

# **SDPeMTBP approach of dldp as a contribution to the PFM reform at the local level in Albania**

## **Review and Outlook**

April 2013

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### List of Acronyms:

dldp	Decentralisation and local development programme
FPT	Financial planning tool
GSBI	Group on Strategy, Budget and Integration
LGU	Local Government Unit
PFM	Public finance management
RDF	Regional development fund
SDC	Swiss Agency for Development and Cooperation
SDP	Strategic development plan
SDPeMTBP	Comprehensive approach of strategic development planning and medium-term budgeting using the electronic financial planning tool
MTBP	Medium-term budget program
Pefa	Public expenditure and financial accountability
PI	Performance indicator, used by Pefa
PPP	Purchasing Power Parity

## **1. The PFM support mission of dldp in its second phase**

The Decentralization and Local Development Program dldp, financed by SDC and implemented by Helvetas Swiss Intercooperation is based on a bilateral agreement between the government of Albania and of Switzerland. In its first phase from 07/2006 to 02/2010, the project was operational in the Qark (region) of Shkodra in Northern Albania, belonging to the poorest regions of the country. The second phase of dldp was planned for 3/2010 to 2/2013 and extended beyond Shkodra Quark to the Qark of Leza covering an area of 54 Local Government Units LGUs in both Quarks with a population of roughly 550,000 people.

In its first phase, dldp supported strategic development planning, capacity building in public service provision, local investments and financial management, civil society participation and inter-municipal exchange (SDC 2010).

### **1.1. PFM support mission of dldp2**

The project goal and the outcome areas of dldp, phase 2, are defined in the dldp project document (p.15) as follows:

Capacities of municipalities and communes in Shkodra and Lezha are strengthened contributing to improved regional development in Northern Albania and decentralization reform at national level.

The main outcome areas of dldp are:

- (1) at local/regional level: supporting the LGUs in the project region to improve their governance structures, capacities and selected local public services;
- (2) at national level: sharing good practices via strengthened associations with the objective of impacting law and policy making and their implementation at national level

Following, this report focuses on strategic development planning and medium-term budgeting where the author of this report had a backstopping mandate. These two processes are summarised in this report under the acronym PFM (public finance management). Certainly, the scope of PFM is much broader than strategic planning and medium-term budgeting; in addition to strategy elaboration and budget preparation, it also includes budget execution and control: “PFM is the system by which financial resources are planned, directed and controlled to enable and influence the efficient and effective delivery of public service goals” (CIPFA, 2010, p. 3f).

For each outcome area, the dldp programme document defines specific output goals (p. 16f.). In the PFM support area, the programme document spells out two output goals:

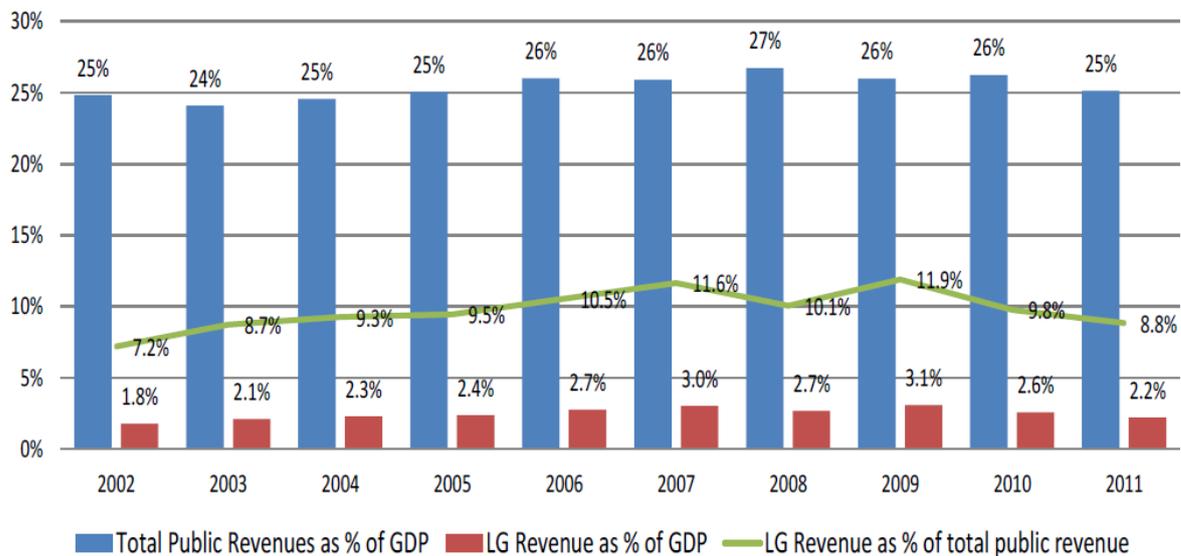
- (1.1) Capacities of LGUs on strategic planning and budgeting are improved and selected LGUs apply strategic planning instruments and methods, linked to annual and midterm budget.
- (1.2) Capacities of LGUs on financial and fiscal management, including the midterm budgeting process are strengthened.

