions (hereinafter the regions) in the RNM through the so-called Beta convergence[4]. Beta-convergence refers to a process in which poorer regions grow faster than richer regions. The concept of Beta-convergence is directly related to the theory of neoclassical growth (Solow, 1956[5]) where a key assumption is that the factors of production, especially capital are with diminishing returns. Accordingly, the growth process should lead the regions to a long-term steady state characterized by a growth rate that depends only on the rates of technological progress, institutional trust and labor force growth (**exogenous factors**). Diminishing returns to economic growth imply that the growth rate of poorer regions should be

[3] See more: CEA (2017): "Determinants of the influence of civil society organizations in creating policies for balanced regional development": https://cea.org.mk/wp-content/uploads/2017/09/CEA-Determinanti.pdf
[4] See more: Monford P. (2008): Convergence of EU regions Measures and evolution, EU Regional series No. 1/2008.
[5] See more Solow R. (1956): A Contribution to the Theory of Economic Growth, The Quarterly Journal of Economics, Vol. 70, No. 1 (Feb., 1956), pp. 65-94.

higher than that of richer regions and their income and/or GDP per capita should possibly reach the level of richer regions.

When all regions converge to the same steady state (in terms of GDP per capita and economic growth rate), **Beta-convergence is said to be absolute**. However, the steady state may also depend on characteristics that are specific for each region i.e. on **endogenous factors**. In that case, when GDP per capita depends on a number of other endogenous factors i.e. on the resources in the regions or on the quality of the institutions in the regions, which may differ from one region to the other even in the long term, **Beta-convergence is said to be conditional**. It is interesting that Sala-I Martin (1996)[6] prove through research that the speed with which economies move towards the steady state is about 2% per year.

In general, the literature on evaluating the speed of Beta-convergence follows the logic that firstly the growth process should lead regions to a long-term steady state characterized by a growth rate that depends only on the rates of technological progress and labor force growth (exogenous factors). Secondly, that the growth rate of poorer regions should be higher and their income and/or GDP per capita should reach the level of richer regions. Mathematically it is represented with the following Equation-1:

$$ln(\Delta y_{i,t}) = \alpha + \beta ln(y_{i,t-1}) + \gamma Z_{i,t} + \mu_{i,t} \quad (1)$$

where: $y_{i,t}$ и $\Delta y_{i,t-1}$ are GDP and GDP per capita growth rate in region-i at time-t

$Z_{i,t}$ is the matrix of other factors affecting the growth rate in which we will also include a variable for fiscal decentralization

$u_{i,t}$ is a standard error

$\alpha, \beta \; and \; \gamma$ are parameters that need to be statistically estimated

If the relationship between the growth rate $\Delta y_{i,t}$ and the initial level of GDP per capita $y_{i,t}$, i.e. β is statistically significant and negative, then it is a sign of convergence of regions. The estimated value of β also indicates the rate at which the regions are approaching their steady state, and hence the rate of convergence.

If the value of γ is equal to 0, it is assumed that there is **absolute convergence**, and if this parameter is statistically significant and different from zero, then it is assumed that there is **conditional convergence**.

Usually, the findings related to Beta-convergence in literature are[7]:

- There is Beta convergence between EU regions;

[6] See more: Sala-I Martin X. (1996): The Classical Approach to Convergence Analysis; The Economic Journal Vol. 106, No. 437 (Jul., 1996), pp. 1019-1036.
[7] See more: Monford P. (2008): Convergence of EU regions Measures and evolution, EU Regional series No. 1/2008.

- The rate of convergence is not constant in time and it has low values that are specific to the eighties and higher values for periods before and after that decade;
- The estimated rate of convergence is quite low when using absolute convergence models and higher when using conditional convergence models, which mostly reflects the fact that although convergence is sometimes higher within some clusters of regions compared to others (e.g. primary versus secondary regions[8]), it is often much lower;
- The inclusion of spatial effects is relevant (presence of significant local spatial autocorrelation and spatial heterogeneity) and tends to reduce the estimated rate of convergence and emphasize the rate of convergence for poorer regions in the EU.

For the RNM, in the research on the determinants of regional inequality we will also include measures for fiscal decentralization because our hypothesis is that fiscal decentralization has an explanatory impact on balanced regional development. We will do that through a matrix of variables-$Z_{i,t}$ in which matrix there are also variables for fiscal decentralization. We base the hypothesis on the empirical fact of convergence that also occurs for the EU. Of course we will need to include other socio-economic factors related to space, labor force, urban/rural characteristics which we will discuss below. The factor of space and population density is important for the RNM because empirical evidence shows that in the RNM population density is negatively correlated with the efficiency of local service provision indicating that a significant part of inefficiencies are more determined by inefficiencies from economies of scale, rather than from the technical efficiency of the use of production factors of public services at LSGUs level[9].

1.2. BETA-CONVERGENCE FOR PLANNING REGIONS IN THE RNM

We present the results of the Beta-convergence calculations for the planning regions in the RNM for the period 2001-2021. The goal is to see if there is absolute convergence for the planning regions in the RNM i.e. to evaluate whether there are also endogenous factors that affect the convergence of the planning regions in the RNM.

The specification of the model is represented with Equation-(2):

$$ln(\Delta y_{i,t}) = \alpha + \beta ln(y_{i,t-1}) + \gamma t + \mu_{i,t} \quad (2)$$

The results of the estimation are presented in the following Table 1[10].

[8] Primary regions are considered regions that have significantly higher GDP per capita, are economically more attractive for the population and are poles for migration. Secondary are those regions that fall behind the primary regions in terms of GDP per capita, the population migrates to the primary regions and thus fall behind the primary regions regarding the socio-economic indicators.

[9] See more CEA (2022): Asymmetric Decentralization: A Brief Report for Public Policy Makers: Options for the Republic of North Macedonia, USAID Strengthening Resource Mobilization Activity.

[10] For econometric analysis we use E-Views 10.

Table 1. Evaluation of Beta-convergence for planning regions in the RNM

	$ln(\Delta y_{i,t})$
α Intercept	**-0.260 (-1.406)**
β GDP growth rate per capita	**0.028** (1.751)**
γ Time	**-0.003*** (-1.881)**

Note: t-statistics are in parentheses. ****, ***, **, and * indicate statistical significance at 1%, 5%, 10%, and 15% level respectively.

1.3. BETA-CONVERGENCE ANALYSIS FOR PLANNING REGIONS IN THE RNM

From the results of the estimation we can conclude that **the estimated parameter - β (*Growth rate of GDP per capita*) is statistically significant at 10% statistical level but it is positive which means that there is no convergence between regions in the RNM.**

We also want to assess whether there are endogenous factors that influence the convergence of regions in the RNM. Therefore, we take another vector matrix of factors into account $(Z_{i,t})$ to evaluate the endogeneity of the convergence model of planning regions in the RNM i.e. we use Equation (1) above in order to insert the matrix $(Z_{i,t})$ in it and is presented in the following Equation-3.

$$\ln(\Delta y(i,t)) = a + \beta_1 TIME + \beta_2 \ln(y(i,t-1)) + \gamma_1 \ln(GUS) + \gamma_2 \ln(URRU) + \gamma_3 \ln(LAB) + \gamma_4 \ln(ETF) + \mu_{(i,t)} \quad (3)$$

For the matrix of endogenous variables $(Z_{i,t})$ we will take into account: population density, the share of urban LSGUs in the total number of LSGUs in the proper region, the activity rate of the labor force and ethnic fragmentation according to Alesina et al (1999) [11](**GUS**=population density in the region; **URRU**=share of urban LGUs in the region; **LAB**=labor force participation; **ETF**=ethnic fragmentation).

Let us explain the choice of these variables in addition to the trivial explanation of data availability and the explanation that such variables are taken into account in other similar studies (Lessmann-2012 or Kyriacou et.al.-2013). In the RNM the difference in fiscal parameters between urban and rural LSGUs[12] is noticeable. The differences are noted in the collected revenues and expenditures, population density, but also differences in labor market characteristics. Furthermore, in the RNM the activity of the working-age population provides a better description of the labor market than just employment and/or unemployment. This may be due to cultural factors on gender differences

[11] See more: *Alesina A., Baquir R. and Easterly W. (1999): "Public goods and Ethnic Division," in e-Library World Bank Policy Research Working Paper Series 2108*
[12] See more CEA (2022).

in labor market participation, migration and/or gray economy participation that make the labor market footprint different from that of richer EU member states. Furthermore, decentralization has so far been used as an instrument to achieve the goals of the post-conflict Constitution in the RNM. At that point, in order to reduce ethnic tensions, expensive preferential policies at LSGU level were chosen (for example bilingualism at LGUs), which require additional resources, but can also be reasons for conducting ethno-political games without effects (zero sum games) that do not end in economically efficient local policies[13]. That is why the selection of variables as endogenous factors for planning regions was made through LSGUs that belong to the respective regions.

The results of the assessment of the model with specification according to Equation (3) are presented in the following Table 2.

Table 2. Estimation of Beta-convergence for planning regions in the RNM with endogenous variables

	$ln(\Delta y_{i,t})$
α Intercept	**1.265*** **(1.453)**
β_1 Time	**-0.012**** **(-3.797)**
β_2 GDP growth rate per capita	**0.187**** **(3.827)**
GUS	**-0.075*** **(-1.435)**
URRU	**0.043** **(1.366)**
LAB	**-0.780**** **(-3.332)**
ETF	**-0.001** **(-0.011)**

Note: t-statistics are in parentheses. ****, ***, **, and * indicate statistical significance at 1%, 5%, 10%, and 15% level respectively.

From the estimation we can see that more densely populated regions and those where the labor force is more active in the labor market have a slower convergence. On the other hand, greater urbanization drives the economic growth of regions (statistically significant at 20% statistical significance). Ethnic fragmentation has no statistically significant influence on the convergence of planning regions.

[13] See more: Nikolov, M. (2013). The measurement and impact of fiscal decentralization: The case of Macedonia. [Doctoral dissertation, University of Ljubljana, School of Economics and Business]

1.4. SIGMA-CONVERGENCE

While Beta-convergence focuses on detecting possible catching-up of poorer regions, Sigma-convergence refers to the reduction of disparities between regions over time. The two concepts are of course closely related. Formally, Beta-convergence is necessary but not sufficient for Sigma-convergence. Intuitively, this is either because regions can converge to each other but random shocks diverge them or because in the case of conditional Beta-convergence, economies can converge to different steady states.

Therefore, it is suggested to analyze the Sigma-convergence that directly explains the distribution of income across regions without relying on the estimation of a statistical model. The most commonly used measures of Sigma-convergence are the coefficient of variation, the weighted standard deviation, and the Gini coefficient, which we will also use in our analysis. The variable that is usually taken into account for the calculation of these measures is the regional GDP per capita.

1.5. SIGMA-CONVERGENCE FOR THE PLANNING REGIONS IN THE RNM

We present the results of the calculations for the three measures of the Sigma-convergence for the planning regions in the RNM for the period 2001-2021. The calculations are taken for GDP per capita with an average uniform population growth rate calculated by comparing the 2021 Census with the 2002 Census (decrease from 2,022,547 inhabitants to 1,836,713 inhabitants). We calculate the Sigma-convergence with three indicators:

- Coefficient of variation $CV = \frac{1}{\bar{y}}\left[{}^{1}/_{n}\sum_{i=1}^{n}(\bar{y} - y_i)\right]^{1/2}$; Equation (4)
- Gini coefficient = $GINI = \frac{\sum_{i=1}^{n}(2i-n-1)y_i}{n\sum_{i=1}^{n} y_i}$; Equation (5)
- Weighted coefficient of variation = $WCV = \frac{1}{\bar{y}}[\sum_{i-1}^{n} p_i(\bar{y} - y_i)]^{1/2}$; Equation (6)

Where:

y- are GDP per capita for the regions; $\bar{y}$- average GDP per capita for the regions for a specific year

i-are regions (for the Gini coefficients they must be in ascending order for the accuracy of the calculation)

n=8 planning regions

t- is the time for the period 2000-2021

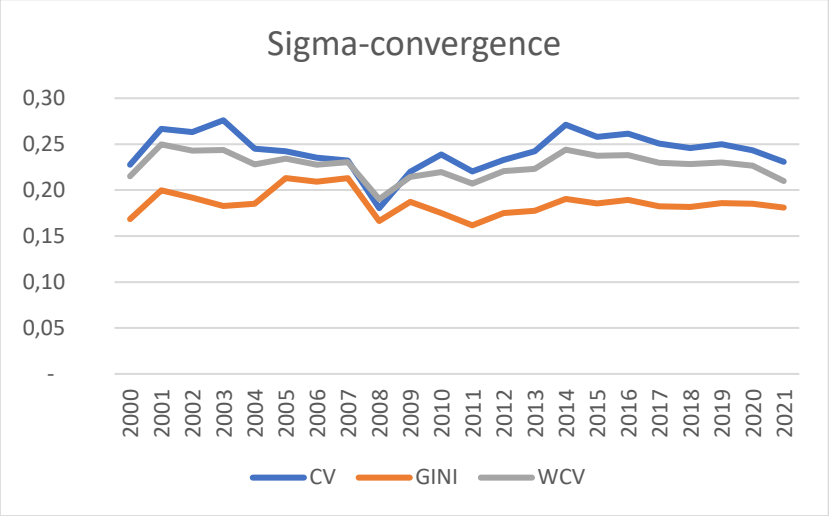
The results are illustrated in the following Graphs.

