# SUMMARY REPORT

## mapping current climate finance practices

*in nine pilot local self-governments in the Republic of North Macedonia*


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# Content



# List of abbreviations

| | |
|---|---|
| **LSGU** | Local self-government unit – municipality |
| **EU** | European Union |
| **ILDP** | Integrated local development plan |
| **LEAP** | Local Environmental Action Plan |
| **LED** | Local economic development |
| **MOEPP** | Ministry of Environment and Physical Planning |
| **MTC** | Ministry of Transport and Communications |
| **RNM** | Republic of North Macedonia |
| **PFM** | Public finance management |
| **PEFA** | Indicators for public expenditure management and financial accountability |

# Executive summary

This summary report synthesizes the findings from an in-depth analysis of climate finance practices in nine pilot local self-government units (LSGUs) in the Republic of North Macedonia, where practices were mapped for each municipality separately.

The purpose of this summary report is a summarized picture of the current situation in municipalities, focusing on systematic findings, rather than individual situations, with the intention of improving the process.

Municipalities in North Macedonia play a central role in the implementation of climate policies, especially in areas such as urban planning, waste management, water services and energy efficiency. However, their capacity is limited by several structural weaknesses that are common to almost all analysed municipalities.

**Key systemic weaknesses**

- Climate expenditures in municipalities are not clearly identified and are not systematically monitored;
- The connection between strategic plans and annual budgets is weak;
- High dependence on external funding (donors and central government);
- Limited administrative and technical capacities for (more) complex infrastructure projects;
- Underdeveloped risk management and internal control mechanisms specific to climate finance;
- Absence of narrative reporting linking budget spending to climate outcomes.

**Positive practices identified**

*Some municipalities apply "green" criteria in the implementation of public procurement, most often in the procurement of vehicles and equipment (through requests for bids with a high energy class and low emissions). This practice is an example that is worth expanding and systematizing in all municipalities.*

*Several of the municipalities have developed detailed and regularly updated strategic documents (LEAP, climate resilience strategies, energy efficiency programs) linked to measurable indicators, which serve as a good basis for (budget) planning.*

*Certain municipalities are showing a proactive approach in networking through international projects, thus building local capacity for project management and access to innovative funding mechanisms.*

*Some municipalities practice participatory planning through forums with citizens and the business community when selecting environmental projects, ensuring greater legitimacy of priorities.*

*An innovative practice of circular economy is also highlighted, where revenues generated through a specific environmental activity are returned to the budget and reused for similar environmental purposes.*

The analysis of budget execution shows relative stability at the aggregate level, but with significant deviations in capital investments related to the environment. Key risks to integrity are related to incomplete transparency, fragmented institutional set-up and the absence of narrative reporting.

# Background

Local government units are taking on an increasing role in managing climate-related activities, stemming from competencies in areas that directly impact climate change mitigation and adaptation, such as: environmental protection, urban planning, waste management, water services, energy efficiency and local infrastructure development. A significant portion of climate change-related finances – climate finance – come from the central budget, and/or international donors and development funds, and are channelled to the municipal level, which imposes the need for enhanced oversight and greater accountability.

Although the decentralisation framework delegates environmental management responsibilities to municipalities, their actual capacity for effective climate action depends on the level of development of local institutional systems for public finance management. In practice, climate objectives are rarely explicitly classified in municipal budgets, and the link between strategic plans and annual budgets remains weak.

These challenges are particularly significant in the process of aligning North Macedonia with the objectives of the EU Green Deal and the Green Finance Frameworks (Chapters 27 and 22 of the acquis). Strengthening local PFM systems is also a prerequisite for preparing municipalities for access to international climate funds.

# Methodological approach

The summarized findings are based on a detailed report of the mapping of the situation in nine municipalities. The nine selected pilot local government units cover all eight planning regions, and the selection was made using a convenience sampling strategy with the following additional criteria:

- Regional representation: at least one LSGU from each planning region
- Administrative capacity: advantage of municipalities with available capacity for meaningful involvement
- Willingness for cooperation: municipalities that have shown interest and availability

The nine pilot municipalities together represent about 13% of the total population and close to 12% of the total expenditures of all LSGUs in the country, providing a representative basis for analysis. The municipalities covered are of different sizes (7,000–70,000 inhabitants), different fiscal capacities and different geographical locations – urban, rural, border and ethnically mixed environments.