## 1.2. Background of the dldp support mission

The background of the dldp’s support mission especially in the area of PFM can be summarized as follows:

- Albania is a potential candidate for EU membership; the country signed a Stabilisation and Association Agreement with the EU in 2006. In December 2012, the European Council decided that Albania will become candidate as soon as improvements are made in domains such as judicial, public administration and parliamentary procedures (European Parliament / News, online). The ambition of becoming a member of the EU is still strong in Albania and proves to be a powerful motivation to adopt good governance standards in the area of PFM and beyond.
- Albania made substantial progress towards decentralization. The Albanian constitution of 1998 stipulates the principle of decentralization and of local autonomy (Art. 13). The law on organization and functioning of local governments, enacted 2000, defines the mission and fundamental principles of LGUs (Art. 3 + 4), the specific rights of LGUs, such as right of governance, property rights, right of fiscal autonomy, etc. (Art. 8), and it specifies the different types of LGU functions: exclusive functions, shared and delegated functions of local governments (Art. 10-12). However, the process of decentralization is still unfinished; the implementation of a national decentralization strategy has not been adopted and LGUs are highly dependent on national grants. The law on local finances, drafted in 2008, is still not adopted. In addition, the territorial structure of Albania is highly fragmented by a vast number of small and poor LGUs; the regional level, the Qark is weak (USAID, 2012, p. 11f.). Finally, the share of local revenues is still relatively small in Albania, both in terms of GDP and total public revenues (see figure 1). From 2002 to 2007, the share of local finances tended to increase, it stagnated between 2007 and 2009 and fall back between 2009 and 2001.

Figure 1: Local government revenues as % of GDP and public revenues

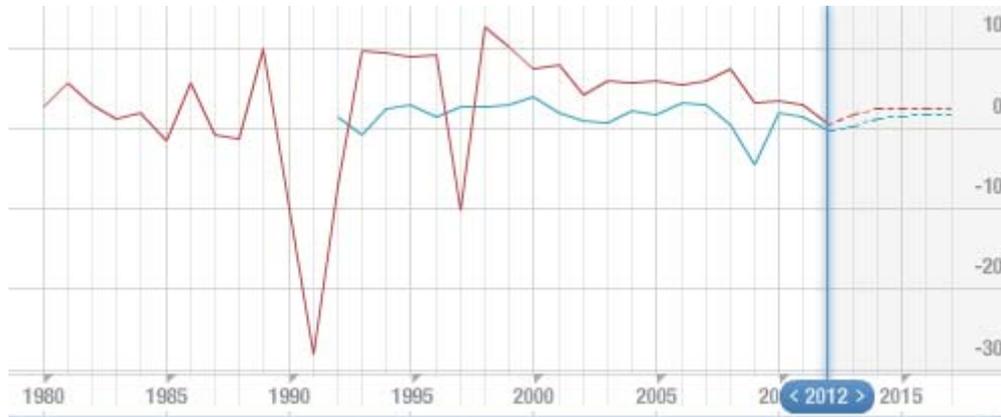


Source: USAID, 2012, p. 59

- The Albanian economy made substantial progress in the past years with relatively high growth rates. In 1998, Albania’s economic growth picked up with growth rates substantially higher

than in the Euro area. However, in the aftermath of the financial crisis in Europe, GDP growth slowed down dramatically also in Albania (see: figure 2).

