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**MACEDONIA LOCAL
GOVERNMENT ACTIVITY**

Working Draft

Current status of capital grants allocation to the units of local self-government in Republic of Macedonia



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List of acronyms

RM – Republic of Macedonia

EU – European Union

ULG – Units of local self-government

ZELS – Association of the Units of Local Self-Government

MTC – Ministry of transport and communications

MF – Ministry of finance

MAFWE – Ministry of agriculture, forestry and water-economy

MLG – Ministry of local self-government

MC – Ministry of culture

CE – Council of Europe

FNRR – Fund for national and regional roads

ANR – Agency for National Roads

BFEUR – Bureau for economically underdeveloped regions

BRD – Bureau for regional development

USA – United States of America

USAID – United States Agency for International Development

MLGA – Macedonian Local Government Activity

GDP – Gross Domestic Product

VAT – Value Added Tax

PIT – Personal Income Tax

1. Introduction

Decentralization of government is very important priority in the overall reforms in Republic of Macedonia, as well as in many other developing and transitional countries. The purpose of the fiscal decentralization, as an exceptionally important segment of the overall changes, is to build an objective, fair, transparent, stable and sustainable system of local public finances, which will provide for sufficient financing for the unit of local self-government (ULG) for successful realization of the legal competencies devolved with the decentralization process, thus providing efficient and effective services for the citizens and improving the quality of life for the citizens in the local communities.

A period of four years has passed since the start of the local government system reform, which is a sufficiently long time period for conducting quality analyses, to perceive the advantages which need to be retained and strengthened, and to determine the failures, weaknesses and shortages to be eliminated and replaced with quality solutions.

Intergovernmental finances are current topic not only in developing and transitional countries, but also in developed countries. Often, the decentralized competences are not accompanied with transfer of adequate finances. Hence, capital grants have dual function. The first is to provide for certain fiscal equalization, which is significant for countries with unequal development, and second to provide for additional funds for capital investments in areas of national priority.

Capital grants are part of intergovernmental finances. Capital grants can be unconditional when the ULGs are entitled to allocate them for projects according to their own criteria, or to be conditioned when the allocation by the central government is made for concretely determined purposes. The allocation is made according to a formula, in order to achieve more fair allocation or on the basis of the submitted projects' quality, when the objective is to raise the standard and quality of life in certain area.

Capital grants have significant importance for ULGs in RM. They serve as significant source of additional finances for the ULGs, which cannot be provided from own sources of revenues to finance the construction of new capital constructions and reconstruction of the existing ones in the fields of: water-supply, waste waters intake and treatment, communal waste treatment, road infrastructure, education, culture, child protection and social welfare, sport etc.

2. Research objectives and scope

The United States Agency for International Development (USAID) with its programs, supported the country in the past ten years, and continues to support the initiatives for local self-government reforms. The USAID financed Macedonian Local Self-government Activity (USAID/MLGA) developed a rational database for the revenues and expenses of ULGs for the years 2006, 2007 and 2008, in cooperation with the Association of the Units of Local Self-Government (ZELS) and the Ministry of finance (MF). Among other important data provided from the state treasury, the database includes data about capital grants transferred from the central government to the ULGs.

The present document has three objectives. The first objective is to provide analysis of laws and secondary legislation in the respective area and to provide an overview of all capital grants, that central government institutions transfer to the ULGs. Also, it includes an overview of the procedures for application, selection criteria, conditions to participate in financing, and transparency in running the procedures, monitoring, reporting and control.

The second objective is to provide analysis of the capital grants status for 2006, 2007 and 2008, the consistency in respecting laws and regulations, and differences between the reported and the real situation in practice.

The third objective of this document is to provide recommendation for improvement based on the findings. This shall refer to the provision of more funds as grants, reforms of the capital grant system, transparency in the procedures, adoption of objective criteria for selection of projects, efficient monitoring and control, as well as establishment of the principle for own-share or co-financing the projects.

3. Methodology

The preparation of the study was preceded by an analysis of the legal framework that regulates the local self-government, financing the ULGs and capital grants¹.

Analysis was carried out on several programs, annual programs and decisions reached by the Government of RM, the Rulebook on allocation of funds for financing the annual

¹ Analysis was conducted on the parts that regulate this field from the: Constitution of RM („Official Gazette of RM” No. 52/92), European Charter for Local Self-government („Official Gazette of RM” No. 23/97), Law on Local Self-government („Official Gazette of RM” No.05/02), Law on the City of Skopje („Official Gazette of RM “ No. 55/04), Law on Financing the Units of Local Self-government („Official Gazette of RM” No. 61/04), Law on Budgets („Official Gazette of RM” No. 64/05), Law on Execution of the Budget of RM for 2006 („Official Gazette of RM” No. 120/05), Law on Execution of the Budget of RM for 2007 („Official Gazette of RM” No. 139/06), Law on Execution of the Budget of RM for 2008 („Official Gazette of RM” No. 160/07), other sectoral laws and changes and amendments to the budgets for the respective years.

program for construction, reconstruction, maintenance and protection of local roads and streets for the municipalities and the City of Skopje, Rulebook on changes of the aforementioned rulebook and other sub-legal acts.

The information from the USAID/MLGA relational database for revenues and expenditures of ULGs for 2006, 2007 and 2008 was also used.

In addition, information was used from the literature about intergovernmental transfers and capital grants from renowned authors. Contacts were made with representatives of: central government, MF, ZELS, ULGs and local experts from this area.

4. Analysis of the legal framework

The financing of the ULGs and capital grants, directly or indirectly are regulated by: Constitution of RM, European Charter of Local Self-government, Law on Local Self-government, Law on the City of Skopje, Law on Financing the Units of Local Self-government, Law on Budgets, several other sectoral laws and many sub-legal acts.

4.1. Overview of the contents in the regulation

4.1.1. Constitution of Republic of Macedonia

Local self-government is established as one of the fundamental values of the constitutional order in the highest act of the state (Article 8).

The municipalities and the City of Skopje are financed from own sources of revenues as specified by law and funds from the Republic (Article 115 and Article 117).

4.1.2. European Charter of Local Self-government

The European Charter of Local Self-government is a document of the Council of Europe, which is ratified by the Parliament of Republic of Macedonia in 1997, and accordingly is a constituent part of the legislation of RM.

Local authorities shall, within the limits of the law, have full discretion to exercise their initiative with regard to any matter which is not excluded from their competence nor assigned to any other authority. Public responsibilities shall generally be exercised, in preference, by those authorities which are closest to the citizens. (Article 4).

Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the law. Local authorities shall be consulted, in an appropriate

manner, on the way in which redistributed resources are to be allocated to them. As far as possible, grants to local authorities shall not be earmarked for the financing of specific projects. The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction. For the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law. (Article 9).

4.1.3. Law on local self-government

The Law on Local Self-government, as law of systematic character among others, regulates the following: competencies and financing the ULGs, surveillance over the work of ULGs and mechanisms for cooperation between ULGs and the Government of RM.

The list of competencies of ULGs, in Article 22, among other contains the following competencies that require financing in the form of capital grants in order to be realized by the ULGs: nature and environment protection, local economic development, communal affairs, culture, sports and recreation, social welfare and child protection, education and fire-fighting protection. These capital grants are needed for the realization of these functions by the municipalities due to the poor financial capacities of municipalities for such large projects.

Financing of ULGs is regulated in Article 11. ULGs are financed from own sources of revenues and other sources of financing in accordance with the economic policy of the state. The sources of funding for the ULGs should provide for adequate realization of their competencies as stipulated by law, and the ULGs within their competencies shall independently dispose of their own sources of revenues, and are entitled to borrow from the domestic and foreign capital market in accordance with the law.

In accordance with Article 14, ULGs can have mutual cooperation for the realization of their competencies. For the realization of mutual interests and performance of joint tasks, the ULGs can join their funds and establish joint public services in accordance with the law.

The mechanisms for cooperation among the ULGs, Government of RM and the administration organs are regulated in Articles 78, 79 and 80. The Government is obligated to consult the ULGs in a timely and adequate manner regarding the planning and decision-making procedures on issues of their concern. In order to coordinate the planning, programming and implementation of policies in certain areas or groups of areas, the Government may conclude agreements for cooperation with one or several ULGs.

On issues of interest for the ULGs, the Government is obligated to cooperate, especially about laws that refer to the municipalities, to the amount of general grants and the sources of finances for the competencies. The Government shall compile a report on the

cooperation regarding those matters, for which consent may or may not be reached, and the report is further submitted to the Parliament of RM.

The provisions from Articles 69 to 73 of the Law on local self-government regulate the supervision over legality, control and auditing of material and financial operations and the previous supervision, which implies having obtained previous consent on the ULGs regulations in cases specified by law.