The analysis is based on a review of a series of budget documents, responses to detailed questionnaires and interviews conducted with municipal administration, as well as the application of an adapted PEFA Climate Framework.

# 1. Municipal planning and strategic framework

## *Priorities and strategic documents*

The analysis showed that all municipalities have defined broad priorities for the protection and improvement of the environment, which consistently focus on energy efficiency (such as replacing public lighting infrastructure, changing and improving thermal facades of public buildings), improving waste management processes and improving water supply and wastewater management. This reflects the basic legal responsibilities of municipalities in the communal sphere for the provision of services to citizens.

In terms of the strategic framework, the situation is heterogeneous:

- Most municipalities have basic strategic documents – Integrated Local Development Plan (ILDP), LED Strategy and Energy Efficiency Program.
- The Local Environmental Action Plan (LEAP) is present in most municipalities, but in a certain number of municipalities it has expired or is in the process of being updated.
- Strategies specifically for climate change and climate resilience are rare and only some municipalities have them.

*Some municipalities demonstrate good examples of forward-looking strategic planning by adopting a detailed longer-term climate resilience strategy, which contains an embedded investment plan, or by developing a smart mobility strategy to decarbonize local transport. Such documents, which link climate goals to specific indicators and financial projections, represent good practice for replication.*

## *Compliance with plans and budgets*

In almost all municipalities, there is an evident structural weakness of a weak connection between strategic documents and the budget, more specifically in practice:

- The financial plan in strategic documents is often incomplete, general or completely absent,
- The implementation of projects depends primarily on the availability of external financing, not on strategic priorities,
- Planning for climate and environmental projects is reactive – it is activated when a specific donor call is opened,
- The dominant focus of the measures is on climate mitigation, while aspects of climate adaptation are less present.

Key risk: Dependence on external financing creates a situation where municipalities plan funds in the budget, but implementation is conditioned by transfers that are not under their control. This leads to oversized budgets, more frequent rebalances, and low implementation, which is especially the case for capital programs.

# 2. Budget process and presentation of climate expenditures

## *Identification and classification of expenses*

All analysed municipalities apply a program budget classification. There is a separate budget Program R (Protection of the Environment and Nature) in all municipalities, but its significance, scope and budget share in the total municipal budget vary significantly. A common feature is the dispersion of climate-relevant expenditures across multiple budget programs:

- Program R – direct environmental activities (such as conducting soil, water, air quality analyses; subsidies for citizens, as well as small interventions).
- Program J (Utility Activities) – which also includes capital infrastructure projects with environmental implications (sewerage, water supply), including financing of public utility companies for the provision of services.
- Program F (Urban Planning) – spatial planning that also includes a climate component

This situation of dispersion of municipal climate expenditures across multiple programs without an established budget tagging system is a systematic problem, as it makes it impossible in practice to monitor and properly calculate allocations and then the effects of total climate financing at the municipal level.

### Narrative reporting

Although municipalities meet their legal obligations for quarterly financial reporting to the Municipal Council, comprehensive narrative annual (or more frequent) reports on the implementation of adopted budget programs are absent. This represents a systemic weakness in ensuring greater transparency and accountability of environmental spending, including climate action:

- The Council most often receives tabular financial reports on the implementation of programs without a qualitative analysis of the climate impact.
- Citizens and stakeholders cannot assess the effectiveness of the funds spent
- There is no strong relationship between financial and operational results.

> The absence of narrative reporting creates information asymmetry and limits democratic oversight, opening space for non-transparent management of climate finance.

### Financing and revenues

Almost all municipalities have a high dependence on external funding sources for larger climate projects, through capital grants from the Ministry of Environment, the Ministry of Transport, the Regional Development Bureau and/or international donors. Their own budgets for climate and environmental activities are modest.

There is a specific problem with the budget recording of funds, namely that often when municipalities appear only as beneficiaries, and projects are implemented directly by ministries or international organizations, the funds are not recorded in the municipal budget.