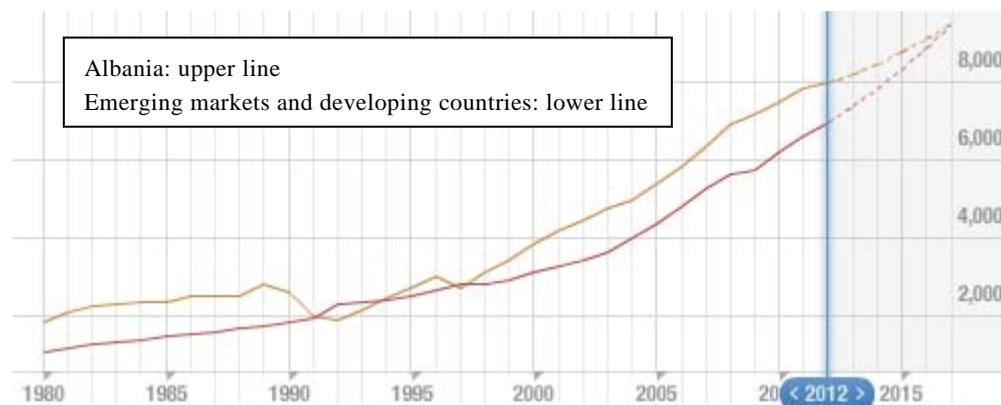
**Figure 2 Real economic growth rates of GDP: Albania (red) vs. Euro area (blue)**



Source: IMF Data Mapper

If we consider the GDP per capita, measured in purchasing power parities, we see that since 1997, when Albania's GDP per capita was around 2500 USD, i.e. at the same level as the average developing country and emerging market at that time, this value more than tripled within 15 years. Albania's GDP per capita in PPP is currently at the level of around 8000 USD. Economic progress in terms of GDP per capita in PPP was higher than in the average emerging market and developing country (see figure 3). However, compared with developed economies with a current level of around 42,000 USD per capita on average, Albania is still far below this level of economic development. Furthermore, as an effect of the on-going economic crisis in (Southern) Europe, it is expected that Albania's growth dynamics becomes sluggish at least over the next three years (see again figure 2).

**Figure 3: GDP per capita in PPP – Albania compared with emerging markets and developing economies**



Source: IMF Data Mapper

The inflation rate is low and quite stable in Albania. Since 2005, the average annual inflation rate remained within the range of 2% and 3.5% (IMF Data Mapper). The Albanian LEK turned out to be a relatively stable currency. Against the Euro, the currency appreciated by about 15% between 2009 and 2011; since then, it remains at a stable rate of 0.007 Euro per LEK (Oanda, online).

Unemployment continues to be a problem in Albania, although some progress was made between 1999 and 2008, where the unemployment rate dropped from 18.4% to 12.5%. However, in 2012, the unemployment rate was again at 15% (IMF Data Mapper).

## 2. Qualitative achievements of the dldp PFM support

In the area of PFM, dldp developed in its 2<sup>nd</sup> phase the SDPeMTBP approach, where “SDP” stands for strategic development planning, “MTBP” for medium-term budgeting based on a performance oriented program structure and “e” represents the excel-based financial planning tool FPT elaborated to facilitate coherent financial plans for the medium term in a combined top-down and bottom-up process. The SDPeMTBP approach was elaborated in full compliance with the legal budgeting requirements of Albania, especially taking into account law No. 9936, enacted in 2008, “On the management of budgetary system in the republic of Albania”. However, at the beginning of dldp2, the concept of MTBP, required by low No. 9936 in its article 26, was rather unclear for most of the stakeholders at local level.

### 2.1. Overview of the dldp PFM intervention

The SDPeMTBP approach combines five important PFM reform elements:

- (1) Strategy oriented budgeting
- (2) Combination of financial and policy planning
- (3) Detailed medium-term planning
- (4) Thinking in comprehensive programs
- (5) Performance orientation

In the area of strategic development planning, dldp could draw from experiences of the first phase and from other donor supported projects. However, under dldp2, the SDP-approach was further improved in order to facilitate its implementation through the MTBP in a transparent way.

Regarding the combined medium-term policy and finance budgeting in a program structure with performance orientation, dldp entered uncharted waters in Albania at local level. This approach was risky; other countries needed much more time to reach this advanced level of PFM described by the above mentioned five PFM reform elements. However, Albania had decided to choose a fast-track reform approach in the area of PFM also at local level and dldp’s support package responded to Albania’s willingness for a comprehensive PFM reform.