4.1.4. Law on financing the units of local self-government

The financing of ULGs is regulated by the Law on financing the units of local self-government, and the financing of the City of Skopje; as special ULG it is regulated under the same law and the Law on the City of Skopje.

The term capital grant, according to the definition of Article 2 of the Law, is grant aimed for financing the ULGs' projects for capital investments.

The specified sources of revenues for financing the ULGs in accordance with Article 3 are as follows: own sources of revenues, grants from the Budget of RM and the budgets from Funds, and funds from borrowing.

Article 8 of the Law stipulates that the grants from the Budget of RM and the budgets of the Funds, shall provide for additional revenues in the budgets of ULGs for financing their competencies as stipulated by law. Thus, capital grant is stipulated among other grants allocated to the ULGs. The type, amount and allocation of capital grants to ULGs is constituent part of the Budget of RM and the budgets of the Funds. The line ministries and the Funds have an obligation to announce and establish the criteria, procedures and deadlines for allocation of capital grants by 30 April in the current year at latest².

The capital grant is regulated in Article 11 in details. It is used for financing investment projects, on the basis of the Program established by the Government of RM. For the allocation of capital grants, the line ministries and the Funds shall give priority to projects with completely provided financing, and are obligated to monitor the use of capital grants. Should any irregularities be identified with regard to the use of the capital grants, it is stipulated that the line ministries and the Funds shall terminate the payment of funds and shall notify the Ministry of finance accordingly. The financing of capital investments may be terminated if identified that some ULGs do not use the finances for the specified purpose.

² Article 8, paragraph 4 of the Law on financing of local governments “ The line ministries and funds shall by 30 April of the current year, the latest, publish determined criteria, procedures and time frames for the distribution of targeted and capital grants”

The transfer of grants from the Budget of RM and the budgets of the Funds, according to the provisions of Article 17, shall be carried out in accordance with the regulations for treasury operations.

The law also prescribes the deadlines for notifying the ULGs. According to Article 14, the minister of finance shall notify each ULG separately with a circular letter about the type and amount of grants for the following budget year, by 30 September in the current year at latest.

According to Article 15, the Government of RM shall establish a Committee to monitor the development of the ULGs' financing system, comprised of 5 representatives from ZELS and one representative from: the Ministry of local self-government, the Ministry of finance, the Ministry of labor and social policy and the Ministry of education and science.

Among others, the Committee shall have the competencies to:

- Monitor the application of criteria for allocation of grants;
- Propose measures to improve the grants system;
- Provide recommendations to overcome the identified shortcomings regarding grants allocation;
- Monitor the transparency of procedures and their consistent realization during allocation of grants;
- Prepare semi-annual and annual reports on the development of the system for financing the ULGs, with proposals for system improvements and
- Monitor the use of grants for the specified purpose.

The Committee is entitled to access all necessary data in accordance with the law and is obligated to submit to the Government of RM the afore mentioned semi-annual and annual reports on the development of the system for financing the ULGs along with the established proposals for system improvement. The Government of RM is obligated to notify the public on the content of the respective reports.

ULGs, in accordance with Articles 18 and 20 of the Law, may make long-termed borrowing for financing capital assets and investments in the country according to conditions specified in the laws, as well as in foreign countries only with previously obtained consent from the Government of RM, based on previously provided opinion by the Ministry of finance. The Government may give guarantees on liabilities based on long-termed borrowing by the ULGs, including the public services established by the ULGs, only in case when the liability is undertaken in accordance with the law (Article 21).

According to the provisions of the law (Article 25), capital revenues of the ULGs budgets shall be the grants from the Budget of RM and from the budgets of the Funds for financing capital investments, self-contribution funds, donations and other sources of revenues, whereas capital expenditures of the ULGs budgets shall be the expenditures for capital investments and capital transfers.

The budget circular letter for the following year, which is drafted by the minister of finance by 30 September in the current year at latest (Article 27), among others shall notify the ULGs for the grants which are transferred from the Budget of RM, from the budgets of the Funds, as well as from other sources.

The Councils of the ULGs are obligated (Article 34) to adopt annual reports. Constituent part of these reports shall be the report on the funds, receivables, liabilities and sources of funds and their respective amounts, as well as the report on the realization of investment programs, categorical grants, capital grants, block grants and grants for delegated competencies.

4.1.5. Law on the City of Skopje

The financing of the City of Skopje and the constituent ULGs, is regulated by the Law on financing the units of local self-government and the Law on the City of Skopje.

Among other sources of revenues, they receive revenues from the Budget of RM and the budgets of the Funds (categorical grants, block grants, capital grants and grants for delegated competencies).

The City of Skopje and the constituent ULGs in the City of Skopje are entitled to make borrowings in the country and abroad, under terms and conditions specified by law.

4.1.6. Law on budgets

Among other, this law stipulates that the budget circular letters for the ULGs contain information on the estimation of revenues for the respective budget year, which are allocated between the Budget of RM and the ULGs, as well as the information on the Decisions of the Government for categorical grants, block grants and other grants for the ULGs specified by law (Article 21).

In cases of undertaking liabilities, the payment of which requires use of budget funds for the following years, the budget beneficiaries must provide consent from the competent authorities (Article 47).

4.2. Analysis on the content of the legal framework for capital grants

The fact that the local self-government is stipulated as fundamental value of the constitutional order, and that the state had ratified the European Charter on Local Self-Government, implies that the state gives great importance to the local self-government as one of the main grounds for the democratic system in the country.

Unfortunately, not all obligations arising out of Constitution and legislation have been fulfilled, especially with regard to the financing of the local self-government.

It is apparent that ULGs are faced with major shortages of funds for realization of the legal competencies, especially for capital investments. The provision of sufficient finances for the local self-government is contingent on the overall financial capacities of the state and the position of the state towards the local self-government.

It would be best to provide for balance in the allocation of the overall national revenues proportionally to the legal competencies of both the central and local government, and to provide for significant and quality sources of funding adequately to the undertaken obligations.

Admittedly, major progress has been achieved in the field of fiscal decentralization in the past four years, besides major shortcomings and weaknesses. Unfortunately, what is being declared is not always consistently put into practice. The competent state authorities have not implemented many significant obligations from the Law on financing the units of local self-government.

The attitude of the central government towards the Committee on monitoring the development of the system for financing the ULGs is of greatest concern. In the past years, although this is a Committee with a significant role, still it had a marginalized role only to accept the proposals by the Ministry of finance and other line ministries prior to their submission to the Government for adoption.

So far, the purpose of establishing this Committee has not been completely accomplished. The Committee did not monitor the use of criteria for grants allocation, did not propose measures to improve the system of grants, did not give recommendations to overcome the identified shortcomings for the allocation of grants, did not monitor the transparency of procedures and their consistent realization for grants allocation, and did not monitor the use of grants according to the specified purpose.

Although obligated by law, the Government has never notified the public about the reports or the recommendations to improve the system.

The reasons may be identified as un-preparedness to respect and implement legal provisions in practice, and also as insufficient staffing in the Department for budgets of the

ULG at the Ministry of finance, as well as the insufficient persistence by the ULGs and ZELS. In addition, neither human nor material resources have been provided for conducting analysis of the situation in the country and comparative analyses for the respective situation in other countries.

Legal obligations have not been respected by the line ministries and the Funds regarding the announcement and establishment of criteria, procedures and deadlines for allocation of capital grants by 30 April in the current year at latest.

Likewise, the minister of finance has not respected legal obligations. The final deadline of 30 September in the current year at latest for the submission of the budget circular letter to the ULGs has not been respected, as well as the obligation regarding the content of the circular letter, considering that each ULG separately has not been notified about the type and amount of grants for the following budget year.

One cannot expect this obligation to be practiced, and the line ministries to determine projects to finance, and to timely (with the Budget Circular Letter) inform the Units of Local Government unless there are clear procedures for application and selection, as well as prescribed deadlines for application.

So, to implement the obligations arising from the Law on Budgets and the Law on financing of the units of local self government, these procedures need to be issued, and the Ministry of finance, if required, to assist the other line ministries in their fulfilling of the obligations.

5. Types of capital grants

5.1. Capital grants from the Fund for National and Regional Roads (ANR)

Every year, funds for construction, reconstruction, maintenance and protection of national and regional roads are planned in the Budget of RM. The Government of RM in accordance with the Law on public roads, every year adopts an Annual program for construction, reconstruction, maintenance and protection of national and regional roads in RM. The expenditures part within the Program contains reserved funds for construction and maintenance of local roads and streets. Then, the Minister of transport and communications in accordance with the law and the program, and on the basis of the Rulebook on criteria for allocation of funds for financing the Annual program for construction, reconstruction, maintenance and protection of local roads and streets of the municipalities and the City of Skopje, shall adopt Decision for allocation of funds to the ULGs. The funds are transferred by the FNRR (ANR) in several installments.