Graph 3. Measures of Sigma convergence

Coefficient of variation-CV

Gini coefficient-GINI

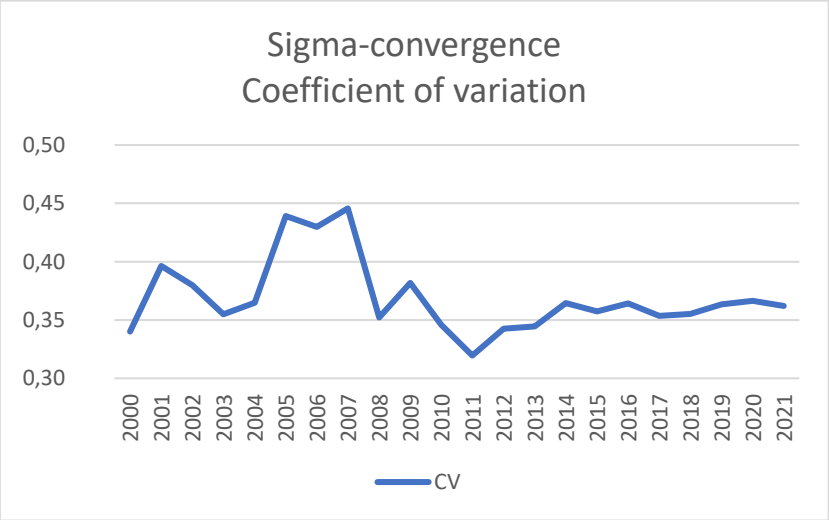
Weighted coefficient of variation-WCV



Equation (4)

$$CV = \frac{1}{\bar{y}}\left[1/n \sum_{i=1}^{n} (\bar{y} - y_i)\right]^{1/2}$$

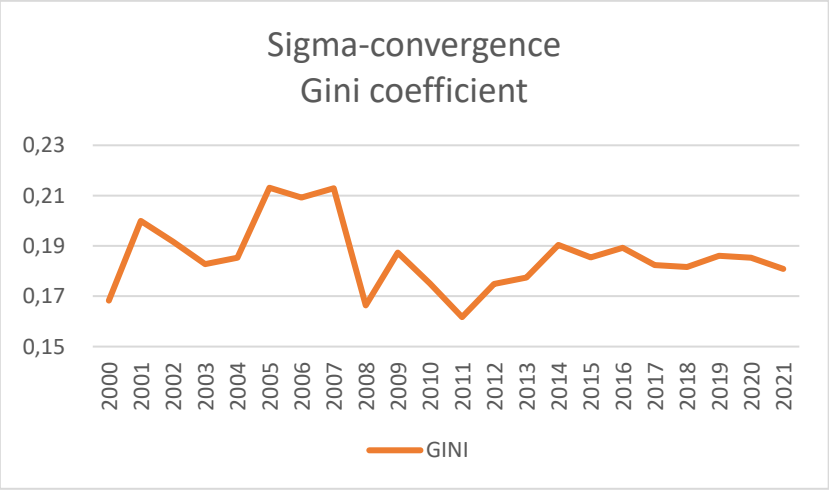
Graph 4. Coefficient of variation-CV



Equation (5)

$$GINI = \frac{\sum_{i=1}^{n}(2i - n - 1)y_i}{n\sum_{i=1}^{n} y_i}$$

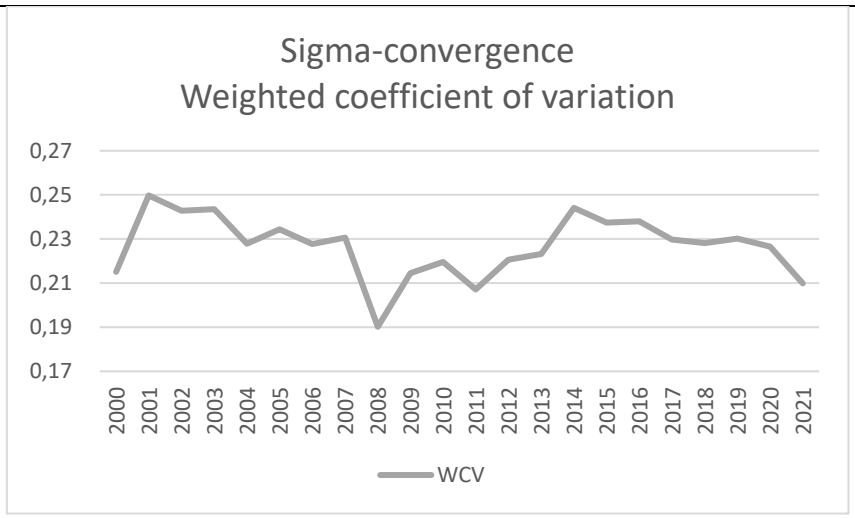
Graph 5. Gini coefficient -GINI



Equation (6)

$$WCV = \frac{1}{\bar{y}}\left[\sum_{i-1}^{n} p_i(\bar{y} - y_i)\right]^{1/2}$$

Graph 6. Weighted coefficient of variation - WCV



1.6. SIGMA-CONVERGENCE ANALYSIS FOR THE PLANNING REGIONS IN THE RNM

The cross-correlation between these three measures of Sigma convergence shows a strong correlation between the coefficient of variation and the Gini coefficient (0.95) indicating that the variables GDP and population are theoretically close to a log-normal statistical model, hence the high correlation coefficient between these two Sigma measures. Therefore, we use this finding for another reason for transforming the variables from the econometric analysis with a natural logarithm.

The Gini coefficient has no unit of measurement i.e. it is invariant to the unit of measurement and is limited from zero to one. On the other hand, the coefficient of variation is dependent on the unit of measurement, but is unlimited in that it can be any non-negative value. The invariance of the Gini scale and the limit between zero and one make it easier to compare the statistical dispersion between two different data sources which is more difficult with the coefficient of variation. But on the other hand, the Gini coefficient is quite sensitive to extreme deviations in the observed parameters (outliers), so an extreme data point (large or small) can dramatically increase the Gini coefficient (for example the extreme with data on the Skopje Planning Region (see Graph 2)). Namely, Graph 2 above clearly shows that the least developed regions (the Polog and Northeastern) measured as gross added value per capita in 2021 do not even reach half of that of the Skopje Planning Region. Therefore, it defines the data for the Skopje Planning Region as an extreme value (outliers) which significantly deviates from the gross added value of other planning regions and thus significantly affects the average gross added value for the planning regions in the RNM and can lead to incorrect conclusions. Hence, the coefficient of variation is sensitive to higher observations, so when we remove the Skopje region from the analysis, the correlation coefficient between the weighted coefficient of variation and the other two Sigma-measures of variation increases. So, the Skopje region as an extreme (outliers) affects the Sigma-measures of convergence even though the three measures show equidistance in their variation over time (see graphs above).

However, although they have the same direction of movement and react to shocks over time, **the coefficient of variation** strongly depends on the results of the Skopje Planning Region. It is therefore good to consider the impact of fiscal decentralization on these measures of Sigma-convergence (convergence of regions) separately for each measure. Namely, **the Gini coefficient** is normalized and has no measurement unit and is limited by definition from 0 to 1 and can be compared with other countries. Furthermore, the coefficient of variation is strongly influenced by the extreme in the observations for the Skopje Planning Region, so we will also take into account the population factor in the planning region i.e. it is good to analyze the impact of fiscal decentralization on the inequality of the regions when that inequality is controlled for the population factor (almost a third of the population lives in the Skopje Planning Region). We will do that through the **weighted coefficient of variation**.

The conclusion here is that the Skopje Planning Region represents a significant statistical extreme measured by GDP and by the number of inhabitants as development measures and affects the measurement of the Sigma-convergence. The practice so far has shown that most of the budget funds end up in the City of Skopje, which has further contributed to the divergence of peripheral areas, especially rural areas compared to the mono-center.

Furthermore, the concentration of capital, investments, human resources, technical infrastructure, social facilities and institutions in the City of Skopje undermines and threatens the concept of polycentric development of the state, which in turn was the starting assumption for a balanced regional development in the state in the first place.

Therefore, and bearing in mind the failure of polycentric development and the strong dominance of the City of Skopje as a separate LSGU in the public finances of the fiscal decentralization, the question is raised on the treatment of the City of Skopje and/or the Skopje Planning Region when allocating funds for a balanced regional development and the allocation of VAT funds (from the fiscal decentralization). For example, the Skopje Planning Region as a whole may have to contribute to the distribution towards other planning regions on the Robin Hood principle over a certain period of time. This could be a transitory decision until a "reasonable balance" is reached (what is reasonable balance is also subject to analysis and evaluation) between the Skopje and the rest of the planning regions. This is in line with the research findings of Dalton (1920) and Pigou (1912) and their transfer principle which indicates that society as a whole would be in a better position if one unit of income was transferred from the richer to the poorer region through the Robin Hood principle[14]. With reference to the VAT transfer, the City of Skopje should be analyzed fragmented at the level of LSGUs that have greater potential compared to those LSGUs in the City of Skopje that do not have enough potential, so for the VAT transfer for the City of Skopje that fact should also be taken into consideration.

2. FISCAL DECENTRALIZATION

Decentralization is regulated within the Constitution of the RNM in Chapter V by defining municipalities as units of local self-government. In the fiscal part, municipalities are financed from

[14] See more: Pigou, A. C. (1912). Wealth and Welfare. London: Macmillan и Dalton, H. (1920). The Measurement of the Inequality of Incomes. Economic Journal, 30(119).

their own sources of revenues determined by law and with funds from the Republic. Furthermore, the Constitution stipulates that in local self-government units, citizens participate directly and through representatives in decision-making on issues of local importance, especially in the areas of urbanism, communal activities, culture, sports, social and child protection, preschool education, primary education, health care services and in other areas established by law.

2.1. ASSUMPTIONS ON FISCAL DECENTRALIZATION

Researches conducted by Bahl and Linn-1992[15] suggest that decentralization for developing countries may be limited to rhetoric i.e. that decentralization is more likely to be successful (or at least less dangerous) in more developed countries. Bahl and Linn indicate that the treatment of smaller jurisdictions/cities should be different from the treatment of larger jurisdictions/cities, regardless of the legal incidence of jurisdictions. In that direction, Prud'homme (1995)[16] gives the example of France, which we quote here because it is relevant to the communal sphere of water supply in the RNM:

For some competences which could be decentralized, separate agencies can be created. For example, France has divided water resources management into six areas, corresponding to six major river basin regions, under the direction of regional agencies. These agencies are quasi-political bodies, with board representatives made up of locally elected officials. They are responsible for both water quality and water quantity management and have the power to determine the rates charged to users and the fees and taxes charged to polluters. They have the appropriate geographic coverage to internalize the externalities associated with water resources management.

For the RNM, this is a clear example why it is not so important that each LSGU has its own utility company for water supply because the Constitution allows them to do so and that otherwise "the constitutional position of LSGUs would be undermined" but that the goal should be for the LSGUs to be socioeconomically efficient and to achieve the potential benefits of decentralization. In order to achieve that, LSGUs must be large enough in terms of population, competences and revenues. **From the above, it can be concluded that the socio-economic efficiency of utility companies can be increased to certain point by training and institutional building, but it should not be expected that the decentralization of this competence to small and weak LSGUs and blindly following the principle of subsidiarity would result in a sustainable water supply to the population**

Here we will also refer to other reasons for the small success in the achievement of positive expectations from the decentralization in the RNM on economic plan[17]:

[15] See more: Bahl R. and Linn J. (1992): Urban Public Finance in Developing Countries, A World Bank book.
[16] See more: Prud'homme, R. (1995). The Dangers of Decentralization. World Bank Research Observer, 10(2).
[17] See more: Asymmetric decentralization: Policy brief for policymakers: Options for the Republic of North Macedonia, USAID Strengthening Resource Mobilization Activity (SRMA), Also: Nikolov

The first factor might be that voters' preferences in the RNM are not as readily translated into budget outcomes as they are in developed countries simply due to the low fiscal transparency and accountability. This is one of the main reasons why decentralization would be preferred, since local authorities are in a more favorable position compared to the central government in finding out what are the preferred packages of services for the citizens on the local territory that they represent. But in the RNM this is not the case because on average there is little connection between the needs of citizens and the LSGUs' budgets over time.