When dldp provided PFM support to strategic development planning and medium-term budgeting, it was clear that dldp didn’t cover the entire PFM cycle; SDPeMTBP is focussed primarily on upstream processes of PFM while downstream processes, i.e. budget execution and control were left out. Dldp had to make a choice, and it wouldn’t have been possible to support a local PFM reform covering all stages of the cycle at the same time. The upstream processes of PFM mainly deal with the question of *what* are the right things to do by LGUs. Only when this question is well answered in the SDP and MTBP, it’s time to ask the question of *how* to do the things right, i.e. how to execute the budget properly and how to monitor its execution. That’s what is meant by downstream PFM processes.

In terms of outputs, dldp provided trainings and coaching for targeted LGUs in the Shkodra and Leza region regarding strategic development planning and medium-term budgeting; it supported the elaboration of SDPs, financial plans and MTBPs; additionally, dldp prepared three publications on the SDPeMTBP approach:

- New SDPs were elaborated and existing plans were updated with support of dldp. Dldp provided an improved planning methodology and guidelines for the publication of a short but comprehensive version of the SDP.
- Financial plans with a medium-term orientation were elaborated in targeted LGUs while making use of the FPT with its combined top down and bottom up procedures.
- Medium-term budget programs MTBP were elaborated in selected LGUs combining strategy related-policy planning for the medium term with financial planning in a performance based programme structure. Communication of the MTBP was facilitated by providing guidance for the elaboration of a short but comprehensive and systematic version of the MTBP.
- A financial planning tool was developed with the purpose to facilitate comprehensive, strategy-oriented, transparent and coherent financial planning in Albanian LGUs.
- Three PFM-related publications were published in order to strengthen the SDPeMTBP approach and facilitate its dissemination:
  - o Long and medium term strategic and financial planning. A manual for local government units in Albania. This publication was first edited in 2011 and reprinted in 2013. The publication is widely used as a basic guide-book for trainings.
  - o Strategic development planning and performance based budgeting in the medium term. A 5 day training course. This publication makes the consolidated content of the dldp training courses on strategic development planning, medium-term budgeting with performance oriented programs and financial planning available for further dissemination. It can be used as a reference book for good up-stream PFM practices in the context of Albanian LGUs.
  - o Medium-term financial planning for local governments in the context of Albania. Manual for the excel based Financial Planning Tool FPT. This manual was made available as a draft in 2012 and published as an improved version in 2013. It provides guidance on the use of the FPT (purpose, procedures and interpretation of output).

In January 2013, dldp evaluated the performance of the SDPeMTBP approach with respect to outcome area 1 and its output goal 1.1 (see above). The methodology of this evaluation and major findings are presented in sub-chapter 2.1 and 2.2 below.

## 2.2. Assessment methodology (overview)

Dldp used a triangulation technique to assess its SDPeMTBP approach. This means that the evaluation was carried out by three different parties independently:

<b>Evaluator</b>	<b>Type of assessment</b>	<b>Scope of assessment</b>
Service providers (local consultants) (1) Coplan (2) ISB	Self-assessment	Formal and material analysis of MTBPs supported by dldp. The formal analysis assesses the comprehensiveness of the MTBP and the communicative quality of its presentation; the material analysis is dedicated to financial and policy trends in the coached LGUs.
Independent Albanian PFM specialist, A. Braho	Comprehensive thematic evaluation	SDPeMTBP regarding outcome area 1 assessed by making use of PEFA indicators adapted to the dldp priorities of work in the area of policy based budgeting,

		predictability of budgets, transparency and participation in budgeting, vertical integration.
MoF / director of intergovernmental fiscal relations	Comparative analysis	Comparing formal quality of MTBPs (regarding comprehensiveness and communicative quality) of dldp supported LGUs with LGUs without support; crosschecking findings from self-assessments.

In chapter 2.2, the results of these analyses are presented summarily as follows. In sub-chapter 2.2.1, the results of the formal assessment are presented; in addition, supported LGUs are compared with LGUs without support; in 2.2.2, the main findings of the outcome of dldp's SDPeMTBP intervention are reflected; in 2.2.3, the findings on major financial and policy trends are reflected.

### **2.3. Results of the dldp PFM intervention**

In chapter 2.3, the results of the multiple evaluation are presented summarily as follows: In sub-chapter 2.3.1, the results of the formal assessment are presented; in addition, supported LGUs are compared with LGUs without support; in 2.3.2, the main findings of the outcome of the thematic evaluation on dldp's SDPeMTBP intervention are reflected; sub-chapter 2.3.3 provides a synthesis of the findings from the formal analysis and thematic evaluation; finally, in 2.3.4, current characteristics of local finances and policy making are reflected.