The allocation of funds from the FNRR (ANR) as for specified purposes is carried out in the special part II. For the three analyzed years, identical sums of money have been planned for

capital grants to the ULGss at the amount of 500.000.000,00 MKD, although the planned budget of FNRR (ANR) has been continuously increased from 4.330.000.000,00 MKD in 2006, 4.676.000.000,00 MKD in 2007, up to 6.257.414.000,00 MKD in 2008.

Some characteristics:

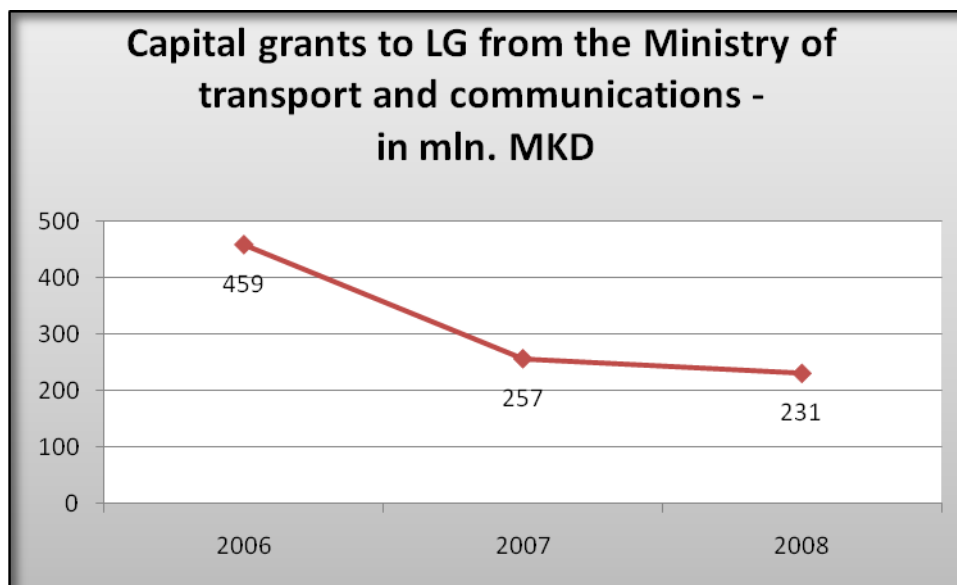
- The program is adopted with great delay, which also results in delayed decision-making on the allocation of funds to the ULGs, which is contrary to the law;
- This does not enable the ULGs to project the transfer of these funds in a timely and accurate manner in their budgets, and this imposes the need to rebalance the budgets in order to correct the amount of funds;
- The planned funds for local roads and streets are insufficient to meet the needs of the ULGs and are identical for 2006, 2007 and 2008, although there was a continuous increase from 2006 to 2008 for the funds in the programs;
- The Rulebook on changes and amendments to the Rulebook on criteria for allocation of funds for financing the Annual program for construction, reconstruction, maintenance and protection of local roads and streets of the municipalities and the City of Skopje, which was adopted by the Minister of transport and communications in 2007, provides changes in the shares of percentages for: total number of registered vehicles, consumption of fuel and number of inhabitants in terms of setting up the amount of funds for the ULGs. The municipalities and ZELS do not know what these amendments mean, and how they reflect the distribution of the fund by municipality in comparison to the previous years. It is not clear which issues have been resolved with the amendments and what are the improvements in the system by these changes.
- The Decision for allocation of funds to ULGs is not published in the Official Gazette of RM, which implies that the public and the ULGs do not know the amount of funds received by each ULG.

5.2. Capital grants for construction of water-supply and sewerage systems

The Budgets of RM for 2006, 2007 and 2008, chapter 130 01 MTC, contain planned funds for the construction of water-supply and sewerage systems, as well as traffic projects.

Capital grants from Min of Transport by years	2006	2007	2008
Total in mln. MKD	396	265	582

Table 1. Overview of capital grants from the Ministry of Transport and communication 2006-2008



Graph no. 1 capital grants from Min of Transport in 2006-2008

The data for 2006-2008 from the Budgets and Final Financial Statements to the Budget of RM presented in the table and graph above show a decrease of funds for 2007 of about 33% and an increase of 47%, in comparison with 2006.

In accordance with the Law on execution of the Budget of RM for 2006 („Official Gazette of RM” No. 120/05), the funds set in the chapter 130.01 MTC, Program 3B - Water-supply systems in the ULGs, item 488 Capital grants for ULGs, are used with previously adopted decision by the Government of RM, on proposal by the MTC, following the previously announced notice and submitted requirements. The same is the situation for 2007 and 2008. Such procedure is not foreseen for the remaining two programs.

The Rulebook on criteria for allocation of funds does not exist. The following is characteristic:

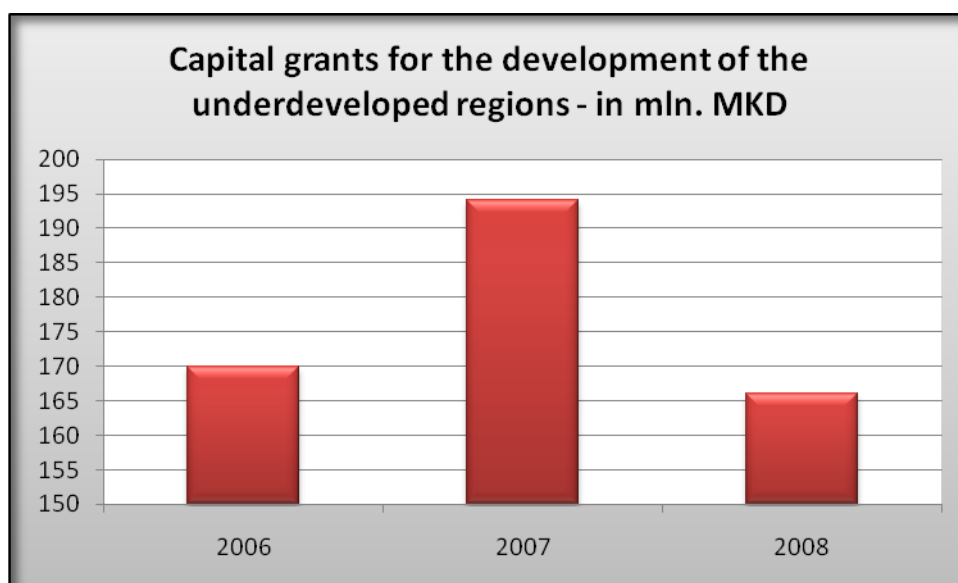
- Provided financial means are insufficient to meet the needs and requirements of the ULGs;
- Part of the funds have been allocated ahead of time for projects of the ULGs with amendments to the Budget of RM, where there is possibility for political impact, and part of the funds are allocated without publishing any notices for the ULGs;
- The non-existence of adopted Rulebook on criteria for allocation of funds creates possibilities for: allocation of funds according to unclear, unfair and non-objective criteria, with great discretionary right to decision-making for the minister and great possibility for political influences;
- Disrespect for the legal obligations for allocation of capital grants to give priority to projects with completely provided financing;

- Attention is not paid to the size of the projects and dynamics of construction, whereby funds are segmented and the real effects can be hardly visible;
- Every year, considerable amounts of funds from the Budget of RM, through the programs of the MTC are invested for construction of water-supply and sewerage systems without any participation of the ULGs, although it is their legal competence.

5.3. Capital grants for development of underdeveloped regions

In the Budget of RM, chapter 28 01 Bureau for economically underdeveloped regions, Subprogram 20 – Development of economically underdeveloped regions, item 488 – Capital grants to ULGs, there have been total of 186.000.000,00 MKD reserved for 2006, and 194.000.000,00 MKD for 2007.

In 2008, in the chapter 28 01 Bureau for regional development, subprogram 20 Implementation of regional development for capital grants to ULG, there have been total of 64.695.462,00 MKD provided.



Graph 2: Capital grants for underdeveloped regions 2006-2008

In accordance with the provisions of the Law on execution of the Budget of RM for 2006 and 2007, the funds are used under a previously adopted program by the Government of RM, on proposal by the Bureau for economically underdeveloped regions, and for 2008 on proposal by the Bureau for regional development.