The second factor is apparent in the RNM during local elections. Namely, during campaigns mayors speak more about national problems than about local ones (thus, the local preferences are not revealed). Most importantly, central level politicians are more active in local elections than the local politicians, going even so far as to state that if people vote for "their" mayors, they will cooperate better with the central government (a classic example of the political family effect when the mayor is more loyal to the political party he/she comes from rather than the citizens who have voted for him/her[18]); local elections are considered as nothing more than a rehearsal and signaling for the parliamentary elections.

The third factor could be that decentralization in the RNM is more of a deconcentration of national power and less of a fiscal autonomy and redirection of decision making power towards municipalities (devolution). With this set-up, dependance on central government funds remains for transfers /public goods, and there are no mechanisms by which local voters can reveal their preferences. In the end, less can be gained from this form of decentralization than in other industrialized countries where there is devolution. This is simply because the power remains in the center and it is likely to lead to lobbying, continuous bargaining, uncertainty, conflict, and economic fluctuations between the central and local government. It might also promote transactional behavior and favoritism for municipalities in which mayors' political affiliation aligns with those in the central government or create obstacles for municipalities with mayors whose political affiliation differs from those in the central government.

The latest developments with the buy-out of the arrears of LSGUs (although after the buy-out, the arrears increased again) by the central government have additionally worsened the situation, and the soft budget control through weak budget planning (difference between realized and planned budget items) which is motivated by the relaxation of budget rules by the Ministry of Finance itself only ended in less fiscal discipline. Namely, the central government itself does not respect the fiscal rule for the LSGUs' budgets which it has introduced, that the own source revenues of the LSGU's basic budget should be planned with an increase of no more than 10% of the average realized revenues in the last three years. The Government itself increased the percentage to 30% in 2019 but even today LSGUs continue with unchanged practices that lead to re-accumulation of arrears.

The fourth factor can be the inadequate transfers of financial resources for certain services (e.g.

M. (2013): The measurement and impact of fiscal decentralization: The case of Macedonia; Doctoral dissertation: http://www.cek.ef.uni-lj.si/doktor/nikolov.pdf.

[18] See more: Alibegovic, J. D, Monastiriotis V., Nikolov M., Galic Marijana: Mayor's political party affiliation and local outcomes: evidence from SEE, discussion paper presented at the first conference CEE-Loc, 21 – 22 September 2023, Wroclaw, Poland.

education, firefighting, and roads) and forcing municipalities in the RNM to provide inefficient services. This hinders the ability to maintain the existing depreciated assets and keep the quality of the services. Also, the non-optimal transfer of competencies to the local government (unfunded mandates for municipalities in the RNM) might create unsustainable fiscal stress on the local self-government due to the large fiscal gap that appears. Hence, the efficient planning of LSGUs' budgets is an additional indicator of the (bad) management rather than of the technical know-how. And what is even more indicative is that it is encouraged by the central government. **Therefore, this effect should also be taken into account in the impact of fiscal decentralization on balanced development of regions.**

The fifth factor is that there might be difficulties in decentralization management given the lack of proper experience, skills and knowledge.

The sixth factor is that in the RNM there are constitutional requirements that have arisen after the Ohrid framework agreement which refer to equal representation of ethnic minorities in the local public administration, language requirements, and education requirements in order to provide country unity along ethnic lines, which are under direct responsibility of the municipalities. Thus, decentralization can be considered the key policy choice for providing political stability and Macedonian national cohesion, not only promoting economic efficiency. But the preferential policies behind the decentralization are costlier and require additional financial resources (e.g., multilanguage administration of services).

These questions raise other issues that are complex to resolve, but must be taken into account in any decentralization reform when planning to transfer more competences to LSGUs i.e. expansion of decentralization as stated by the Ministry of Local Self-Government and are to be further taken into account in carrying out policies for balanced regional development.

This situation shows that in the RNM there has never been devolution in the true sense of the word so LSGUs in the RNM have never had the chance to work on the provision of the socio-economic benefits of decentralization to their citizens.

As we have indicated, good management is also an important factor which we will analyze through the difference between the planned and realized budgets of the LSGUs. But corruption control is also important for good management. The RNM may have contributed to further worsening of the corruption situation with the decentralization. Namely, as Prud'homme (1995)[19] points out, corruption is more widespread at local level than at national level due to increased costs in relation to allocative efficiency as this leads to the provision of services for which corruption levels are higher rather than providing those services for which there is a real demand from the citizens (the examples with the famous DUPs in LSGUs and, in contrast the need for better roads, better quality kindergartens, schools, changing water pipes, waste water and storm water drainage). In that sense, instead of infrastructural solutions that meet citizens' needs, the political cycle demands politically preferred "projects" that bring quick lucrative benefits due to the effect of a political family, all at the expense of the citizens. That cost makes services more expensive for the citizens as it leads to LSGU management strategies that increase costs, favor inefficient technologies, and waste time. One indicative area is the so-called "construction" in the municipalities where the thesis that LSGUs need construction because it brings reliable income to

[19] See more: Prud'homme, R. (1995). The Dangers of Decentralization. World Bank Research Observer, 10(2).

the budgets is wrongly put forward. As if it is forgotten that construction is also an obligation of the LSGU to provide adequate infrastructure for which an adequate fee should have already been charged for the usage of the construction land. Perhaps the trivial fact about the frivolity of this thesis is that even today this income is not properly treated as capital income in the classification of revenues. A "*recurrent*" income at a LSGU can be current income, not capital income. What's more, this creates spatial challenges because of limited mobility, threatened socio-economic sustainability and erosion of citizens' quality of life. **It is necessary here to at least make an appropriate reclassification for the construction land fee in the revenue classification as capital income.**

Furthermore, why is corruption more likely to be present at local rather than national level. First of all, there are probably more opportunities for corruption at local level. Politicians and the local administration are likely to be more susceptible to urgent demands by local business interest groups (whose money and votes matter). In addition to this, local governments usually have more discretion than national decision makers. And instead of using precisely this position of the local government where they quickly reveal the preferences and "important" requests of interest groups in order to understand their local businesses' preferences and the constitutional discretion of the LSGU in the decision making for the benefit of the citizens as the main theoretical advantage of the decentralization process, it ends in an unethical, lucrative, corrupt act in line with the effects and motives of the political family and personal interests, contrary to the expected benefits of the decentralization. As opposed to those from the central government, it is a little more difficult for the local officials not to fall under the influence of these negative phenomena because they continue to live locally, while the central officials move horizontally through the administration and government. Hence, the difference between the administration and politicians at local level is smaller than at central level i.e. the local administration has less independence from local politicians than the central government administration. Furthermore, monitoring and auditing as well as public pressure through the media are usually better developed at national level than at local level. These effects need to be further analyzed into more detail, but here we only announce theses for such future researches.

2.2. MEASURING FISCAL DECENTRALIZATION

Measuring of decentralization for the purposes of this research will focus more on the fiscal pillar rather than the political autonomy of LSGUs. However, we also discuss the effects of the local government political economy on the fiscal decentralization at a given moment, which can have an effect on the balanced regional development in the RNM.

In the fiscal decentralization section we will measure the degree of decentralization of expenditures (**EXP**) and the decentralization degree of revenues (**REV**). Both measures are commonly used in the literature on decentralization[20].

However, we still need to clarify how these variables were calculated for the purposes of this research. Regarding expenditures we only take those LSGUs' expenditures from the program

[20] See more: Lessmann C. (2012): Regional inequality and decentralization - An empirical analysis; Document de treball de l'IEB 2012/20.

presentation of expenditures for which we can assume with considerable certainty that LSGUs decide independently on the provision of services to the citizens: urban planning, local economic development and communal activities. **Basically, we are more interested in the full devolution of decision-making than in the expenditures that occur due to transfers from the central government.** In the income section, we take into account own revenues and shared personal income tax, but without the VAT transfers. Similarly, here we also **want to take into consideration only those revenues that are at the discretion of the LSGU, but also the revenues from personal income which is collected based on origin, thus taking into account implicitly, as a proxy the potential for economic activity for the LSGU in the given region.**

These two variables (EXP/REV) are taken in three variants: as **nominal (EXP/REV), per capita (EXPPOP/REVPOP)** and as a **share of the total revenues of the LSGU (EXPSH/REVSH).** All three variants measure different phenomena. Nominal values are related to absolute levels of income and economic power of LSGUs. Per capita measures the relative levels normalized for the number of inhabitants as holders of economic activity but implicitly, they also include the effort of the LSGU to collect its own revenues. The third variant measures implicitly, through the collected revenues as a share of total revenues, the **LSGU's effort in collecting its own revenues** or the power and flexibility of the LSGU for independent decision-making through revenues and expenditures.

Based on the above, we take the budget realization of LSGU (BUDGREAL) as measures for institutional effects and good governance. We group all these variables by LSGUs in the respective regions.

3. THE IMPACT OF FISCAL DECENTRALIZATION ON BALANCED REGIONAL DEVELOPMENT

According to Oates (1972)[21] and Tiebout (1956)[22], local governments should first reveal and then meet the needs for heterogeneous preferences of voters through local policies with the decentralization process because LSGUs as a government are closer to citizens than the central government and are better acquainted with citizens' needs. But apart from these expected benefits of decentralization, there are also potential negative redistributive consequences because unlimited decentralization can lead to concentration of resources in several geographical locations and thereby increase the differences of regions, which is also the case in the RNM (Martinez- Vazquez and McNab-2003)[23]. Also, according to Prud'homme (1995)[24], decentralization weakens the budgetary power of the central government, thus reducing the scope for redistribution of resources from richer to poorer regions, thereby increasing regional disparities. At the same time decentralization often involves fiscal competitiveness, which further puts weaker regions at a disadvantage.

[21] See more: Oates, W. E. (1972): Fiscal Federalism. New York: Harcourt Brace Jovanovich.
[22] See more: Tiebout, C. M. (1956). A Pure Theory of Local Expenditures. Journal of Political Economy, 64(5).
[23] See more: Martinez-Vazquez, J. and R. McNab (2003). Fiscal Decentralization and Economic Growth. World Development, 31(9), pp. 1597{1616).
[24] See more: Prud'homme, R. (1995). The Dangers of Decentralization. World Bank Research Observer, 10(2).

Let's clarify this with a few examples. If the central government introduces policies to reduce the inequality in the regions, and at the same time takes the income inequality between the regions as a measurement indicator, in that case the regions which may be poorer than other regions but have smaller income inequality of the population within the same region will find themselves in an unfair position. This is because their measurement of inequality may be lower than the inequality in richer regions, so most resources will be directed towards richer regions simply because the income in richer regions is more unequally distributed. Thus, this measure is not only unfair but also inefficient and ineffective because in this case it favors the richer regions. **Hence, the social risk of poverty and unemployment would be better managed at regional level rather than at the level of LSGUs. In this direction, it is necessary to think about "expansion of the transfer of competences"/deconcentration (or transfer of competences to the regional level) related to social work centers and regional units of the Employment Agency.**

Furthermore, poor populations in low-income regions are poor for a reason because they may live in region(s) that offer fewer economic opportunities and may have weaker infrastructure and do not enjoy positive externalities from an agglomeration economy because the region is larger in area and /or due to other region-specific externalities. Hence, increasing the individual incomes of the population is not the same as increasing the potential for growth and development of the regions and/or appropriate addressing due to surface area and low population density. This would mean that the regions would need other policies instead of addressing population poverty because that would not solve the poverty problem. Also, the poverty degree may be a challenge with reference to its technically-measurable nature because there is a high degree of gray economy and non-reporting of turnover resulting in an overestimation of the parameters for relative poverty. There may also be "poor" regions due to an indicative low tax effort in some LSGUs.

Prud'homme (1995) argues that wealthier regions have a larger tax base than poorer regions and will therefore either collect more taxes and provide more local public services or provide the same quantity and quality of public goods with lower tax rates (for example, in the RNM tax competition between LSGUs in the area of property tax is not yet felt. Namely, although LSGUs have a range from which to choose the tax rate for this tax, in the period 2013-2021 only 5 to 7 LSGUs chose a higher tax rate of property tax[25]).