This creates a “false” picture of low-climate financing and makes the overall assessment difficult.

# 3. Budgetary credibility and execution

### *Overall rating*

The analysis of budget execution, for example for 2024, shows relative stability at the aggregate level for most municipalities, with total deviations that usually do not exceed 10% of the initial budget plan and the final budget execution. However, this aggregate stability is the result of compensation effects - stable revenues in mandatory programs and for earmarked transfers (such as education, administration, etc.) cover deviations in development and environmental programs.

### *Program R – Environment*

In the Program R, which directly and explicitly addresses environmental protection, the following common findings are identified:

- The share of the R program in the total municipal budget is small – usually around 0.5% in most municipalities,
- In most municipalities, implementation is relatively stable for current activities.
- In smaller municipalities, the program may be reduced to a symbolic budget or completely abolished during a rebalance,
- Rebalancing upwards (when securing new donations) and downwards (during budget pressure) is frequent.

> *In certain municipalities, Program R shows high stability and implementation rates above 90%, with well-planned ongoing activities. Such stable implementation can serve as a model for introducing climate budgeting (including tracking) in other programs.*

### *Capital investments*

Capital infrastructure projects with an environmental component (sewerage, water supply, wastewater treatment plants), located mainly in Program J (Communal Activities), show significant deviations between the plan and the budget implementation. There are frequent cases of rebalancing to increase the program budget when additional funds are provided from external sources of financing, but also accompanied by a low rate of implementation of the budget plan, due to administrative and technical barriers in the implementation.

According to the municipalities, the most commonly identified reasons for delays are:

- Complex and lengthy public procurement procedures,
- Insufficient coordination with the central government for timely implementation of capital grant transfers
- Limited capacity to manage multiple projects simultaneously
- Technical documentation that is not fully prepared before the start of the budget process

# 4. Institutional arrangements and capacities

### *Organizational structure*

In most municipalities, the responsibility for broad environmental issues is integrated within the Urban Planning Sector – without a separate environmental department. The exception is larger municipalities that have established separate sectors or departments for the environment with expert staff. This arrangement limits the specialized capacities for climate finance in smaller municipalities.

Coordination between sectors (urban planning, finance, LED, public procurement) is present, but varies in quality. In most municipalities, it is project-oriented, not systematically established.

### *Inspection services*

The lack of inspection capacity is a common problem in many municipalities. This situation limits the efficiency of control and sanctioning of environmental violations. Although an inspection function exists, in practice very few or no fines are imposed, which is why the revenues from this basis are negligible.

### *Green finance capacities*

Municipal employees have budgeting capacities, but specialized knowledge such as climate budgeting, expenditure tagging and green public procurement is still in its infancy. Municipalities that have participated and have experience in international projects (EU funds, Horizon, Interreg) have significantly built capacity for project management and preparation of strategic documents, which represents a valuable human capacity for municipalities that can be agents of change.

# 5. Public procurement and green criteria

The application of green criteria in public procurement, although legally enabled, is uneven and not systematically established, at the level of exceptions to good examples:

- The majority of municipalities still predominantly follow the "lowest price" criterion when selecting an economic operator in public procurement.
- A smaller number of municipalities apply green criteria to some of the procurement of equipment and vehicles (by introducing conditions for high energy class and low emissions)
- Several municipalities incorporate environmental requirements into the technical documentation of projects (certificates for construction materials).
- There is uncertainty among municipalities regarding the appropriate application of green criteria due to the potential possibility of eventually limiting competition in the local market – which is a challenge that requires targeted technical assistance and greater awareness and coordination from the competent bodies managing public procurement processes.

*Certain municipalities apply green criteria in the procurement of municipal equipment and vehicles, requiring high energy efficiency and low emissions of harmful gases. Some incorporate this into the technical specifications for construction works as well. These examples*

*show that the application of green procurement is feasible in the Macedonian context and should be expanded, but coordinated awareness-raising is also needed.*

# 6. Internal controls and risks

### *Control mechanisms*

Standard internal control and audit mechanisms are present in all municipalities – internal audit unit, integrity officer, anti-corruption action plan. Externally funded projects are subject to additional monitoring controls by donors.