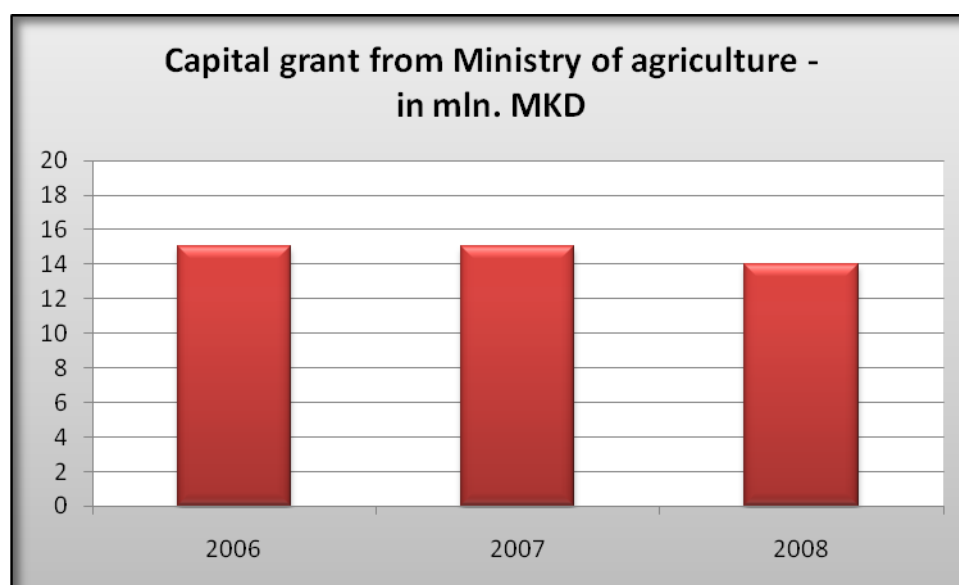
The following characteristics have been identified:

- The provided funds are insufficient to meet the needs of the ULGs in such an important area;

- The non-existence of the Rulebook on the criteria for allocation of funds, creates the possibilities: for allocation of funds according to unclear, unfair and non-objective criteria, great discretionary right to decision-making for the minister and great possibility for political influences;
- Disrespect for the legal obligation during the capital grants allocation for giving priority to projects with completely provided financing;
- Lack of transparency in running the procedures for allocation of funds.

5.4. Capital grant from the Ministry of agriculture, forestry and water economy

In the Budget of RM, chapter 140 01 MAFWE, funds for capital grants to the ULGs have been provided in the Program B Poverty reduction, subprogram BB Revitalization of villages. The funds are aimed for realization of projects for improving the living conditions in the villages. In all three years from 2006 to 2008, the amount of 15.000.000,00 has been planned. In 2007 by a “Decision for reallocation of funds among budget users (Official Gazette of RM no. 152/07) these funds were decreased to 10.000.000,00 MKD. In 2008, 14.091.125,00 MKD were spent.



Graph 3: Capital Grants from the Ministry of Agriculture

The research identified that there were no published public notices for the allocation of these capital grants to the ULGs, and there are no criteria for the allocation of funds.

It is apparent that:

- Provided finances for improving the living conditions in the villages are scarce and insignificant;

- The non-existence of the Rulebook on the criteria for allocation of funds, creates the possibilities: for allocation of funds according to unclear, unfair and non-objective criteria, great discretionary right to decision-making for the minister and great possibility for political influences;
- Disrespect for the legal obligation during the capital grants allocation for giving priority to projects with completely provided financing;
- Lack of transparency in running the procedures for allocation of funds.

5.5. Capital donation from the Ministry of finance

In 2006, in chapter 09 001 Ministry of finance Program B Measures for poverty reduction, Subprogram BB Projects for municipal development, in item 488 Capital grants to ULGs, total of 141.000.000,00 MKD were planned.

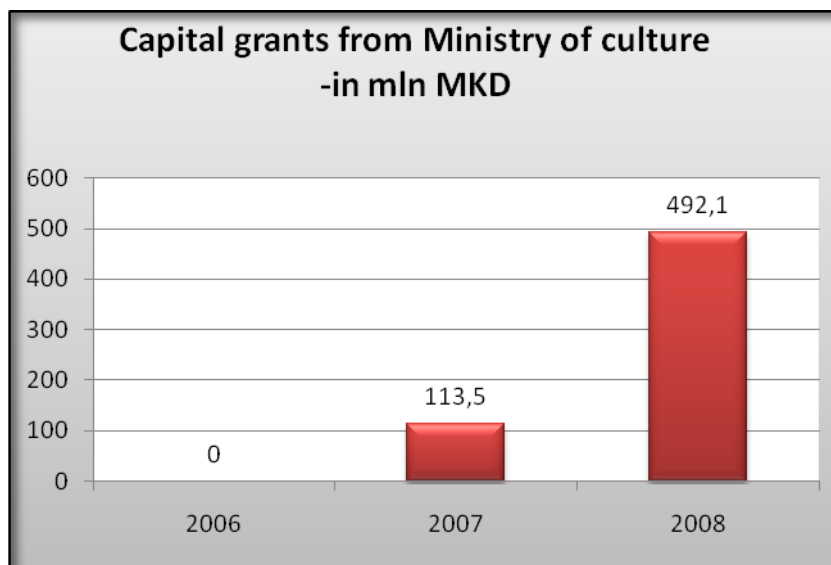
In the Budget for 2007, capital grants from the Ministry of Finance to the ULGs had not been foreseen, but with the decision for reallocation of funds among budget users 40 mln. MKD have been allocated to the Ministry, and for 2008 in the Program 2 Functions of the state, there were 21 mil. MKD allocated.

It is characteristic that:

- Lack of procedure and criteria for selection of ULGs involved in the MEAP project, to which funds are allocated from this capital grant,
- ULGs and ZELS are completely excluded from the procedures.

5.6. Capital grant from the Ministry of culture

The national budgets for 2006 and 2007 do not foresee capital grants from the Ministry of culture. The changes and amendments of the Budget for 2007 allocate 13.500.000,00 MKD , and the Decision for reallocation of funds among budget users this amount was increased to 100 mln. MKD. In 2008, in the chapter 18 010 Ministry of culture – financing of cultural activities, in the Program A2 Transferring the competencies to the ULGs, Subprogram 5B Monumental fountain at the square, in item 488 Capital grants to the ULGs there were 7.100.000,00 MKD planned, but at the end of the year according to the annual statement there have been realized transfers at the amount of 492.100.000,00 MKD.



Graph 4: Capital grants from Ministry of Culture 2006-2008

It is characteristic that:

- It is unclear which strategic goals have been taken into consideration for selection of the projects of priority importance,
- ULGs and ZELS are excluded from the procedures for selection of priorities and the allocation of funds.

5.7. Direct financing by the central authorities for investment projects in areas, which are competencies of the ULGs

In RM, there is practice that besides the above stated capital grants which are transferred to the ULGs, considerable amounts are allocated for investment projects from the budgets of the Agency for youth and sport, FNRR(ANR) and the following ministries: Ministry of transport and communications, Ministry of environment and spatial planning, Ministry of culture, Ministry of education and science and the Ministry of labor and social policy.

The financing of projects, which are competence of the central government, is indisputable. However, in the past several years, as well as currently, the above-stated state institutions finance projects in areas, which are competencies of the local authorities under the decentralization, such as construction or reconstruction of: primary and secondary schools, kindergartens, cultural homes, sporting halls, sport fields, big monuments, monumental fountains etc.

In addition, great number of the public procurements made by the central government institutions are for procurement of technical and other equipment and vehicles, which are

under the competencies of the ULGs such as: procurement of computers, school desks and chairs and buses for primary and secondary schools.

Such central procurement would only be acceptable for price and uniform standard purposes. But this also means that such public procurement should include the municipalities.

The following characteristics have been identified:

- Disrespect for the legal obligations to decentralize the capital grants;
- ULGs and ZELS are completely excluded from the procedures for setting priorities in the areas under the competence of ULGs and for the selection of projects to be financed;
- The non-existence of the Rulebook on the criteria for allocation of funds, creates the possibilities for: allocation of funds according to unclear, unfair and non-objective criteria, great discretionary right to decision-making for the minister and great possibility for political influences;
- Disrespect for the legal obligation during the capital grants allocation for giving priority to projects with completely provided financing;
- Lack of transparency in running the procedures for allocation of funds.

5.8. Capital grants from foreign donors

Eventhough beyond he scope of this analyses, due to their importance and size for the Local Government Units, I will discuss the Capital Investment Grants from foreign governments and non-governmental institutions as well as international donor organizations.

In the past years, large capital investments were made in the municipalities. These investments significantly raised the quality of life in many towns and villages throughout Macedonia. They also contributed to the strengthening of the capacities of the municipalities, especially in the acquiring of new skills for management of investment projects. The following donors provided such assistance: USAID, EU, UNDP, KfW Bank, The Government of Holland, the Swedish agency for international development, the Government of Norway etc.

One needs to also mention that in the past period a good system for monitoring, coordinating and the directing of foreign assistance was lacking. This needs to be overcome so that the period ahead yields better effects of this assistance.