In any case, mobile production factors will prefer wealthier regions for their investments, further expanding the tax base of wealthier regions at the expense of poorer ones and further widening the inequality gap between regions. Let's take for instance the construction and prices of apartments in Skopje compared to other LSGUs in the RNM. For example, according to the RNM Cadastre Agency, the average construction price per m^2 for apartments in Skopje increased in 2023 compared to 2022 by 14%, but the average prices for apartments outside Skopje increased by only 9%. Furthermore, the average prices per m^2 of apartments in Skopje for the first three quarters of 2023 are 61 thousand denars, and in other LSGUs they are an average of 41 thousand denars[26]. Hence, the effect of voting with their feet of Tiebout (1956) as one of the benefits of

[25] See more: CEA (2023), Evaluation of the efficiency of the current property tax administration system

[26] Data from the Agency for Real Estate Cadastre: https://www.katastar.gov.mk/%d1%80%d0%b5%d0%b3%d0%b8%d1%81%d1%82%d1%80%d0%b8/

decentralization cannot be observed for individuals in the RNM in terms of different tax rates to encourage LSGU competition, but it is observed in the mobile capital that invests in Skopje into construction of apartments, so maybe Prud'homme (1995) is right when he says that decentralization can be the mother of segregation.

Other challenges of decentralization may relate to coordination problems, excessive regulation, higher administrative expenses or poor quality of local administration in developing countries (Tanzi, 1996[27]). An example here are the preferential policies to reduce ethnic tensions and the need for bilingualism in some LSGUs, which in turn makes services more expensive for bilingual LSGUs, but this category also includes ethnic tensions in education, which instead of integration lead to segregation. In addition to this, decentralization can increase corruption and cronyism in developing countries (already discussed above) undermining decentralization's potential for higher efficiency (Lessmann 2012)[28]. Thus, many of the assumptions that positively link decentralization to lower regional inequality may be valid for highly developed countries but not for less developed countries such as the RNM.

3.1. MODELS FOR EMPIRICAL ANALYSIS

The challenge for this analysis is the selection of appropriate data/indicators, but in our case not so much as a selection from the many indicators, but rather as the lack of data at regional level and of course from a statistical point of view due to the lack of sufficient observations per indicator. We use an analysis with a balanced panel of data for the period from 2013 to 2021 because for this period we have data for all variables. We base the specification of the models mostly on the research of Lessman (2012) and Kuriacou et.al. (2013)[29].

Firstly, we will estimate the model specification as in formula (7) to be able to evaluate the impact of decentralization measures on regional inequality:

$$Ineq_{i,t} = \alpha + \sum_{j-1}^{k} \beta_j Control_{j,t} + \gamma Dec_{i,t} + \mu_t + \epsilon_{i,t} \quad (7)$$

Secondly, we want to control whether the possible economic changes measured through GDP have an impact on the relationship between decentralization and balanced regional development and whether the proxy measure of good governance through budget implementation has an impact on the relationship between decentralization and balanced regional development. This second specification of the panel model is presented in formula (8):

$$Ineq_{i,t} = \alpha + \sum_{j-1}^{k} \beta_j Control_{j,t} + \gamma_1 Dec_{i,t} + \gamma_2 Dec_{i,t} GDPPOP_{i,t} + \gamma_3 Dec_{i,t} BUDGEREAL_{i,t} + \mu_t + \epsilon_{i,t} \quad (8)$$

%d1%80%d0%b5%d0%b3%d0%b8%d1%81%d1%82%d0%b0%d1%80-%d0%bd%d0%b0-%d1%86%d0%b5%d0%bd%d0%b8-%d0%b8-%d0%b7%d0%b0%d0%ba%d1%83%d0%bf%d0%b8/

[27] See more: Tanzi, V. (1996). Fiscal Federalism and Decentralization: A Review of Some Efficiency and Macroeconomic Aspects. In M. Bruno and B. Pleskovic (editors), Annual World Bank Conference on Economic Development, pp. 539{567. Washington D.C.: World Bank.

[28] See more: Lessmann C. (2012): Regional inequality and decentralization - An empirical analysis; Document de treball de l'IEB 2012/20

[29] See more: Kyriacou et.al. (2013): Fiscal decentralization and regional disparities: The importance of good governance; Papers on regional science, Vol. 94, 1; doi:10.1111/pirs.12061

The panel in formula (8) is like the panel in formula (7) in that we add GDP per capita (**GDPPOP**), as well as budget realization per LSGU summarized by region (**BUDGREAL**) to control for the impact of economic change and good governance between fiscal decentralization and regional development inequality. DEC-is the measure of fiscal decentralization=**REV** or **EXP**.

In the section of control variables (the matrix of Control variables) we control for the following endogenous factors: the relative area of the regions through the population density (**GUS**); the labor market effect through the labor market participation rate instead of the unemployment rate (due to the gray economy effect, the activity rate is a more realistic approximation for the labor market-**LAB**); the effect of ethnic fragmentation (**ETF**) and the effect of urbanization through the number of urban/rural LSGUs in the regions (**URRU**).

3.2. POLITICAL ECONOMY OF FISCAL DECENTRALIZATION

During an election year for local elections in the RNM, in those LSGUs where the mayors are of the same affiliation as the majority in the central government, current expenditures have a larger share of total expenditures compared to LSGUs that are led by parties belonging to the opposition[30]. The result for the expenditure structure changes after one and three years after the election or in the year before the elections.

The results of the same research show that municipalities that elect mayors from an ethnicity that reflects the ethnic majority in the LSGU tend to have lower running costs in the year prior to the election year. These LSGUs also tend to have a slowdown in the accumulation of arrears one year before the election year.

But the political family effect does play a clear role in the rate of change in arrears over time. In the RNM, the political family effect is associated with a slowdown in the accumulation of arrears one year after the election year. In other words, those LSGUs where the mayors have the same affiliation as the majority in the government reduce arrears after election years due to the political family effect and financial assistance from the central government.

Newly elected mayors who have been elected for the first time tend to accumulate more arrears than their incumbent colleagues who have been re-elected as mayors (this has no bearing on whether the mayor is of the same political affiliation as the majority of the central government, i.e. there is no effect of political family for this finding).

3.3. EMPIRICAL ANALYSIS RESULTS

Panel specification

With the first model we want to evaluate the impact of fiscal decentralization on the balanced regional development in the RNM. The results of the estimation are presented in the following Table

[30] See more: Alibegovic, J. D, Monastiriotis V., Nikolov M., Galic Marijana: Mayor's political party affiliation and local outcomes: evidence from SEE, discussion paper presented at the first conference CEE-Loc, 21 – 22 September 2023, Wroclaw, Poland.

3. The estimation is presented for that dependent variable for which the measure of decentralization is statistically significant. This table presents the findings for the **REVPOP** (revenue per capita) and **EXP** (expenditure) measures of fiscal decentralization.

Table 3. Estimation of decentralization effect for planning regions in the RNM with panel specification

Dependent variable **According to Equation (7), the estimation for the control variables are also presented-** **Control: GUS; LAB; ETF; URRU**	**CV**	**WCV**
α	**-1.212***** **(-2.031)**	**-2.977****** **(-2.462)**
TIME	**0.006****** **(3.312)**	**0.006***** **(2.014)**
GUS	**0.012** **(0.344)**	**0.089** **(1.361)**
LAB	**0.097** **(0.718)**	**0.200** **(0.854)**
ETF	**0.003** **(0.167)**	**-0.003** **(-0.100)**
URRU	**0.005** **(0.231)**	**0.009** **(0.233)**
EXP		**0.053** **(1.361)**
REVPOP	**-0.040**** **(-1.773)**	

Note: t-statistics are in parentheses. ****, ***, **, and * indicate statistical significance at 1%, 5%, 10%, and 15% level of significance respectively.

It is evident from the table that the empirical results show that per capita income statistically explains the inequality of planning regions measured as a coefficient of variation. **The effect is such that a 1% increase in income per capita in the LSGU is correlated with up to a 4% reduction in inequality in the regions. In other words, those regions where LSGUs have higher revenues on average affect the reduction of the inequality in the development of the planning regions measured as the coefficient of variation of GDP per capita.** So, the factor of own collected revenues, including the economic activity measured through the collected personal income tax have a positive influence for the reduction of inequality in the regions.

Other endogenous factors are not statistically significant, except for the time which shows that inequality grows over time. Regarding expenditures, they show statistical significance at the 20% level for the weighted coefficient of variation measure. This points to the fact that if balanced development is reached with expenditure measures then one must take into account the impact

of population size in regions when measuring inequality (because it is significant for the weighted coefficient of variation).

From a statistical point, the correlation coefficient for both evaluations is small, which indicates that perhaps other endogenous independent variables should be taken into account in the specification of the model which may influence regional inequality. Therefore, further on we take into account GDP per capita (**GDPPOP**), as well as budget realization per LSGU summarized by region (**BUDGREAL**) to control for the impact of economic changes and good governance between fiscal decentralization and the balanced development of the regions according to the above discussion.

Panel specification with control for the effect of economic changes across regions and with control for the effect of LSGU good governance across regions

With the second model from Equation-8, we want to control whether the possible economic changes measured through GDP per capita as well as the good governance measured through budget realization per LSGU have an impact on the relationship between decentralization and balanced regional development.

The results of the estimation are presented in the following table. The estimates are presented for each dependent variable as a measure of inequality i.e. the Sigma-convergence measures: coefficient of variation-**CV**, weighted coefficient of variation-**WCV** and GINI coefficient-**GINI**, depending on the measure of fiscal decentralization-**REV** (own revenues); **REVPOP** (own revenues per capita) and **REVSH** (share of own revenues in total revenues)[31].

Table 4. Estimation of the impact of fiscal decentralization (measured through **REV**-revenues) on balanced regional development

	CVREV	CVREVPOP	CVREVSH	WCVREV	WCVREVPOP	WCVREVSH	GINIREV	GINIREVPOP	GINIREVSH
α	-1.346**** (-4.501)	-1.248**** (-4.161)	-1.412**** (-5.017)	-0.756 (-1.014)	-0.614 (-0.813)	-0.663 (-0.906)	-2.200**** (-4.542)	-2.209**** (-4.464)	-1.986**** (-4.273)
TIME	0.001 (0.667)	0.001 (0.571)	-0.001 (-0.373)	-0.023**** (-7.293)	-0.022**** (-7.393)	-0.021**** (-6.775)	-0.007**** (-3.704)	-0.008**** (-3.726)	-0.006**** (-2.952)
REV	-0.070**** (-4.388)	-0.200**** (-4.825)	1.019**** (5.041)	-0.126*** (-2.184)	-0.368**** (-3.539)	1.596**** (3.038)	-0.076**** (-2.940)	-0.194**** (-2.849)	0.934**** (2.801)
GDPPOP	0.002*** (2.093)	0.006**** (2.937)	0.037**** (5.041)	0.004*** (2.232)	0.014*** (2.551)	-0.058** (-1.690)	0.002** (1.731)	0.006** (1.633)	-0.019 (0.892)
BUDGREAL	0.008**** (7.148)	0.021**** (7.406)	-0.134**** (-7.694)	0.014**** (4.865)	0.036**** (5.033)	-0.197**** (-4.354)	0.011**** (5.867)	0.027**** (5.715)	-0.152**** (-5.293)
GUS	0.036*** (2.305)	0.033*** (2.214)	0.031*** (2.051)	0.070** (1.783)	0.070** (1.856)	0.053 (1.352)	0.050** (1.965)	0.052*** (2.088)	0.033 (1.350)
LAB	0.109* (1.621)	0.076 (1.241)	0.058 (0.963)	0.116 (0.691)	0.100 (0.644)	0.048 (0.309)	0.115 (1.051)	0.119 (1.175)	0.073 (0.733)
ETF	-0.006 (-0.761)	-0.003 (-0.412)	-0.003 (-0.352)	-0.005 (-0.249)	-0.001 (-0.003)	-0.009 (-0.439)	-0.012 (-0.895)	-0.011 (-0.780)	-0.016 (-1.239)

[31]Estimate of the impact of EXP-expenditures on the inequality of planning regions is presented in Annex.

URRU	**-0.032**** (-2.996)**	**-0.021*** (-2.149)**	**-0.029**** (-2.995)**	**-0.050** (-1.862)**	**-0.037* (-1.528)**	**-0.046** (-1.810)**	**-0.036*** (-2.051)**	**-0.033*** (-2.067)**	**-0.035*** (-2.182)**

Note: t-statistics are in parentheses. ****, ***, **, and * indicate statistical significance at 1%, 5%, 10%, and 15% significance level respectively.