However, there is a systemic weakness: internal audit is focused on procedural compliance, not on the effectiveness and climate impact of the funds spent. There are no examples of thematic audits specifically for climate or environmental funding.

### *System vulnerability*

The following common vulnerabilities have been identified:

- The absence of climate tagging makes it impossible to measure and verify the climate effect,
- Incomplete recording of financing in the municipal budget leads to informational incompleteness,
- Lack of coverage of climate change-related risks in risk management strategies,
- Limited specialized capacities to conduct internal audit,
- The Council makes decisions without full information about the climate impact of expenditures.

# 7. Corruption risk and integrity assessment

### *Methodological approach*

The corruption risk assessment was conducted according to the methodology of the UNGP Anti-Corruption Risk Assessment Guide (2013), following the four phases of the budget cycle: preparation, execution, reporting and audit/oversight.

### *Common risk factors*

Despite the different contexts of individual municipalities, the analysis identified a high consistency in the types of risks. The following risk factors are present in the majority of municipalities:

- **In the budget preparation phase:**
  - Incomplete connection of strategic documents with the budget;
  - Insufficiently clear criteria for selecting climate projects;
  - Dependence on external funding with the risk of targeting "easily available" donor funds instead of real local needs and strategic goals.
- **In the execution phase:**
  - Dispersed climate expenditures without labeling, making them difficult to track and link to purpose;

- Weak control over the implementation of projects financed through the central government;
- Dominant application of the "lowest price" criterion in procurement.

➢ **In the reporting and surveillance phase:**

- The absence of narrative reports reduces the ability of the Council and citizens to monitor and oversee;
- Risk of 'green-washing' by presenting utility expenditures as climate investments;
- Supervisory bodies do not have a methodology for assessing value for money for green projects.

Structural risk: The State Audit Office does not conduct an annual audit of every municipality, and climate finance is rarely subject to specialized performance audits.

# 8. Assessment using an adapted PEFA climate framework

An adapted version of the PEFA Climate Framework was used to assess the climate sensitivity of local public finance systems. The ranking is on a scale of A-D, with A indicating full integration of climate aspects and D indicating absence or minimal presence. (No scores are given for elements that are not applicable in the local context, i.e. indicators 6, 9, 10, 13).

## *Synthetic findings*

The ratings for the nine pilot municipalities show a high degree of homogeneity, i.e. almost all indicators are dominated by low ratings (D and D+), which indicates systemic and structural, but not isolated weaknesses in an individual municipality.

| Indicator | Description | Typical rating |
|---|---|---|
| **CRPFM-1** | Alignment of the budget with climate-relevant strategies | **D (2 municipalities C)** |
| **CRPFM-2** | Tracking climate expenditures (tagging) | **D – all municipalities** |
| **CRPFM-3** | Climate-sensitive budget circular | **D – all municipalities** |
| **CRPFM-4** | Council oversight | **D / D+** |
| **CRPFM-5** | Managing public investments with climate change sensitivity | **D / D+** |
| **CRPFM-7** | Managing climate-related liabilities | **D – all municipalities** |
| **CRPFM-8** | Green public procurement | **D – almost all municipalities** |
| **CRPFM-11** | Fiscal decentralization and climate | **D – all municipalities** |
| **CRPFM-12** | Performance information | **D to C** |

| | | |
|---|---|---|
| **CRPFM-14** | Implementation of climate expenditure | **D to B (varies)** |

- **Climate Expenditure Monitoring (CRPFM-2):**All municipalities are rated D. None of the municipalities implement a budget marking system or have a separate budget classification appropriate for recording climate-related expenditures (climate expenditures).
- **Budget Circular (CRPFM-3):**All municipalities are rated D because the budget guidelines do not contain requirements for separate identification of climate effects.
- **Green Public Procurement (CRPFM-8):**Almost all municipalities are rated D because climate criteria are not systematically integrated into public procurement.
- **Climate expenditure execution (CRPFM-14):**There is greater variability in this indicator. Certain municipalities show a relatively good implementation rate (grade B or C), but for the majority there are significant deviations, especially in conditions of high dependence on external financing.