6. Analysis of the capital grants status

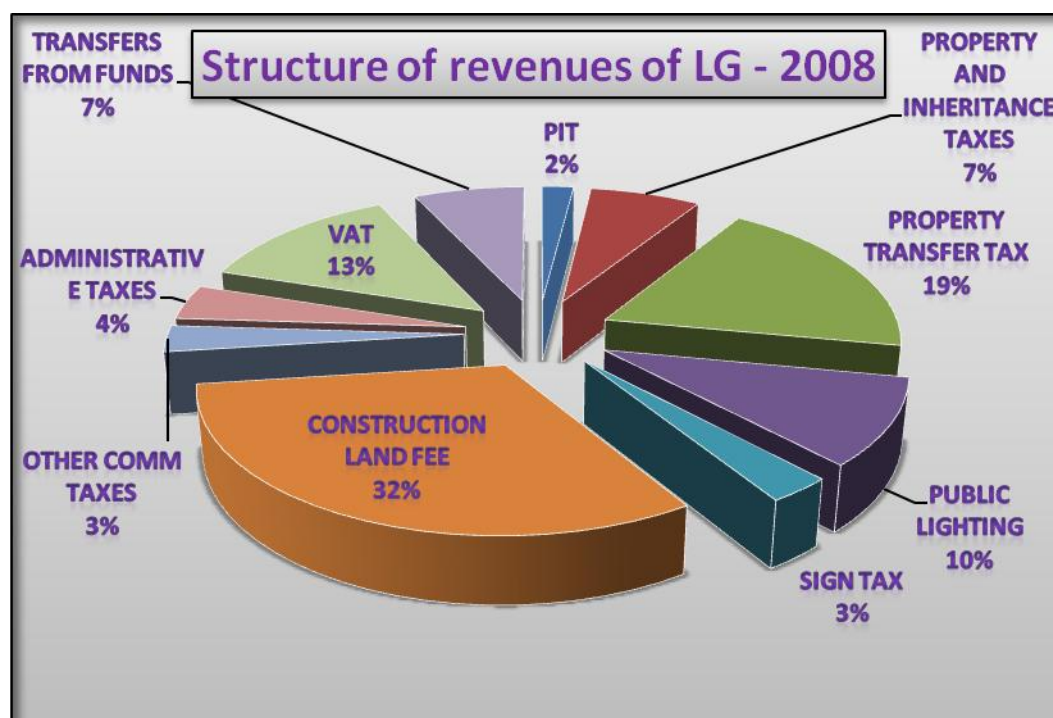
1. One-level local self-government with monotypic municipalities implies that capital grants are of great importance. Namely, ULGs have equal competencies regardless of their size in terms of the number of citizens and the size of the territory. The municipality of Vraneshtica is the smallest municipality according to the number of citizens with only 1.322 citizens and has the same competencies as the municipality of Kumanovo, which is the biggest municipality according to the number of citizens- 105.484 citizens.

2. Republic of Macedonia is a country with exceptionally unequal development. There are great differences in the level of development among the ULGs. Especially the differences in development are considerable between the City of Skopje and the ULGs in its composition on one hand, and the other ULGs on the other hand. Differences in the level of development are also quite significant in terms of the extent of infrastructure development within the ULGs which are towns, among the towns on one hand and the rural areas on the other hand.

3. The level of economic development has direct impact on the power of the ULGs to generate sufficient own revenues to finance the competencies and capital investments. Bigger and more developed ULGs plan considerably bigger amounts of funds in their budgets from their own sources of revenues for capital investments, in comparison with small and underdeveloped ULGs, which do not have sufficient financial means from own sources of revenues to finance the legal competencies, and they can hardly finance any capital investments.

Small and underdeveloped ULGs face problems in providing sufficient funds for their normal operations. They also face problems regarding the financing of general and urban plans, strategies, studies, local action plans and major construction projects.

In the analysis provided within the USAID/MLGA publication „Current status of municipal finances in Macedonia: Possible future reforms” prepared by Tony Levitas, the differences are identified as a serious problem, and the solution would require identification of appropriate system solutions. On the contrary, there is a threat that the differences would be even more emphasized.



Graph 5: Structure of revenues of municipalities in 2008

4. The amount of provided finances for capital grants are very insignificant, and do not meet the needs of the ULGs at all. Contemporary life style, necessity for continuous improvement of the quality of life for the citizens in the local communities, also imposes the need for major investments in investment projects. Especially this refers to construction of: water-supply and sewerage systems, treatment stations, roads, streets, factories and landfills for communal waste treatment, schools, kindergartens, homes for students, homes for old people, cultural homes, libraries, museums, sporting halls and fields, bridges, quays, atmospheric sewerage, squares and other types of buildings.

	2006	2007	2008
GDP of RM	310.932.000.000	353.786.000.000	398.640.000.000
Total revenues in Budget of RM	104.044.000.000	119.609.000.000	136.415.000.000
Capital grants to municipalities	941.029.852	1.037.713.791	1.863.242.102
Capital grant to municipalities as % of GDP	0,30%	0,29%	0,47%
Capital grant to municipalities as a % of total revenues in budget of RM	0,90%	0,87%	1,37%

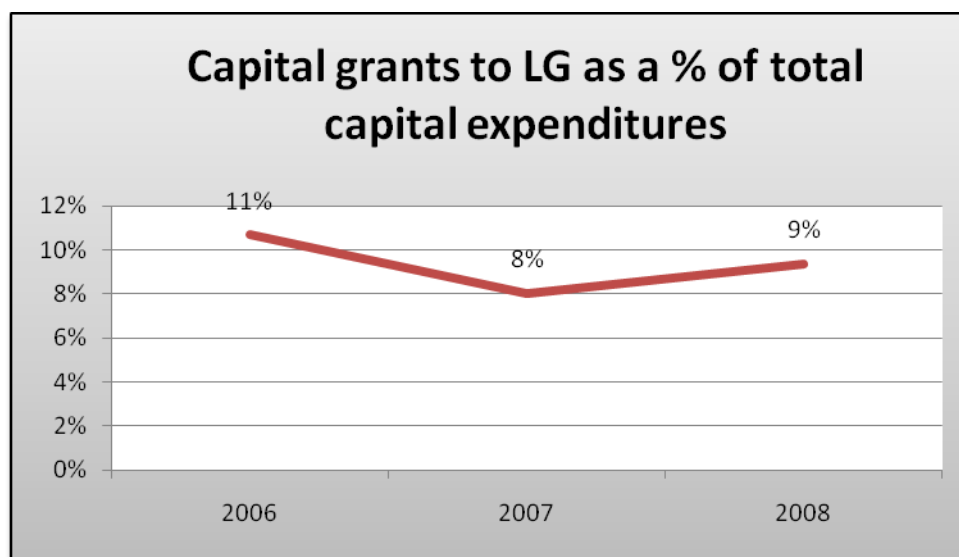
Table No.2: Graphic representation of GDP, total revenues, capital expenditures and capital grants.

The current system of local public finances does not create opportunities for provision of sufficient finances for the ULGs, neither regarding the scope nor the structure. ULGs' own sources of revenues are scarce. The transfers from value added tax (VAT) and from personal income tax (PIT) are also insufficient. Therefore, ULGs have great hopes about the capital grants and the grants from the international institutions that support the local self-government reform in RM, but unfortunately their support has been declining in the past years. The tables below contain data, which illustrate

the situation and the relations among the Budget of RM, central budget and capital grants for the years being part of the analysis.

Budget of RM	2006	2007	2008
Total Revenues	104.044.000.000	119.608.000.000	136.415.000.000
Total Expenditures	105.744.000.000	117.455.000.000	140.219.000.000
Capital expenditures in the Budget of RM	8.816.273.582	12.909.274.772	19.902.183.458
Capital grants to municipalities	941.029.852	1.037.713.791	1.863.242.102
Capital grants to municipalities as % of total capital expenditures in budget of RM	10,7%	8,0%	9,4%

Table 3: Relations between the capital grants and capital expenditures in the Budget of RM for 2006-2008