Several things can be concluded from the Table:

- All decentralization measures: **REV** (own revenues); **REVPOP** (own revenues per capita) and **REVSH** (share of own revenues in total revenues) have a statistically significant impact on regional inequality measured by GDP per capita.
- On average, when we control for population in regions (weighted coefficient of variation), the impact of income is higher on regional inequality. The impact is in the range of:
    - **1% increased revenues at LSGUs are correlated with 7% to 7.6% reduction in regional inequality (CV or GINI) but if we take into account the number of population in the regions, then the impact per capita can be higher and up to 12.6 % in reducing the inequality of GDP per capita for the planning regions.** This is an indication that population size is significant for the reduction of inequality in regions. Emigration and the attractiveness of secondary regions for their inhabitants is important in order to remain a productive economic factor in those secondary regions.
    - For the decentralization measure - revenues per capita (**REVPOP**), the impact is higher which indicates that the inequality of the regions is correlated with a double-digit percentage reduction if LSGUs have a higher effort to collect their own revenues per capita. Shared taxes from personal income tax are included here in own revenues, which indicates that higher economic activity of the labor force in LSGUs can lead to lower inequality in the regions. **On the other hand, an increase in the share of LSGUs' own revenues in their total revenues is correlated with increased inequality of the regions. This means that the lower economic power in the LSGUs themselves reflects the economic reality of the less developed regions, because even if the effort to collect own revenues in the LSGUs increases, then the inequality in the regions would increase too due to the fact that the economic activity of the population is either lower or the potentials of that less developed region have been exhausted. In that case, the role of the central government is to sustainably influence the less developed regions through the instruments for regional development, to increase their economic potential rather than to solve the challenge with instruments for reduction of poverty, for example.**
- The recommendation from what has been stated so far is that when designing fiscal decentralization, the reality of LSGUs within the planning regions should be taken into consideration. In that sense, the economic power of the region has a strong effect that exceeds the effect of a greater effort to collect own revenues at LSGUs in some regions. Collection of own revenues with a higher tax effort for each LSGU is of course a preferred solution, but the central government should take into account the reality related to the LSGU's tax base in the region when considering the degree of development of the regions

according to which it will distribute the means for balanced regional development. **In other words, the collection of own revenues by LSGUs is a good indicator on how much revenues can be expected from the tax base, but it is also an indicator of the level of the limited economic potential of poorer regions where there is a relatively higher tax effort at LSGUs. In that case, the central government should work on increasing the economic potential of the less developed regions so that they can converge to the steady state of the more developed regions.**

- Furthermore, it is interesting to see the statistical significance of the time dynamics of the inequalities of the regions. Namely, if we nominally follow the dynamics of the Sigma-convergence i.e. the inequality through the coefficient of variation, time is not statistically significant but if we weight the measure and control for the number of population (weighted coefficient of variation), then it becomes evident that the decreased number of population increases the degree of inequality in the regions, but not only with the weighted coefficient of variation, but also with the GINI coefficient (which coefficient has no measurement unit, so the influence of the number of population has a low degree of possible multicollinearity in the independent variables with the population). At the same time, for each approximately 1% decrease in population, the inequality in the regions measured through the weighted coefficient of variation increases by approximately 2% or by approximately 0.7% measured through the GINI coefficient. **In other words, a decrease in the number of inhabitants by 1% leads on average to 2% increased inequality in the planning regions in the RNM.**
- If we control for economic changes measured through GDP per capita (GDPPOP) we will see that this factor is statistically significant in all specifications. The effect is such that higher GDP per capita leads to an increase in the inequality of the development of regions measured by the three Sigma-coefficients. **This is another signal for the central government that the focus on average economic growth does not lead to absolute Beta-convergence but to conditional convergence where the endogenous factors for the regions have the influence on the regions that are clustering to converge towards different steady states[32]. In that direction, the recommendation for the central government is to focus on raising the potential for economic growth in less developed regions. Even to consider the transfer of funds from the more developed to the less developed regions either through Robin Hood models or by leaving out the more developed regions for a certain period of time until the absolute convergence of the planning regions in the RNM is achieved.**
- If we control for the effect of good management measured through budget implementation at LSGUs, we will see that this factor is statistically significant in all specifications. **The effect is such that a higher budget realization in LSGUs is correlated with an increase in the degree of inequality. This finding must be seen from at least three aspects. Firstly**, the budget realization here is of the total revenues of LSGUs, which on average have low fiscal autonomy in the RNM, so the impact of transfers is such that they may influence the increase of inequality in the regions (in fact, the block grants from the fiscal decentralization are designed in such a way that they finance existing facilities rather than service development). **Secondly**, those primary regions where the LSGUs have sufficient economic power leave behind the secondary regions where the LSGUs have less

[32] See more: CEA (2023): Analysis of disparities between the countries of the Western Balkans-Cluster analysis. https://cea.org.mk/wp-content/uploads/2019/09/1.-Vol-3-Report-Task-2-Cluster-analysisMKtopublishmaps18062023-1.pdf

attractive economic appeal. **Thirdly**, in the context of the findings above, the budget realization has limited power to be correlated with higher development because the effect of the economic attractiveness of the regions has a higher negative effect than the possibility of a positive effect, even with full budget realization of the LSGUs because the secondary regions have a lower economic potential.

- Regarding the endogenous variables, we conclude:
    - **Density (GUS) is statistically significant. Higher regional density affects an average increase in inequality of 2%-7%** (depending on the Sigma measure and the measure of decentralization) for every one percent increase in density. This means that the concentration of population, and especially the gravitational power of the Skopje Planning Region leaves other regions without the production factor of human capital aside from the effect of emigration of the population outside the country[33].
    - **Labor force activity (LAB)** has no statistical significance except when measuring the degree of convergence for collected revenues (REV) at 15% statistical significance. **The impact is such that a higher economic activity of the labor force affects the increase of the inequality of the regions**. And this effect should be considered in the context of what has been said so far that the economic activity is higher in the primary regions where the gravitational power is higher and they leave the less developed secondary regions behind[34].
    - **Ethnic fragmentation (ETF) does not have a statistically significant impact in explaining regional inequality.**
    - The share of urban LSGUs in the total number of LSGUs in planning regions (**URRU**) has a statistically significant impact. **A greater share of urban LSGUs in regions leads to greater inequality in planning regions.** And this effect should be considered in the context of what has been said so far that economic activity is higher in primary regions where the gravitational power is higher, there are effects of agglomeration through population density and they leave less developed secondary regions behind[35].
    - **The findings for the endogenous variables are that the less developed secondary regions are left behind in the development by the more developed primary regions due to the effect of migrations to urban centers. The magnetic attraction of the more developed regions (specific to the Skopje Planning Region) enhances the differences compared to the secondary less developed regions. The effects of agglomeration draw people to these centers of productivity growth and higher earnings, leaving the less developed regions without factors of production and without potential.**
    - **In that sense, an opportunity should be given to increase the potentials of secondary regions in order to increase their attractiveness and competitiveness.**

[33] See more: CEA (2023): Analysis of territorial challenges, needs and potentials of the six countries of the Western Balkans: Economic overview. https://cea.org.mk/wp-content/uploads/2019/09/0.-VOL-2-Report-Task-2-Economic-view-of-disparitiesMK-za-objava14062023.pdf.
[34] Ibid.
[35] Ibid.

Despite the lack of results in achieving balanced regional development, so far there is no analysis for the RNM that more systematically investigates the impact of fiscal decentralization on balanced regional development. One of the reasons for the lack of quantitative research is the poor availability of data per LSGU and by regions, which are necessary for research and analysis. The results of international research indicate that richer countries benefit from decentralization in terms of a more even distribution of income, while decentralization can lead to higher regional inequalities in developing countries. The results of those researches have the same findings both for fiscal and political decentralization measures, which implies that when "further" decentralization is encouraged in the RNM, the potential negative effect should be taken into account for more balanced balanced development.

In the RNM both fiscal decentralization and balanced regional development are constitutional categories. So, although it is not the subject of this analysis, a distinction should be made when talking about the expansion of decentralization which may imply both political and administrative decentralization, but may also include transfer of responsibilities to the planning regions (for which there should also be constitutional amendments) and when talking about the transfer of institutions to LSGUs within the already transferred competences. The transfer of institutions within the existing transferred competences to LGUs accepts the existing organization of the state and refers to the transfer of institutions that are mostly already defined within the framework of competences with the Law on local self-government (or minimal changes are required in the legislation). This does not involve the political and administrative decentralization and/or transfer of competences to the planning regions that might occur. An example of this is the transferred competences in culture to the LGUs, where the transfer of libraries as institutions from central to local authorities is ongoing. In this document, as a result of the analysis of the impact of fiscal decentralization and the documents from the MLSG, certain recommendations are provided for the possible transfer of responsibilities to the planning regions.

FINDINGS

- In the RNM, decentralization after 2001 is treated as an instrument for calming ethnic tensions rather than as an instrument for achieving **economic efficiency and good government management.**
- Recently the appetite for **expanding the decentralization process** has increased, as it is stated in the documents from the MLSG, but this requires an adequate analysis of the achievements from the decentralization process so far, both in political and economic terms, before moving on to the transfer of new competences. This is important because in the RNM there has never actually been devolution in the true sense of the word, so LSGUs in the RNM have never had a chance to work sustainably so that citizens can feel the socio-economic benefits of the "real" decentralization (devolution).
- A category of balanced development of planning regions was introduced in the RNM after 2008. The success in the balanced development of the regions has so far lagged behind despite the existing legal and institutional framework for achieving the goal of balancing the development of planning regions.
- Furthermore, **planning regions in the RNM do not converge to a steady state i.e. there is no absolute Beta-convergence**. This means that even when achieving a reduction in disparities between regions, they converge towards different steady states and clusters towards different steady states are likely to occur, i.e. some regions converge towards a higher development

level, and others towards a lower development level. **In order to change this, it is necessary to implement policies that will increase the potential of endogenous factors for development in those secondary regions that are lagging behind.** This means that secondary regions that lag behind should receive capital investment to increase the potential of growth factors (infrastructure, people and institutions).

- **In that direction, and bearing in mind that the RNM aims to achieve EU membership, Article 174 of the Treaty on the Functioning of the EU should be taken into account**: "*In particular, the Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favored regions. Among the regions concerned, particular attention shall be paid to rural areas, areas affected by industrial transition, and regions which suffer from severe and permanent natural or demographic handicaps such as the northernmost regions with very low population density and island, cross-border and mountain regions*".
- Findings on endogenous factors that are specific to planning regions show that more densely populated regions and those regions where the labor force participates more in the labor market have slower convergence (these regions are more developed and it is to be expected that they have slower convergence due to diminishing marginal returns). On the other hand, greater urbanization leads to higher growth in regions. Ethnic fragmentation has no statistically significant influence on the convergence of planning regions. **This means that for balanced regional development, those LSGUs that are in regions that have a lower population density and in which the labor force does not participate sufficiently in the labor market should be taken into account.**
- The concentration of capital, investments, human resources, technical infrastructure, social facilities and institutions in the City of Skopje violates and threatens the concept of polycentric development of the state, which in turn is a starting assumption for balanced regional development in the state. This means that **there is at least one cluster of secondary regions that do not include the Skopje Planning Region.**
- **In the RNM, the same economic benefits cannot be expected from the fiscal decentralization as in more developed economies, and therefore it should be dimensioned and designed in such a way as to take into account the relevant specifics of the RNM, the development of democracy and good governance in the RNM.**
- **Fiscal decentralization and transfer of responsibilities may negatively affect the balanced development of the regions. There are certain categories such as economies of scale and externalities that lead to spillover effects from some LSGUs to other LSGUs. For such competences, one should approach either asymmetric decentralization or the transfer of competences to the planning regions.** For example, the social risk of poverty, unemployment and other social risks would be better managed by regions than by LSGUs. Another example is the population density of LSGUs where more densely populated LSGUs may enjoy positive effects of economies of scale compared to LSGUs similar in territory but with a smaller number of inhabitants within a planning region. Here, the measure of population income increase does not affect balanced development because those regions with fewer inhabitants per m^2 in their LSGUs have lower income perhaps simply due to the lack of population and therefore have lower economic activity.
- All decentralization measures: **REV** (own revenues); **REVPOP** (own revenues per capita) and **REVSH** (share of own revenues in total revenues) have a statistically significant impact on regional inequality measured by GDP per capita. Likewise, expenditures as a measure of

decentralization have a statistically significant impact on regional inequality measured by GDP per capita.