# 9. Recommendations and proposed measures

## *Priority measures in the short term*

The following short-term measures can be implemented within existing systems without the need for legislative changes:

1. ***Introducing budget climate tagging (Climate Tagging) -***Municipalities can start by internally marking items in budget programs that have a climate component, applying a simple systematic code. This will allow for tracking the purpose and reduce the risks of misallocation of funds, as well as monitoring achievements.

2. ***Standardized regular narrative reporting -***Adoption of a standard format for a narrative annex to the quarterly financial reports to the Council – with a brief description of the climate impact of the funds spent (energy savings, implemented infrastructure improvements, etc.). This reduces the risks of 'green-washing' and increases accountability. Accordingly, annual programs should also contain appropriate and regular annual narrative reporting on the activities implemented and results achieved.

3. ***Strengthening transparency - 'Green Citizens' Budget'***– Following the example of preparing a citizen budget, a simple infographic/visualization can be prepared and published on the municipality's website that will show how much money is planned and spent for various climate actions (activities). This allows for better citizen control and reduces the risks of non-transparent allocation of expenditures, as well as greater accountability.

4. ***Environmental checklists in public procurement -***Introducing a mandatory check (checklist) when preparing tender documentation for energy efficiency or equipment, in order to ensure that technical specifications do not favour outdated and un-environmental technologies, and yet do not conflict with the principles of competition.

5. ***Rulebook on earmarked spending of environmental revenues -***Drafting a short internal rulebook that will define that funds collected from environmental fees, concessions and permits will be spent on measures envisaged in the LEAP, limiting the discretionary right to their repurposing.

## *Medium-term measures*

6. ***Updating and/or creating LEAP*** with a realistic financial structure linked to the budget
7. ***Strategy - climate measure - budget***- Clear connection of each climate measure in strategic documents to a specific budget program
8. ***Capacity building*** on climate budgeting in municipal administration
9. ***More conservative projections*** when rebalancing capital projects dependent on external financing

10. ***Strengthening inspection services*** for more efficient control in the field of the environment

### *Long-term measures*

11. ***System integration*** of climate aspects in the budget circular of the Ministry of Finance
12. ***Establishing a national methodology*** for climate budgeting applicable at local level
13. ***Regular thematic performance audits*** for climate finance at the local level
14. ***Introduction of the IFMIS system*** which will enable better integration of financial management.

# 10. Conclusion

This analysis showed that local public finance management systems in the nine pilot municipalities in North Macedonia are structurally weakly climate-sensitive. The findings indicate that these are not isolated failures, but systemic gaps that occur regardless of the size, fiscal capacity, or geographical location of the municipalities.

Key systemic problems are: the absence of climate labelling, weak linkages between strategies and budgets, lack of narrative reporting and weak implementation of green procurement, leaving room for discretionary decisions and limited democratic oversight throughout the climate finance cycle.

At the same time, the analysis identified positive practices and municipalities with a higher degree of built institutional capacity, which can serve as models for sharing experiences within the partnership network.

*Strengthening local PFM systems is a key prerequisite for effective, transparent and accountable management of climate finance. This will enable municipalities not only to better respond to climate challenges, but also to more effectively access the growing international sources of climate finance – national funds, IPA III instruments and other mechanisms.*

## ABOUT THIS DOCUMENT

This summary document from the mapping was prepared within the framework of the project **Strengthening integrity in climate finance** (2025/488-600), funded by the EU Rule of Law Programme (IPA 2021), and implemented by **Center for Economic Analysis – CEA.**

The project aims to contribute to strengthening the integrity, transparency and accountability of climate related financing at the local level in North Macedonia, thereby contributing to reducing the risks of irregularities and improving the allocation of local resources.

This document is based on the document Mapping of Current Climate Finance Practices in Nine Pilot Local Government Units in the Republic of North Macedonia and presents a summary of the most commonly detected findings, prepared by CEA.

**Source of illustrations:** The graphic displays are created with the support of artificial intelligence technology.

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