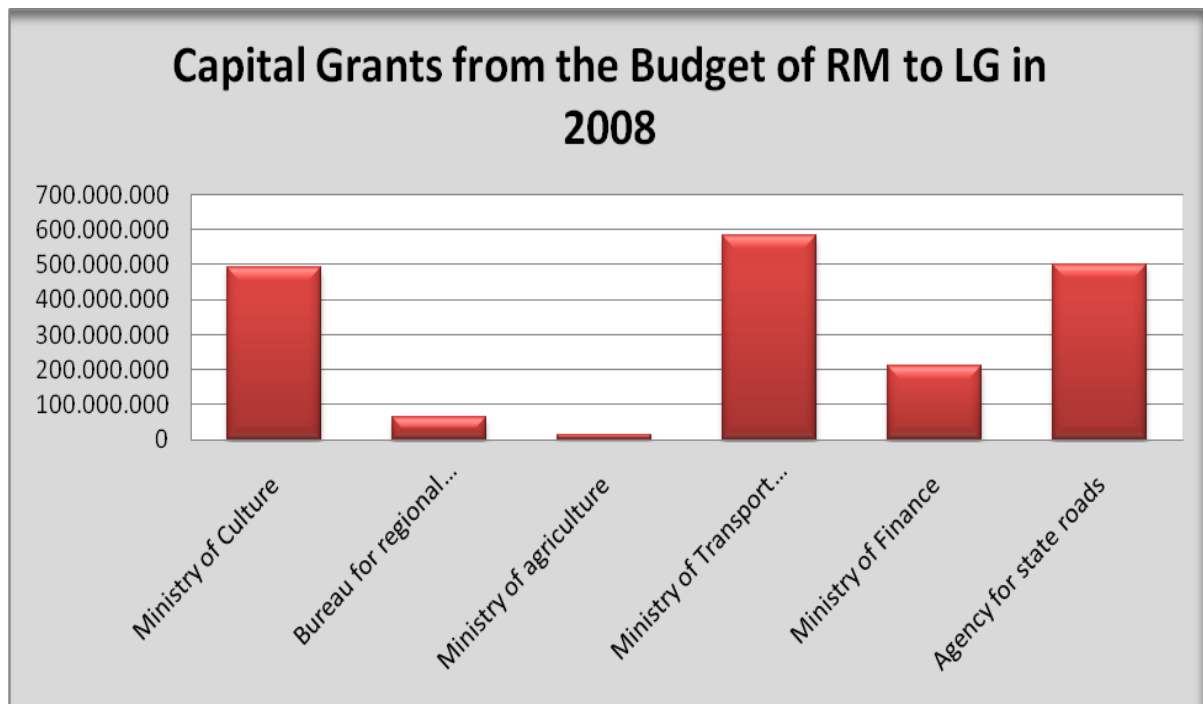


Graph 6: Capital grants to municipalities as percentage of total capital expenditures of the Budget of RM in 2006-2008

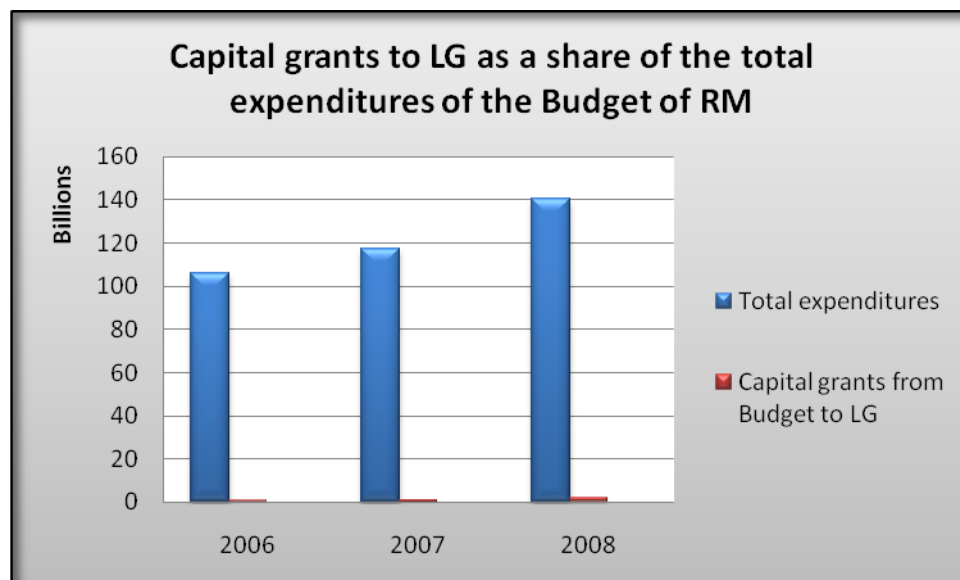
Capital grants to municipalities	2006	2007	2008
Ministry of Culture	0	Info not available	492.100.000
Bureau for regional development	Info not available ³	Info not available	64.695.462
Ministry of agriculture	Info not available	Info not available	14.091.125
Ministry of Transport and Communication	Info not available	Info not available	582.355.514
Ministry of Finance	Info not available	Info not available	210.000.000
Central Budget	440.029.852	538.713.791	1.363.242.102
Agency for state roads	501.000.000	499.000.000	500.000.000
Total capital grants from Budget of RM to municipalities	941.029.852	1.037.713.791	1.863.242.102

Table 3a: Capital Grants as per Annual Financial Statements to the Budget of RM for 2006-2008

³ The Annual financial statements to the Budgets of RM for 2006-2008 do not contain this data



Graph 6: Capital Grants from the Budget of RM in 2008



Graph 7: Total capital grants to the municipalities in comparison to the total expenditures of the Budget of RM

5. Besides the shortage of finances, another problem that must not be neglected is the lack of adequate human and technical resources for selection of the right priorities, for preparation of quality projects and running the overall process from the idea to its realization. There is insufficient staffing in the organizational units for communal affairs, finance departments and internal audit for financial operations.

Besides the organized trainings for acquiring knowledge and skills on: setting priorities, capital investments planning, project preparation, financial planning and budgeting and reporting, still the level of knowledge is not satisfactory. This shall have negative impact in the forthcoming period, when the finances for capital investments will become available from the EU pre-accession funds.

6. The transfers from the Budget of RM and the budgets of the Funds for the ULGs as capital grants are carried out in a manner that does not provide for equality, equal access, objectiveness and fairness. This is of great concern as the allocated funds are revenues from the taxpayers, which are collected on different grounds in the central budget. As such, they should be allocated according to the real needs of the ULGs, under previously established priorities, with a transparent procedure and according to clear and fair criteria. The data in Table below illustrate the differences in the transfers of finances from the Budget of RM per capita among the ULGs.

	Municipalities with highest per capita capital transfers	Per capita amounts	Municipalities with lowest per capita capital transfers	Per capita amounts
1.	Centar	13.149	City of Skopje	251
2.	Gradsko	6.766	Suto Orizari	344
3.	Vranestica	4.698	Cair	479
4.	Jegunovce	4.543	Ohrid	497
5.	Rankovce	3.987	Kicevo	507
6.	Konce	3.955	Saraj	526
7.	Novaci	3.847	Vrapciste	566
8.	Karbinci	3.693	Aerodrom	575
9.	Zelenikovo	3.584	Kriva Palanka	576
10.	Vevcani	3.454	Vinica	590

Table No.4: Graphic representation of the ten ULGs with the highest and lowest per capita transfers from other levels of government in the period 2006 – 2008

The data from the following table confirm the thesis for unequal and non-objective allocation of funds, which instead of reducing the differences, many times it increases the differences in the level of development.

	Municipality	Capital grants for 2006	Municipality	Capital grants for 2007	Municipality	Capital grants for 2008
1.	Lipkovo	19.390.096	Centar Центар	110.666.094	Centar	442.100.000
2.	Kocani	11.479.613	City of Skopje	43.989.000	Bitola	170.000.000
3.	Karbinci	6.424.637	Debar	30.690.000	Prilep	50.000.000
4.	Novo Selo	8.245.992	Prilep	17.009.576	Gostivar	35.706.938
5.	Brvenica	4.434.108	Gjorce Petrov	12.466.803	Gazi Baba	31.637.232
6.	Berovo	4.268.904	Sveti Nikole	8.680.479	Jegunovce	27.006.563
7.	Demir Hisar	4.028.808	Brvenica	8.184.000	Debar	20.000.000
8.	Jegunovce	4.166.581	Jegunovce	7.568.024	Gjorce Petrov	19.177.868
9.	Stip	3.695.090	Demir Hisar	6.353.372	Pehcevo	9.544.000
10.	Dojran	2.106.957	Bitola	6.270.990	Lipkovo	9.386.475

Table No.5: Graphic representation of the ten ULGs with the total of biggest revenues from capital grants from 2006 to 2008.

7. In RM there is no one single capital grant. The system of capital grants is fragmented. The following state institutions transfer capital grants:

- Ministry of finance
- Ministry of transport and communications
- Ministry of local self-government
- Ministry of agriculture, forestry and water-economy
- Ministry of culture
- Fund for national and regional roads (now Agency for national roads).
- Bureau for regional development (previously Bureau for economic underdeveloped regions)

There is no coordination in the allocation of capital grants among the Government, the ministries and other state authorities. Some ULGs receive capital grants from several sources, compared with other ULGs that do not receive capital grants at all, with the exception of capital grants from the FNRR (ANR), which are received by all ULGs.

8. In the period from 2006 to 2008 , besides the capital grants, there have been directly transferred funds to the ULGs for construction of capital buildings. The table below shows the five most characteristic and biggest transfers to the ULGs.