- On average, when we control for population in regions (weighted coefficient of variation), the impact of income is higher on regional inequality. The impact is in the range of:
  - **1% increased income at LSGUs are correlated with 7% to 7.6% reduction in regional inequality (CV or GINI) but if we take into account the number of population in the regions, then the impact per capita can be higher and up to 12.6 % in reducing the inequality of GDP per capita for the planning regions.** This is an indication that population size is significant for the reduction of inequality in regions. Emigration and the attractiveness of secondary regions for their inhabitants is important in order to remain a productive economic factor in those secondary regions.
  - For the decentralization measure - revenues per capita (**REVPOP**) the impact is higher which indicates that the inequality of the regions is correlated with a double-digit percentage reduction if LSGUs have a higher effort to collect their own revenues per capita. Shared taxes from personal income tax are included here in own revenues, which indicates that higher economic activity of the labor force in LSGUs can lead to lower inequality in the regions. **On the other hand, an increase in the share of LSGUs' own revenues in their total revenues is correlated with increased inequality of the regions. This means that the lower economic power in the LSGUs themselves reflects the economic reality of the less developed regions, because even if the effort to collect own revenues in the LSGUs increases, then the inequality in the regions would increase too due to the fact that the economic activity of the population is either lower or the potentials of that less developed region have been exhausted. In that case, the role of the central government is to sustainably influence the less developed regions through the instruments for regional development, to increase their economic potential rather than to solve the challenge with instruments for reduction of poverty, for example.**
- The recommendation from what has been stated so far is that when designing fiscal decentralization, the reality of LSGUs within the planning regions should be taken into account. In that sense, the economic power of the region has a strong effect that exceeds the effect of a greater effort to collect own revenues at LSGUs in some regions. Collection of own revenues with a higher tax effort for each LSGU is of course a preferred solution, but the central government should take into account the reality related to the LSGU's tax base in the region when considering the degree of development of the regions according to which it will distribute the means for balanced regional development. **In other words, the collection of own revenues by LSGUs is a good indicator on how far revenues can be expected from the tax base, but it is also an indicator of the level of the limited economic potential of poorer regions where there is a relatively higher tax effort at LSGUs. In that case, the central government should work on increasing the economic potential of the less developed regions so that they can converge to the steady state of the more developed regions.**
- Furthermore, it is interesting to see the statistical significance of the time of the balanced regional development. Namely, if we nominally follow the dynamics of the degrees of Sigma-convergence i.e. the inequality through the coefficient of variation, time is not statistically significant but if we weight the measure and control for the number of population (weighted coefficient of variation), then it becomes evident that the decreased number of population increases the degree of inequality in the regions, but not only with the weighted coefficient of variation, but also with the GINI coefficient (which coefficient has no measurement unit, so

the influence of the number of population has a low degree of possible multicollinearity in the independent variables with the population). At the same time, for each approximately 1% decrease in population, the inequality in the regions measured through the weighted coefficient of variation increases by approximately 2% or by approximately 0.7% measured through the GINI coefficient. **In other words, a decrease in the number of inhabitants by 1% leads on average to 2% increased inequality in the planning regions in the RNM.**

- If we control for economic changes measured through GDP per capita (GDPPOP) we will see that this factor is statistically significant in all specifications. The effect is such that higher GDP per capita leads to an increase in the inequality of the development regions measured by the three Sigma-coefficients. **This is another signal for the central government that the focus on average economic growth does not lead to absolute Beta-convergence but to conditional convergence where the endogenous factors for the regions have the influence on the regions in clustering convergence towards different steady states[36]. In that direction, the recommendation for the central government is to focus on raising the potential for economic growth in less developed regions**. **Even to consider the transfer of funds from the more developed to the less developed regions either through Robin Hood models or by leaving out the more developed regions for a certain period of time until the absolute convergence of the planning regions in the RNM is achieved.**
- If we control for the effect of good governance measured through budget implementation at LSGUs, we will see that this factor is statistically significant in all specifications. **The effect is such that a higher budget realization in LSGUs is correlated with an increase in the degree of inequality. This finding must be seen from at least three aspects. Firstly**, the budget realization here is of the total revenues of LSGUs, which in the RNM on average have low fiscal autonomy, so the impact of transfers is such that they may influence the increase of inequality in the regions (in fact, the block grants from the fiscal decentralization are designed in such a way that they finance existing facilities rather than service development). **Secondly**, those primary regions where the LSGUs have sufficient economic power leave behind the secondary regions where the LSGUs have less attractive economic appeal. **Thirdly**, in the context of the findings above, the budget realization has limited power to be correlated with higher development because the effect of the economic attractiveness of the regions has a higher negative effect than the possibility of a positive effect even with full budget realization of the LSGUs because the secondary regions have a lower economic potential.
- Regarding the endogenous variables, we conclude:
  - **Density (GUS) is statistically significant. Higher regional density affects an average increase in inequality of 2%-7%** (depending on the Sigma measure and the measure of decentralization) for every one percent increase in density. This means that the concentration of population, and especially the gravitational power of the Skopje Planning Region leaves other regions without the production factor of human capital aside from the effect of emigration of the population outside the country[37].

[36] See more: CEA (2023): Analysis of disparities between the countries of the Western Balkans-Cluster analysis. https://cea.org.mk/wp-content/uploads/2019/09/1.-Vol-3-Report-Task-2-Cluster-analysisMKtopublishmaps18062023-1.pdf

[37] See more: CEA (2023): Analysis of territorial challenges, needs and potentials of the six countries of the Western Balkans: Economic overview. https://cea.org.mk/wp-content/uploads/2019/09/0.-VOL-2-Report-Task-2-Economic-view-of-disparitiesMK-za-objava14062023.pdf.

- **Labor force activity (LAB)** has no statistical significance except when measuring the degree of convergence for collected revenues (REV) at 15% statistical significance. **The impact is such that a higher economic activity of the labor force affects the increase of the inequality of the regions**. And this effect should be considered in the context of what has been said so far that the economic activity is higher in the primary regions where the gravitational power is higher and they leave the less developed secondary regions behind[38].
- **Ethnic fragmentation (ETF) does not have a statistically significant impact in explaining regional inequality.**
- The share of urban LSGUs in the total number of LSGUs in planning regions (**URRU**) has a statistically significant impact. **A greater share of urban LSGUs in regions leads to greater inequality in planning regions.** And this effect should be considered in the context of what has been said so far that economic activity is higher in primary regions where the gravitational power is higher, there are effects of agglomeration through population density and they leave less developed secondary regions behind[39].
- **The findings for the endogenous variables are that the less developed secondary regions are left behind the development of the more developed primary regions due to the effect of migrations to urban centers. The magnetic attraction of the more developed regions (specific to the Skopje Planning Region) enhances the differences compared to the secondary less developed regions. The effects of agglomeration draw people to these centers of productivity growth and higher earnings, leaving the less developed regions without factors of production and without potential.**
- **In that sense, an opportunity should be given to increase the potentials of secondary regions in order to increase their attractiveness and competitiveness.**

RECOMMENDATIONS

- **Analysis of decentralization achievements so far.** To prepare an appropriate analysis of the achievements so far from the decentralization process, both in political and economic terms.
- **Analysis of the failure to achieve balanced regional development.** To prepare an appropriate analysis of the main factors for the failure to achieve balanced regional development.
- **Fiscal decentralization should be seen as a socio-economic instrument and not as an instrument for ethnic consolidation.** Having in mind that the objectives of the post-conflict Constitution of the RNM dated 2001 have been achieved, fiscal decentralization and decentralization in general should be viewed as an economic instrument that affects the balanced development of the regions. This is especially important because, considering the degree of democratic development in the RNM, we cannot by definition expect that decentralization will introduce automatism in economic efficiency.
- **The focus should be on the economic development, not economic growth**. In order to achieve absolute Beta-convergence, it is necessary to carry out policies that will increase the potential of endogenous factors for development in those secondary regions that are lagging behind. This means that secondary lagging regions should receive capital investment to increase the potential of growth factors (infrastructure, people and institutions).

[38] Ibid.
[39] Ibid.

- **Decentralization cannot be viewed separately from balanced regional development**. In the further expansion of decentralization, the impact of decentralization on balanced regional development should also be taken into consideration.
- **Evaluation of the factors that are taken as measures for the degree of development of the regions**. While population density can be taken into account in the indicators of the level of development of planning regions, an increase in labor force participation in the labor market should be addressed by other policies at national level outside the instruments of balanced regional development simply because of the fact that there are spillovers, i.e. externalities of productive labor from one region to another, apart from emigration, due to the fact of the attractive gravitational force of more developed regions compared to the secondary regions.
- **The City of Skopje and the Skopje Planning Region should be excluded for a certain period of time from VAT transfers and from the distribution of funds for balanced regional development (even the Robin Hood instruments should be considered).** Taking into account the failure of polycentric development and the strong dominance of the City of Skopje as a separate LSGU in the public finances of fiscal decentralization, the question arises whether the City of Skopje and/or the Skopje Planning Region should not be excluded for a certain period of time from allocation of funds for balanced regional development and from the distribution of VAT funds (from the fiscal decentralization for the City of Skopje and the municipalities in the City of Skopje) for example or whether a Robin Hood system should be introduced. This could be a transitory decision until a "reasonable" balance (what is reasonable balance is also subject to analysis and assessment) between Skopje and the rest of the planning regions is achieved. In this way, the RNM as a whole would be in a better position if one unit of income was transferred from the richer to the poorer region.
- **It is necessary to introduce asymmetry: territorial (cities and municipalities) and/or fiscal/competencies and analysis for the potential transfer of competencies to the planning regions**. It is necessary to review the monitoring of symmetry in the assignment of competences to LSGUs in order to take into account the economic principles of efficiency and economy of scale. It is necessary to make a detailed analysis of asymmetry in the transfer of competences and/or in the introduction of two-level competence in the territorial organization by introducing cities and municipalities that would have different competences, or to make an analysis of the potential transfer of competences to the planning regions. This is important because it cannot be expected that each LSGU should have its own utility company for water supply only because the Constitution allows it and that otherwise the constitutional position of LSGUs would be violated, but that LSGUs should be socio-economically efficient and in condition to achieve the potential benefits of decentralization, they must be large enough in terms of population, competences and revenues. The message to policy makers and donors is that the socio-economic efficiency of utility companies can for example be increased to certain extend by trainings and institutional building, but it should not be expected that the decentralization of this competence to small and weak LSGUs and blindly following the principle of subsidiarity would result in a sustainable water supply to the population. Another example are the Social Work Centers and the regional units of the Employment agency which as competences can be transferred to the regions.

4. ANALYSIS OF THE PROPOSAL DOCUMENT OF THE WORKING GROUP FOR THE EXPANSION OF THE DECENTRALIZATION PROCESS

4.1. METHODOLOGY FOR COMPETENCES ANALYSIS

In this section we set up the methodology for the analysis of competences for which, in addition to the analysis, we would also make an assessment of their possible impact on the regional development. As an input material, we use the *Proposal document of the working group for the expansion of the decentralization process* dated 2019 and the *Information on the continued process of institutional decentralization* prepared by the MLSG dated 2019[40].

In that direction and in order to provide a more efficient further work, for the purposes of this document and based on the documents from the MLSG, **we set the following criteria** for the analysis of competences (according to the expert assessment of the authors of this document in consultation with the project and in consultation with MLSG representatives):

1. Position of the competent ministry on the competence (this is available from the *Proposal document of the working group for the expansion of the decentralization process*)
2. Opinion of the working group on decentralization (this is available from the *Proposal document of the working group for the expansion of the decentralization process*)
3. Complexity of the transfer of competencies-resources in scope and resources (incorporation right, employees, movable assets)- expert assessment of the authors of this text in consultation with the project and in consultation with MLSG representatives
4. Whether the ownership of the fixed assets-real estate can in principle be disputed (expert assessment of the authors of this text in consultation with the project and in consultation with MLSG representatives)
5. Is the competence politically sensitive (expert assessment of the authors of this text in consultation with the project and in consultation with MLSG representatives)
6. The impact on regional development (expert assessment of the authors of this text)

Furthermore, we will also introduce socio-economic criteria for the selection of competences following the example of Kessides (1993)[41], according to whom public services (competencies) show different characteristics, so some services are better privatized based on:

- The specifics of the service,
- The specifics of the market and
- The specifics of the demand.

[40] These documents were made available by the representatives of the Ministry of Local Self-Government to serve the purposes of this document.
[41] See more: Kessides C. (1993): Institutional Options for the Provision of Infrastructure. World Bank Discussion Paper 212. Washington, D.C.

We can carry out a similar exercise for our purpose by choosing the competencies for which we will make a fiscal assessment. **Accordingly, we introduce three indicators for the analysis of competences: externalities, billing and technique**.

Externalities refer to the quantity, effects and geographic spillovers related to the service. Some responsibilities, such as regional roads, fire protection, water supply etc. have effects beyond the borders of the LSGU and spill over to other LSGUs. This is the case with most so-called "network" infrastructure investments, such as water supply, roads etc.

Billing of a service refers to how easily the service can be financed by fees, as opposed to taxes. Water or electricity can easily be billed to consumers; public transport is a little harder to finance with a fee alone; it is more difficult to get people to pay for municipal waste collection or for usage of certain streets for example. Technological progress, however, is constantly expanding the domain of billing (zone parking via mobile devices for example). Some services such as education, which could technically be funded by fees, are nevertheless funded by taxes because they are considered a public service or because there are social as well as private benefits associated with that educational service. In general, the greater the possibility of billing for the service, the easier it is for decentralization.