Municipality	Capital Transfers	year
1. Tetovo	61.746.382	2008
2. Tetovo	25.851.716	2007
3. Sveti Nikole	12.702.242	2008
4. Gradsko	6.940.709	2007
5. Gradsko	5.582.198	2008

Table No.6: Graphic representation of the five ULGs with highest individual transfers of funds from the Budget of RM in the period from 2006 to 2008.

The following ULGs have not received transfers from the central government in the period from 2006 to 2008, with the exception of capital grants from the FNRR: Arachinovo, Debarca, Drugovo, Zajas, Mavrovo and Rostusha, Rosoman, Centar Zupa, Chashka and Suto Orizari.

Capital grants are still not completely decentralized, which is contrary to the law. It is unusual that funds are allocated from the Budget of RM for capital investments in the ULGs, for works which are under the competence of the local self-government (construction of new and reconstruction of the existing: water-supply and sewerage systems, primary and secondary schools, kindergartens, homes for old people, cultural homes, museums, libraries, sporting halls and other buildings as well as procurement of technical and other equipment), whereby the procedures are completely managed by the ministries or other central government bodies. The reasons for such unusual, distorted situation may be located in:

- Distrust by the central authorities in the capacities of the local self-government;
- Lack of adequate resources in some ULGs for managing major investment projects;
- Un-preparedness by the central authorities to give up the right (to which they are no longer entitled) to decide about priorities and funds spending, and the possibility to take advantage of projects for political purposes.

The following state bodies spend funds for capital investments in the ULGs, for matters, which are not under their competence in accordance with the law:

- Ministry of education and science
- Ministry of labor and social policy
- Ministry of culture
- Ministry of transport and communications
- Ministry of environment and spatial planning
- Agency for youth and sport

Parts of the funds are allocated with the Budget of RM, and the other part under the programs of the Government of RM per areas. ULGs are not involved in the selection of priorities or defining the procedures and criteria for allocation. This situation should be changed as soon as possible. ULGs are most familiar with their problems and needs and they should be involved.

9. The obligation that the line ministries and the Funds must announce and set the criteria, procedures and deadlines for allocation of capital grants, is determined by law. In practice the situation is different.

a. The line ministries do not announce the criteria, but also do not even establish the criteria (with the exception of FNRR(ANR)).

b. The procedures and deadlines for allocation of capital grants are not published (with the exception of the ANR and MTC).

c. There is no transparency because the public and ULGs are not notified about the allocation of capital grants (with the exception of the decision for allocation of capital grants for construction of water-supply and sewerage systems, which is published in the Official Gazette of RM).

The content of the data in the following table illustrates the situation and confirms the above stated assessment.

Type of capital grant	Procedure	Criteria	Are municipalities informed (transparency)	Are municipalities involved in discussion for the level of the capital grants and monitoring
1. Ministry of Finance	-	-	-	-
2. Ministry of Transport	✓	-	✓	-
3. Ministry of Agriculture	-	-	-	-
4. Bureau for regional development	-	-	-	-
5. Agency for state roads	✓	✓	-	-
6. Ministry of Culture	-	-	-	-

Table No.7. Graphic representation of the procedures, criteria and transparency and involvement of ULGs in the procedures for allocation of capital grants.

The State Audit office in its Final Report no. 0903-38/7 for the audit of the financial statement of the Ministry of Transport for 2007 found that “The Ministry does not have an internal act – guidelines for the activities in the allocation and transfer of funds to the municipalities that would determine criteria and a methodology for distribution of the funds

for construction of water supply systems and treatment of waste waters approved by the Budget of RM, which for 2007 amount to 94,000 MKD, due to which there is a risk of a non objective distribution for this intention.”

In March of 2007, the Ministry of Transport designed a proposal Methodology which has been distributed to all competent institutions for an opinion.

Further in its recommendations, the State Audit Office says: “The Ministry of Transport, in cooperation with responsible persons in the Sector for housing-communal works and infrastructure, should prepare and submit a proposal – act on the basis of which the Government will issue a legal act which would prescribe criteria and procedures for the distribution of funds intended for water supply and sewerage systems, approved by the Budget of RM, and in accordance with the amendments to the Law for potable water supply and waste water treatment of August, 2008”.

10. The analysis on the structure of capital grants shows the dominant position of the capital grants from the FNRR (ANR). For the three years being analyzed, there have been funds allocated on continuous basis from the MTC, MAFWE and FNRR (ANR). Capital grants from the MF have been transferred in 2006 and 2008, and from the MC in 2007 and 2008. It is characteristic that the funds from the Min of Culture, which have been planned in the Budget of RM, are being continuously increased with the budget amendments at the end of the fiscal year, and they have not been completely used so far according to planned purposes.

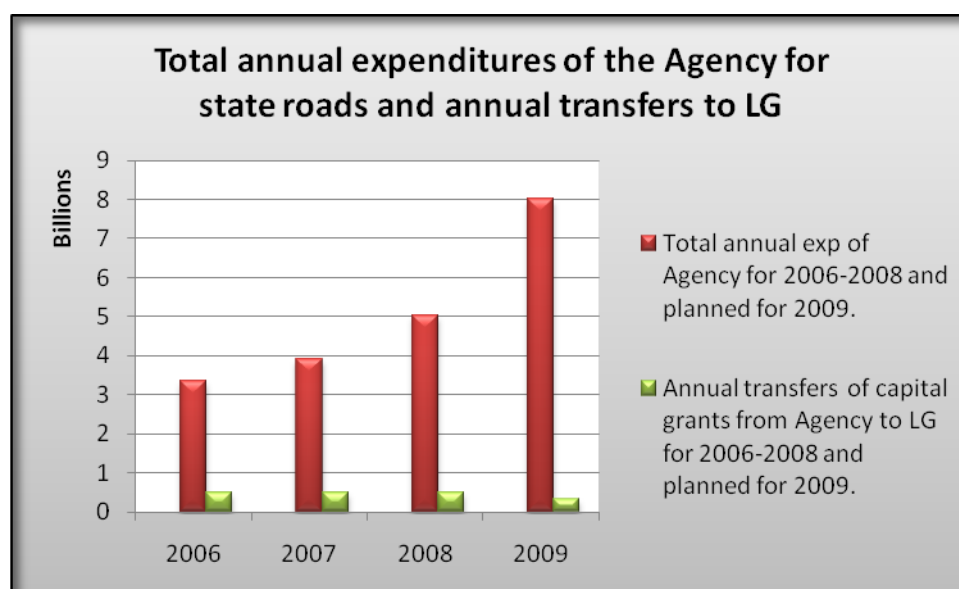
	2006	2007	2008
Min of Finance	141.000.000	40.000	210.000.000
Min of Transport	396.106.000	182.400.000	306.000.000
Min of Agriculture	15.000.000	10.000.000	14.091.125
Agency for State Roads	501.000.000	499.000.000	500.000.000
Bureau for regional development	186.000.000	194.500.000	64.695.462
Min of Culture	0	113.500.000	492.100.000

Table No.8: Graphic representation on the structure of capital grants according to the origin

11. The information from Table No.9, i.e. graph No.2, confirm that the capital grant from the FNRR (ANR) to the ULG, is being drastically reduced every year. It is especially concerning the fact that drastic reduction of the capital grant is planned for 2009, although considerably higher revenues have been planned for the FNRR (ANR) for the same year. Possibly, the reason may be the loan from the World Bank that RM took for reconstruction of the local road network. Anyhow, it will have negative impact on the activities of the ULGs for construction, reconstruction and maintenance of local roads and streets because the use of funds is considerably delayed.

	Year	Total annual exp of the Agency for state roads for 2006-2008 and planned exp for 2009	Annual transfers of capital grants from Agency for state roads to municipalities for 2006-2008 and planned for 2009	Capital grants to municipalities from Agency for state roads as % of total exp for 2006-2008 and planned exp for 2009
1.	2006	3.343.764.379	501.000.000	14,98 %
2.	2007	3.915.926.303	499.000.000	12,74 %
3.	2008	5.021.388.921	500.000.000	9,96 %
4.	2009	8.004.047.000	330.000.000	4,12 %

Table No.9: Graphic representation of the share of the capital grant from FNRR (ANR) to ULG in the overall expenditures of the FNRR (ANR).



Graph No.2: Graphic representation of the share of the capital grant from FNRR (ANR) to ULG in the overall expenditures of the FNRR (ANR).

7. Final considerations

The previous parts of this document contain an analysis of the legal framework, as well as identification of all capital grants, which are being transferred from the central government institutions to the ULGs on different grounds. The direct investments by the ministries and the other bodies in areas, which have become competencies of the local authorities under the decentralization, have also been identified.

The following conclusions arise out of the analyses:

1. Local self-government, one of the grounds of contemporary democratic system, is established as one of the fundamental values of the constitutional order in RM. The European Charter of Local Self-Government had been ratified and the key

laws had been adopted; yet there are serious inconsistencies regarding the implementation of the laws and discrepancies between what is declared and what is really happening in practice regarding the financing of ULGs and the capital grants.