Technique of service refers to the degree of technical and management expertise required to provide the service. Municipal waste collection is much easier to provide compared to providing potable water. The less technique for providing the service, the easier it is to decentralize it because the economy of scale for these services is lower, and thus the potential losses in production efficiency will be lower when measuring the efficiency of providing local services.

Hence, we summarize the technique for a more detailed analysis of competencies in the following table. The depth of the analysis depends on the available time resources for this task of ours to be able to do a detailed analysis for all competencies.

The technique is based on a simple grading of the "difficulty" for the transfer of competence that are already listed in the *Proposal document of the working group for the expansion of the decentralization process*. At the same time:

- **1 means that the competence is the least easy to transfer,**
- **2 means that the competence is easy to transfer,**
- **3 means that the competence is the easiest to transfer.**

Thus, each competence from the Proposal document of the working group for the expansion of the decentralization process will receive qualification 1, 2 or 3. Since we have 8 evaluation indicators, this means that theoretically the competence that will receive a total score of 24 is the easiest to transfer to LSGUs, and the competence that will receive a total score of 8 is the least easy to transfer to the LSGU.

Table 5. Methodology for ranking of competencies

Competency	Position of the Ministry	Opinion of the Working group	Complexity of the transfer	Real estate disputes	Political Sensitivity	Externalities	Billing	Technique	Overall score
	1	2	3	4	5	6	7	8	
Ministry of Culture									
Redefining the network of cultural national institutions and determining a new network of cultural institutions of culture by transferring certain institutions of national interest to the local level	3	3	3	3	3	1	3	3	22
Libraries	3	3	3	3	3	1	3	3	22
Theatres	3	3	3	3	3	1	3	3	22
Cultural Centers	1	1	1	1	1	1	3	3	12
Museums	1	1	1	1	1	1	3	3	12
Ministry of Health									
Patronage services	2	3	3	3	3	2	3	3	22
Emergency Medical Assistance and Dental Care	2	3	3	2	3	2	3	3	21
Prevention, detection and treatment of mouth and teeth diseases and dental-prosthetic rehabilitation	2	3	3	2	3	2	3	3	21
Immunization	2	3	1	3	1	2	3	3	18
City Hospital-Skopje-proposal of the City of Skopje	1	1	1	1	2	1	1	1	9
Ministry of Transport and Communications									
Management of residential buildings, apartments, business buildings and premises that the RNM has the right to use, manage or has at its disposal	3	3	3	3	3	2	2	2	21
Distribution of public housing	3	3	3	3	3	2	2	2	21
Business buildings that are under the management of the Public Enterprise for Management of Business Buildings and PUIK are transferred as property to the municipalities.	1	1	1	2	1	2	2	2	12
Communal services									
The municipality has the right to remove and store damaged vehicles that are located on public area	3	3	1	3	3	3	2	2	20
Measuring decibels for loud music and imposing measures for law disobedience The measurement is carried out by services in the municipality or by a private company hired by the municipality The measuring is carried out on public areas when receiving information or by own initiative	3	3	1	3	3	3	2	2	20
Video surveillance of public areas for greater safety of citizens Video surveillance can be physically installed in separate premises in the municipality or carried out by the Ministry of Internal Affairs on behalf and at the expense of the municipality	3	3	1	3	3	3	2	2	20

In order to regulate and solve the problem of illegal markets, the communal inspectorate with the help of the municipal police has the right to confiscate goods that are sold at illegal places outside the markets	3	3	1	3	3	3	2	2	20
Ministry of Economy									
Licenses for catering activities	1	2	3	3	2	3	3	3	20
Licenses for tourism activities	1	2	3	3	2	3	3	3	20
Concessions for mineral resources	1	2	1	1	2	1	1	1	10
Ministry of Agriculture									
Management of agricultural land	1	2	1	3	1	3	3	3	17
Management of grassland	1	2	1	3	1	3	3	3	17
Management of 12 subsidiaries of AD Vodostopanstvo	1	2	1	3	1	1	2	2	13
Sports									
Sports facilities owned by the RNM can be of national and local importance	2	3	3	1	1	1	1	2	14
Review of the classification of sports facilities in order to hand over sports facilities to municipalities	2	3	3	1	1	1	1	2	14
Ministry of Labor and Social Policy									
One-time financial assistance	1	1	1	3	1	1	2	2	12
Compensation for assistance and care from another person	1	1	1	3	1	1	2	2	12
Guaranteed minimum assistance	1	1	1	3	1	1	2	2	12
Compensation due to disability	1	1	1	3	1	1	2	2	12
Compensation for part-time wages	1	1	1	3	1	1	2	2	12
Housing allowance	1	1	1	3	1	1	2	2	12
Permanent compensation	1	1	1	3	1	1	2	2	12
Health protection of users	1	1	1	3	1	1	2	2	12
Transfer of competence and works under the competence of the Employment Agencies to municipalities	1	1	1	3	1	1	2	2	12
Ministry of Internal Affairs									
Maintenance of public order and peace in the municipality Municipal police force is established for this purpose	1	1	1	3	3	1	1	1	12
Regulation and control of traffic on local roads and municipal streets, collector streets, service streets and residential streets Municipal police force is established for this purpose	1	1	1	3	3	1	1	1	12
Issuance of traffic and driver's licenses	1	1	1	3	1	1	1	1	10
Ministry of Education									
Capital investments	1	1	1	1	1	2	2	2	11
Ministry of Justice									
Keeping registers (births, marriages, deaths)	1	1	1	3	1	1	1	1	10
Ministry of Defense									
Protection and rescue system	1	1	1	1	1	1	1	1	8
Crisis management system	1	1	1	1	1	1	1	1	8
Establishment, organization and operation of fire-fighting units	1	1	1	1	1	1	1	1	8

4.2. QUALIFICATION OF COMPETENCES ACCORDING TO METHODOLOGY

We provide certain explanations as a basis for the appropriate qualification in the table per ministries/competencies as presented in the *Proposal document of the working group for the expansion of the decentralization process* prepared by the MLSG, dated 2019.

The rankings in the table were made by the authors of this document in consultation with the project and in consultation with MLSG representatives. The competencies in the Table above are ordered according to the appropriate qualification from 1 (least easy to transfer to the local self-government) to 3 (easiest to transfer to the local self-government) according to the criteria determined by the authors of this text. Qualifications are provided in consultation with the project and in consultation with MLSG representatives. The ranking in the table is according to that methodology, that is according to the assessment which competences could be most easily transferred to the local self-government.

Ministry of Culture

Here we take into consideration libraries, theaters, museums, cultural centers according to the *Proposal document of the working group for the expansion of the decentralization process* by the MLSG, dated 2019.

According to the qualifications in the table above, competences from the **Ministry of Culture** could be transferred most easily. We need to be more precise here. It is not about the transfer of competences in the field of culture (which have already been transferred with the Law on Local Self-Government), but about the additional transfer of institutions (libraries, theaters, museums and culture centers) to the management of local authorities, except for those which are of national importance.

According to the MLSG, the transfer of these institutions has already started and should continue with a more accelerated dynamic, but with clear criteria and in a transparent manner. The challenge here is that there is no consistency on the part of the central government as to what is actually transferred as "competence" to the local government. Namely, since 2005 (according to ZELS), some LSGUs have established cultural institutions, but they have not been included in the system of calculation and distribution of block grants as institutions in the field of culture by the central government. **The question arises as to what the central government actually transfers to the local government, institutions or competences? If these are institutions, in that case the block grants are only a hybrid system of payment for delegated competences rather than a devolution of competence from the field of culture to the local government. If competences are transferred, in that case at least these newly established institutions should be part of the national network whose management costs should be taken into account during the designing and implementation of the block grants for culture. In addition to this, there is the question of those LSGUs that do not have cultural institutions? Shouldn't they be funded for that service by the central government? How will this be incorporated in the block grants?**

On the other hand, since the transfer of institutions has already started, that process should continue but the central government will have to redefine what it actually wants to achieve with the transfer of competences in the field of culture, assess what has been achieved so far and introduce a completely new system of financing decentralized competencies in the field of

culture. **Here the asymmetry of some competences in the field of culture should also be considered towards those LSGUs to which LSGUs would gravitate and other LSGUs with lower capacity in order to enjoy the offer of services in the field of culture and/or consider the transfer of some competences at the level of planning regions, which is certainly subject to a future more serious architecture of decentralization** to further take into account the externalities i.e. the spillover of benefits from one LSGU to another. In any case, those institutions that have already been established by LSGUs after 2005 should be included in the system of financing competences in the field of culture.

Another technical challenge is the existence of institutions of national importance that are located on the territories of several LSGUs, which requires the redefinition of the network of national cultural institutions and the establishment of a new network of institutions of culture, possibly by transferring certain institutions of national interest to local level. Another challenge is the hybrid operation of institutions with a dual function (museum activity and cultural heritage protection). However, a network of institutions has been adopted in the meantime (information from the interview) and no special challenges are expected with these competences other than the usual ones for the transfer of fixed assets, equipment and personnel. The transfer of institutions was expected to take place together with the transfer of funds for salaries, overheads and current maintenance i.e. the funds that were paid out monthly to those institutions according to the average from the last 2 years per institution, which is another indication that it refers more to delegation of authority rather than devolution. Some of these institutions have been transferred to LSGUs in the meantime. Here we expect externalities and overflows from one LSGU to another, but we do not expect special challenges in billing and technique.

With the National Strategy for Development of Culture for the period 2018-2022, the need to adopt a new law on culture was determined, which among other things would have a legal basis for further decentralization.

Ministry of Health

According to the table, competences related to: patronage services, emergency medical and dental care, prevention, detection and treatment of mouth and teeth diseases and dental-prosthetic rehabilitation, immunization and City Hospital (as a proposal of the City of Skopje) have been analyzed. According to the ranking/qualifications in the table above, here as well competences could most easily be transferred from the **Ministry of Health to the primary healthcare**.

A special challenge here is the fact that primary healthcare is decentralized, but not the secondary healthcare, which already requires legal intervention in the regulation and is a more complex operation (for example, for the City Hospital in Skopje). In the area of emergency medical assistance, patronage service and immunization no challenges are expected by the working group, but caution is recommended by the ministry (especially in the immunization part, in accordance with the COVID-19 experiences). Here we expect some challenges with externalities in the sense that not every LSGU has the staff to provide these services, so one LSGU is likely to serve several neighboring LSGUs. Therefore, here too **the possible asymmetry of competences in the field of primary healthcare should also be considered towards those LSGUs to which LSGUs would gravitate and other LSGUs with lower capacity in order to enjoy the offer of services in the field of primary healthcare and/or consider the transfer of some competences at the level of planning regions (perhaps even elements of secondary healthcare), which is certainly**

subject to a future more serious architecture of decentralization to further take into account the externalities i.e. the spillover of benefits from one LSGU to another.

Ministry of Transport and Communications

According to the table above, the following competencies have been analyzed: management of residential buildings, apartments, business buildings and premises that the RNM has the right to use, manage or has at its disposal. Related to this competence, determining the amount of the lease was considered i.e. the signing of contracts for lease on residential and business premises to be determined by the municipality. Furthermore, distribution of public housing and business buildings that are under the management of the Public Enterprise for Management of Business Facilities and PUIK to be transferred as property to the municipalities. For this distribution of public housing, there is a Commission consisting of five members, three of which are from the Ministry of Transport and Communications and two members are from the Ministry of Labor and Social Policy. The Minister of Transport and Communications makes the decisions on the distribution of these public housings.

A committee has been established at the MTC for these competencies and there is a positive opinion on the transfer of competencies. There is a certain challenge with those business facilities that are under PUIK and for which the state pays borrowing interests. The need to update and register property has also been highlighted, that is the need for a property inventory in the possession of state-owned companies**. The challenge is that the interest repayment obligation for that property should also be transferred to the LSGU.**

Communal services

According to the table above, the following competences are considered: removal and storage of damaged vehicles located on public areas, measuring decibels for loud music and imposing measures for law disobedience, video surveillance of public areas for greater safety of citizens, for regulating and solving the problem of illegal markets, the communal inspectorate with the help of the municipal police has the right to confiscate goods that are sold at illegal places outside the markets.

There are challenges here related to the establishment of a municipal/communal police that would have competences for identification, imposing mandatory penalties etc. There are no externalities, but there are challenges in billing and technique for implementing the competencies.

Ministry of Economy

According to the table above, the following competences are analyzed: issuing licenses for restaurants and licenses for tourism activities, as well as concessions for mineral resources.