2. The system of one-level organization of the local self-government in RM with monotypic municipalities which have identical competencies, regardless of their size and capability to generate sufficient amounts of own revenues, creates a situation whereby small and poor ULGs are dependent on the central government grants, especially on capital grants.
3. Extremely unequal development of ULGs, especially between the City of Skopje and ULGs in its composition and the other ULGs, as well as the differences in the infrastructure development among the towns in the ULGs and the rural municipalities in their composition. Therefore capital grants are very important in order to overcome the differences in the development.
4. The local self- government reforms and the fiscal decentralization have not accomplished the goal to provide for balance in the allocation of the overall national revenues, proportionally to the devolved constitutional and legal obligations of the central and local government, because considerable and quality sources of financing have not been provided in order to be proportionate to the undertaken obligations.
5. The fiscal decentralization did not create stable, transparent, sustainable, objective and fair system for financing the ULGs. Sufficient finances have not been provided neither regarding the scope nor the structure of the new competencies of ULGs, adequate for financing the new competencies of the ULGs. As far as possible, grants have not been provided to the local authorities, which shall not be earmarked for the financing of specific projects and the provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction.
6. Due to inherited debts and insignificant own revenues, ULGs still do not have real access to the domestic and international capital market for long-termed borrowing to finance capital assets and investments.
7. Capital grants for financing capital investment projects of ULGs are not well regulated, they are fragmented to several capital grants, and there is no reconciliation and coordination for planning, programming and implementation of policies.

8. Funds provided for capital grants are insufficient, and cannot meet the increasing needs of the ULGs.
9. The share of capital grants for the ULGs in the GDP and the overall public expenditure has been reduced because during the period from 2006 to 2008 there is a tendency to increase the overall revenues of the Budget of RM on the one hand and to reduce the capital grants to the ULGs on the other hand.

The municipalities and ZELS have not been involved in negotiations with the Government in determining of the priorities for financing with capital grants, in determining the amounts from the Budget of RM, and the manner of the distribution of these funds.

10. The Government of RM, although obligated by law, has not cooperated sufficiently with the ULGs on issues related to the areas of financing the competencies, and has not prepared reports on works for which consent has been or has not been reached, and have not submitted the reports to the Parliament of RM.
11. The line ministries and the Funds have not respected the legal obligation to announce and establish the criteria, procedures and deadlines for allocation of capital grants by 30 April in the current year at latest.
12. The minister of finance did not respect the legal obligation by 30 September in the current year at latest, with a budget circular letter to notify each ULG separately on the type and amount of capital grants for the following budget year.
13. The programs and decisions for the category and allocation of funds have been adopted with great delays, contrary to the legal deadlines, which created problems for the ULGs as they have been prevented from timely budget planning of the funds which will be allocated, and have been enforced to make budget rebalancing in the course of the year in order to plan the exact amounts of grants.
14. The Ministry of finance, which is the competent body to deal with the financing of ULGs, has not developed adequate human and technical capacities to monitor and analyze the situation and to propose concrete solutions for improvement of the capital grants system.
15. The Committee of the Government of RM for monitoring the development of the financing system for ULGs does not perform the legal obligations completely because: the Committee did not monitor the application of criteria for grants allocation, did not propose measures for grants system improvement, did not

give recommendations to overcome the identified shortages in the allocation of grants, did not monitor the transparency of procedures and their consistent realization for grants allocation, did not monitor the earmarked use of grants, and the Government of RM although obligated by law, did not notify the public about the reports and recommendations for improving the system.

16. ULGs and ZELS do not dispose of adequate human, financial and technical capacities for: monitoring and analysis of the situation in RM and the other countries, making initiatives to improve the system, adequate mechanisms to pressurize and lobby, setting priorities, capital investments planning, project preparation, financial planning, budgeting and reporting.

8. Recommendations for improvement of the situation

Universal and ideal solutions do not exist. Each country creates its own model based on the respective needs and strategic goals. The globalization and decentralization wave in the 90-ies has spread over many countries in the world, hence, this topic is still significant both in big and small, rich and poor, developed and developing countries.

Capital grants as especially important segment of the overall intergovernmental transfers for countries like RM, whereby ULGs are dependent on the grants from the central government as their own revenues are insufficient to cover all expenses.

In fact, intergovernmental transfers are not only used for the vertical equalization in order to reduce the imbalance from the allocation of revenues between the central and the local authorities, but are also used for horizontal equalization in order to iron out the differences among ULGs, which result from different fiscal capacities of the ULGs.

RM does not have long and rich experience with the allocation of capital grants. The overall economic situation in the country, the quality of local self-government reforms, the scope of fiscal decentralization, and the continuous lack of finances contribute to the fact that capital grants are very important source of finances. This situation will be like this until some adequate solutions are identified for provision of sufficient funds from ULGs own sources of revenues, as well as possibilities for easier access to quality loans from the capital market.

The fragmented approach, the un-preparedness by the central government for complete decentralization, and the inadequate resources of the ULGs, have great impact so that capital grants do not accomplish the goals, which may be accomplished under different conditions.

On the basis of the analysis of the current situation and information about other countries' experiences, hereby I give the following recommendations to improve the situation regarding capital grants.

General Recommendations:

1. Preparation of a comprehensive analysis about the effects from the application of the local public finances system, preparation of comparative analysis about best practices in the countries which are ahead of RM regarding the reforms, and changes and amendments to the laws and sub-legal acts that regulate the financing of ULGs.
2. Fair allocation of revenues between the central government and local authorities, which will be adequate to the undertaken obligations and responsibilities in line with the law.
3. Increasing the revenues of ULGs both in terms of the scope and the structure, and establishment of an optimal system for fiscal equalization in order to overcome the differences in development, which result from historical circumstances and unequal fiscal capacities.
4. Initiating procedures for amendments of existing legislation and adoption of new laws to simplify and stimulate the access of the municipalities to the domestic and foreign capital markets and for emission of municipal bonds.

Specific Recommendations:

1. Provision of significantly higher financial means for capital investments in the municipalities by increasing the revenues for capital grants to the Local Governments.
2. The current way of distribution of capital grants needs to be reformed to achieve greater efficiency and efficacy in the accomplishment of the goals of the capital grants. The changes should be made to improve the detected shortfalls, and to possibly gradually integrate the capital grants in one system with the possibility of subsystems.
3. Clear delineation of the authorities for the capital grants between the central and local governments.
4. Establishing of a practice for the Units of Local Government through ZELS to participate in negotiations with the Government and line ministries every year in the determining of the amounts of the capital grants from the Central Government, for the financing of strategic priorities of the Local Governments. ZELS should also be involved in the designing of criteria for the allocation of the funds, in the determining of the application, monitoring and reporting procedures.
5. The capital grant for the construction of water supply and sewerage systems which is now under the competence of the Ministry of Transport should be transferred to the

Ministry responsible for the water and protection of the living environment. Significantly higher finances need to be available for the construction of the collector system and purifying stations for the treatment of fecal waters, as well as for the construction of facilities for the treatment of communal waste. The construction of such communal facilities is of critical importance for the improvement of the quality of life and protection of the living environment, but their construction requires enormous funding which municipalities cannot make available from their own revenue sources.

6. Adoption of clear, objective and fair criteria for allocation of funds for capital grants and their implementation.
7. Complete transparency in running the procedures for provision of equal access for all ULGs and notifying the ULGs, the central government and the public about allocated capital grants.
8. Establishing of so-called, “matching funds” for realization of projects with specific goals (eg in the area of protection of the living environment, energy efficiency projects) in partnership with the central government and ULGs. These funds would be of high importance for the Municipalities, for their co-financing projects from the EU Pre-accession funds.
9. The Committee for monitoring of the system of financing of the municipalities has a significant role in the System prescribed by Law. The Ministry of Finance should create conditions for fully implementing the legal obligations of this Committee.
10. The Committee for monitoring of the system of financing of the municipalities in cooperation with ZELS , the Secretariat for European Affairs of the Government of Macedonia, and the line ministries should establish a working group with the task:
 - a. To assist the line ministries determine procedures and criteria for the distribution of capital grants , and regulations for monitoring of the utilization of the grants
 - b. In cooperation with donors, to select and share best practice skills, techniques and practices for management of capital grants
 - c. To design recommendations for simplifying and consolidating funds for capital grants from the central government bodies
 - d. To design recommendations for improving the coordination of international assistance, especially for capital grants to municipalities in cooperation with donors
11. ZELS and municipalities should improve their capacities for: monitoring and analyzing the conditions in RM and abroad, for the preparation of initiatives for the improvement of

the system and appropriate mechanisms for lobbying, priority selection, planning of capital investments, project design, financial planning, budgeting and reporting.