The Ministry has not issued its position and the working group assessed at that time that an opinion should also be sought from the LSGU on these competences. The assessment is that the Ministry does not have a positive attitude towards these competences, and that the working group has reservations in terms of the need for consultations with LSGUs. No challenges are expected related to externalities, billing and technology for restaurants and tourism activities. Regarding the licenses

for restaurants and tourism activities, the working group's opinion is that the transfer of the issuance of these types of licenses to municipalities is possible, but only with reference to domestic, while operations at international level should remain within central level competence. Regarding the mineral resources, it is assessed that there are externalities and that there may be challenges with billing and with technique, and this is qualified as a less easy competence to transfer.

Ministry of Agriculture

From the table above, the following competences have been analyzed: management of agricultural land, management of grassland, management of 12 subsidiaries of AD Vodostopanstvo. In 2019, for example the total rent based on the basic lease of state agricultural land amounted to almost 7 million euros, which is about 1% of the total LSGU revenues for 2019 or about 3% of the LSGU's own revenues (account 630).
In 2019, the Ministry expressed a positive attitude and the working group is of the opinion that the regional units of the Ministry should be decentralized, become an integral part of the local self-government and continue with the collection of requests for subsidies and the payment should continue through the Payment Agency. At the same time, LSGUs must first meet certain criteria that will be determined by the ministry before assuming these powers. During the interviews with the representative from MLSG, it has been emphasized that there is a new Law on agricultural land and that the position of the Ministry now is to wait with the transfer of competences.
In the part that refers to agricultural land management, the consideration for which a debate has been opened within the institutions on the delegation of the competency for management of agricultural arable land up to 5 hectares was mentioned. At the same time, as was mentioned in the interview with the MLSG representative, a pilot project is currently being implemented with the help of the EU for the transformation of certain public enterprises and agencies and their merger, such as the transformation of the Public Enterprise Makedonski Shumi, and the merger of certain subsidiaries into one.
In the externalities part there are certain spillovers in water management because services spill over the territorial border of the LSGU (for which we expect challenges in the billing and technique of service provision), but apart from that, we do not foresee any special challenge in the billing for pastures and land management. On the other hand, in 2019 it was expected that the management, improvement and use of **pastures** by the municipalities would encourage local economic development in general and especially that it would attract national, local and foreign investments. It was planned that the Public Enterprise for Pastures would continue to operate with competencies over the **pastures** that are located in the National Parks. It has established 12 subsidiaries of AD Vodostopanstvo in Skopje, Strumica, Berovo, Gostivar, Bitola, Gevgelija, Kavadarci, Prilep, Kochani, Kumanovo, Ohrid and Radovish.

In 2019, the Ministry of Agriculture indicated that in order to implement the transfer of competences to LSGUs, it is first necessary to prepare an amendment to the Law on Local Self-Government ("Official Gazette of the Republic of Macedonia" No. 5/2002) in Article 22 and list all competences from the field of agriculture, water management and forestry that are handed over to local self-government units.

Sports

According to the table above, the review of the classification of sports facilities was analyzed with the aim of handing over sports facilities to the municipalities. The sports fields and facilities are managed by the Public Enterprise for Management of Sports Facilities. The opinion of the working group is that all sports facilities in which there is an interest on the part of LSGU should be handed over to them for use, with the exception of facilities of national importance. There are certain externalities, as well as challenges related to billing and technique. Many of the facilities, for example are given under concession management to private operators.

Ministry of Labor and Social Policy

The following competences have been analyzed: one-time financial assistance, guaranteed minimum assistance, compensation due to disability, compensation for part-time wages, housing allowance, permanent compensation, health protection of users, transfer of competence and works under the competence of the Agencies for employment.

The competences from the social sphere are a request for transfer from ZELS. During the interview it was conveyed that from the conversations taking part a few years ago at ministry level, the opinion was reached that time should be given to see the effects of the new law on social protection dated 2019 before proceeding to further transfer of competences to LSGUs. That's why we will rate with -1 here for the attitude of ministries and the working group. Furthermore, **for the part of externalities, we would like to point out here that the Social Work Centers - SWC and regional units of the Employment Agency have a regional character with elements of externalities in their work. What should be considered here is the need for an analysis of whether the SWCs could be transferred as a competence or just deconcentrated or transferred to the management of the planning regions. In the area of billing and technique, it requires a more complex approach towards the need for development of methodologies, regulations, etc.**

Ministry of Internal Affairs

The establishment of municipal police and issuing of traffic and driver's licenses has been analyzed.

Here it is required to analyze whether the functions of the Ministry of Internal Affairs which are of general competence (public order and peace) could be transferred to LSGUs with all the complexity of the transfer. Furthermore, there is a need to make an analysis on whether to establish a municipal/communal police force to maintain public order and peace in the LSGU in the area of regulation and control of traffic on local roads and municipal roads, collection streets, service streets and residential streets, control and measurement of noise in catering facilities. The transfer of registers keeping to the municipalities is also open to consideration. Here there are certain externalities and spillovers from one LSGU to another, as well as challenges with billing and technique usage.

Ministry of Education

Capital investments in education are analyzed here, which are distributed by LSGUs and according to a formula depending on the number of students and educational facilities. **The opinion from the interview is that this should be seen from the point of view of balanced regional development and not at LSGU level. The idea that the capital funds allocated by the ministry to**

the municipalities should be divided equally in accordance with the level of development of each municipality was emphasized. There are elements of externalities here.

Ministry of Justice

The analysis is about the competence of keeping civil registers (births, marriages, deaths). The attitude of the Ministry of Justice is negative considering the fact that the institution has an integral data system connected to the database of the Ministry of Internal Affairs and other institutions. **They were in the process of networking all branches and making it possible to retrieve these documents from any place, regardless of the place of birth. There are also plans to procure ATMs that would issue these documents.**

Ministry of Defense

For the analyzed competences (protection and rescue system, crisis management system, establishment, organization and operation of fire-fighting units) there is a working group in the Ministry of Interior and solutions were worked on that will most likely be solved with the **establishment of an Agency that will cover the function for protection and rescue, crisis management system and part from the Crisis Management Centre (CMC) and possibly firefighting units. These competences face externalities, complexity in billing and face complexity in the technique of providing services**.

4.3. CONCLUSIONS FROM THE COMPETENCE ANALYSIS

A more detailed analysis is needed for the situation with decentralized competences and for the need to transfer new competences and/or institutions to LSGUs. Four years have passed since the preparation of the *Proposal document of the working group for the expansion of the decentralization process* dated 2019 and the *Information on the continued process of institutional decentralization* prepared by the Ministry of Local Self-Government dated 2019 and these are documents that were prepared prior to the Covid-19. The new amendments in the legislation, the activities undertaken and the political dynamics and state priorities should be taken into consideration when updating these documents as a basis for a more detailed analysis that would include other criteria and elements for an objective analysis for the transfer of new competences and/or institutions to LSGUs.

The central government should set clear criteria, determination, consistency and transparency towards the local government, and therefore towards the citizens. For example, for some competencies the path of development, at least according to the plan, leads to the fact that although the competency is a central level obligation, according to the technique for provision of the service it can be local, so for the service user the level at which the service is provided is irrelevant (perhaps deconcentration). Here we refer to services from the registry books, which can increase the efficiency and effectiveness of service provision at low costs with good technique, digitization, payment method etc. **However, the central government's plans dated 4 years ago have not moved forward in the implementation according to their plans for networking and establishment of "ATMs" for these documents.**

The transfer of competences and/or institutions and delegation of competences is not the same as devolution of competences. For example, in the field of culture block grants appear to be a hybrid payment system for delegated competency rather than devolution. An indication of this is the fact that those institutions that are in the field of culture which have already been established by LSGUs after 2005, have not been included in the calculation system and distribution of block grants. Here it can help if the central government sets a clear goal what it wants to achieve with the decentralization of a specific competence.

A more detailed analysis is needed for the introduction of asymmetry and/or the introduction of competences of the planning regions, which would make them the second level of local government. An analysis is required for the introduction of asymmetry of some competencies in the fields of culture, health, water supply, roads, capital investments, firefighting services and wherever it is determined with an appropriate analysis towards those LSGUs to which other LSGUs would gravitate and other LSGUs with lower capacity in order to enjoy the offer of services in the field of culture and/or consider the transfer of some competences at the level of planning regions, which is certainly subject to a future more complex architecture of decentralization to further take into account the externalities i.e. the spillover of benefits from one LSGU to another.

More specifically, for some competences one could consider deconcentration or asymmetric decentralization or changing the territorial organization by introducing cities and municipalities, introducing a two-level local government with LSGUs and regions or simply consolidating LSGUs according to the old division into 34 LSGUs. This refers to competences such as social services and labor market services for example, where currently SWC and regional units of the Agency for employment, water management, and roads are operating.

Our technique of qualification and evaluation of competences as the easiest to transfer (from 20 to 28 total score) evaluates (according to expert assessment) the following competences for which the transfer can start/continue in the easiest way:

Ministry of Culture	Continuation of the transfer of institutions-libraries and theaters in a transparent manner with clear criteria
Ministry of Health	Patronage services, Emergency Medical Assistance and Dental Care
Ministry of Transport and Communications	Management of residential buildings, apartments, business buildings and premises that the RNM has the right to use, manage or has at its disposal Distribution of public housing
Communal services	Removal and storage of damaged vehicles Measuring decibels for loud music Municipal police
Ministry of Economy	Licenses for restaurants and tourism activities

We are of the opinion that these competences do not require major legal amendments and/or preparations. However, we point out once again the fact that these documents, *the Proposal document of the working group for the expansion of the decentralization process* dated 2019 and the *Information on the continued process of institutional decentralization* were prepared by the MLSG in 2019.

5. ANNEX. ASSESSMENTS OF THE IMPACT OF FISCAL DECENTRALIZATION MEASURED THROUGH EXP-EXPENDITURES

Table-6 presents the Estimates for that dependent variable for which the measure of decentralization-**EXP** (expenditure) is statistically significant for fiscal decentralization for the three Sigma-measures of convergence. Statistical significance and effects are similar to those of the decentralization-**REV** (revenue) measure from the previous table.

Table 6. Estimates of the impact of fiscal decentralization (measured through **EXP**-expenditures) on regional inequality

	CVEXP	CVEXPPOP	CVEXPSH	WCVEXP	WCVEXPPOP	WCVEXPSH	GINIEXP	GINIEXPPOP	GINIEXPSH
α	-1.373****	-1.400****	-1.705****	-1.108	-0.987	-1.497*	-2.314****	-2.353****	-2.479****
	(-3.656)	(-3.402)	(-4.811)	(-1.214)	(-0.986)	(-1.778)	(-3.923)	(-3.654)	(-4.401)
TIME	0.001	0.001	0.001	-0.024****	-0.023****	-0.022****	-0.008****	-0.008****	-0.006****
	(0.419)	(0.380)	(1.135)	(-7.253)	(-7.190)	(-7.278)	(-3.710)	(-3.776)	(-3.205)
EXP	-0.056****	-0.140****	0.485****	-0.098***	-0.276***	1.118****	-0.070***	-0.184****	0.726****
	(-3.156)	(-3.262)	(3.042)	(-2.278)	(-2.630)	(2.952)	(-2.513)	(-2.731)	(2.866)
GDPPOP	0.002**	0.004**	-0.003	0.004***	0.011**	-0.022**	0.002**	0.005**	-0.009
	(1.919)	(1.748)	(-0.261)	(2.072)	(1.760)	(-0.771)	(1.697)	(1.418)	(0.466)
BUDGREAL	0.008****	0.019****	-0.097****	0.019****	0.034****	-0.180****	0.011****	0.028****	-0.136****
	(6.751)	(6.606)	(-7.067)	(4.883)	(4.476)	(-5.524)	(6.115)	(6.054)	(-6.263)
GUS	0.029**	0.030**	0.030**	0.065**	0.070**	0.072**	0.050***	0.055***	0.048**
	(1.861)	(1.784)	(1.910)	(1.714)	(1.699)	(1.912)	(2.026)	(2.072)	(1.883)
LAB	0.063	0.062	0.140**	0.084	0.107	0.259	0.111	0.134	0.186*
	(0.980)	(0.819)	(1.746)	(0.537)	(0.578)	(1.362)	(1.093)	(1.120)	(1.458)
ETF	-0.008	-0.007	-0.011	-0.007	-0.005	-0.011	-0.012	-0.011	-0.015
	(-0.986)	(-0.875)	(-1.347)	(-0.333)	(-0.252)	(-0.614)	(-0.894)	(-0.795)	(-1.243)
URRU	-0.025***	-0.022**	-0.038****	-0.043**	-0.042	-0.082***	-0.035***	-0.037**	-0.049***
	(-2.418)	(-1.705)	(-3.078)	(-1.750)	(-1.351)	(-2.789)	(-2.178)	(-1.815)	(-2.466)

Note: t-statistics are in parentheses. ****, ***, **, and * indicate statistical significance at 1%, 5%, 10%, and 15% respectively.

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