#### **2.3.1. Comprehensiveness of the MTBP and communicative quality of its presentation**

The first sub-chapter presents the findings on the comprehensiveness of the MTBPs in the supported LGUs and compares these findings with MTBPs of LGUs without support. The second sub-chapter outlines the findings on the communicative quality of the MTBPs.

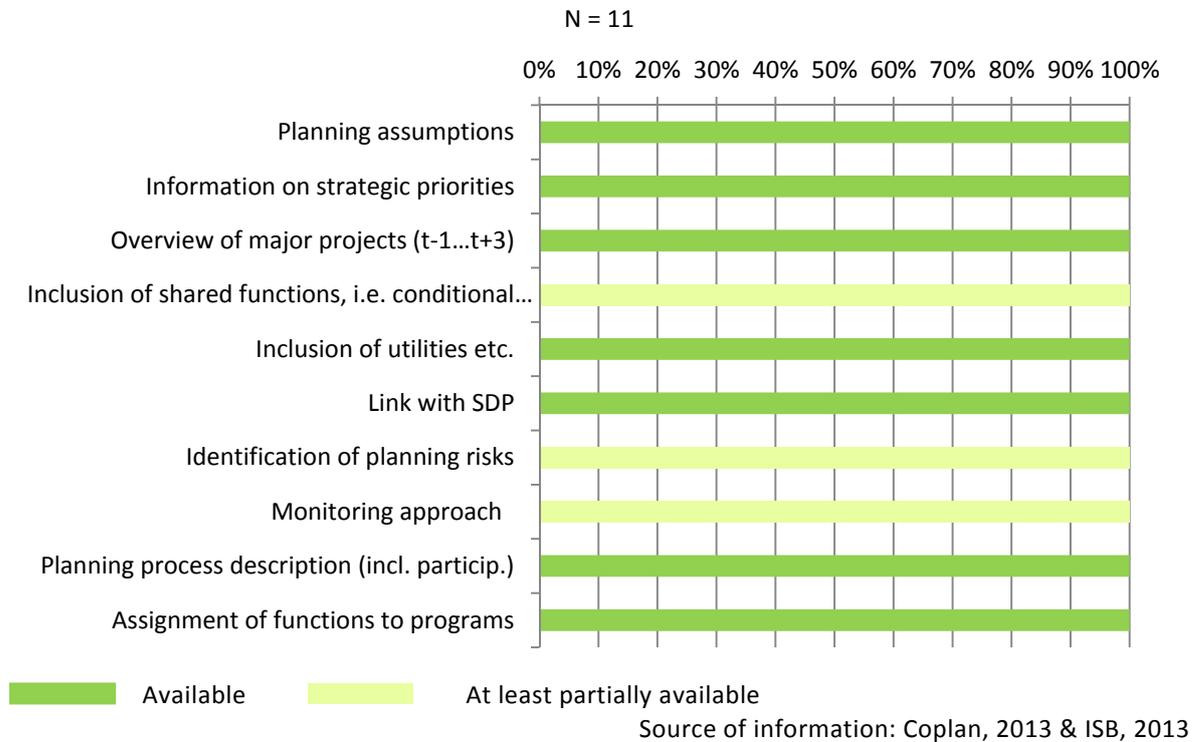
##### **2.3.1.1. Comprehensiveness of the MTBP**

The comprehensiveness of the MTBP elaborated in the eleven LGUs coached by dldp was assessed by the consultants of the assisted LGUs with two analyses; both analyses can be considered as self-assessments; they were carried out independently one from the other but used the same methodology. The findings from these analyses are aggregated and condensed in the following section of this report. Three aspects of MTBPs are considered: (i) general information, (ii) financial information, and (iii) program information. Requirements regarding budget comprehensiveness reflect recognized PFM standards such as Pefa (PI-6). Finally, in section (iv), the findings (i to iii) from the self-assessment of the consultants are crosschecked by the independent observations made by the directorate for intergovernmental fiscal relations / MoF. In addition, these results regarding MTBP comprehensiveness are compared with comparable LGUs without support in PFM.

##### **(i) General information in the MTBP**

In all of the coached eleven LGUs, the MTBP provide the required elements of general information. In most of the cases, this information is fully available (see figure 4).

**Figure 4: Availability of general information in the MTBP**

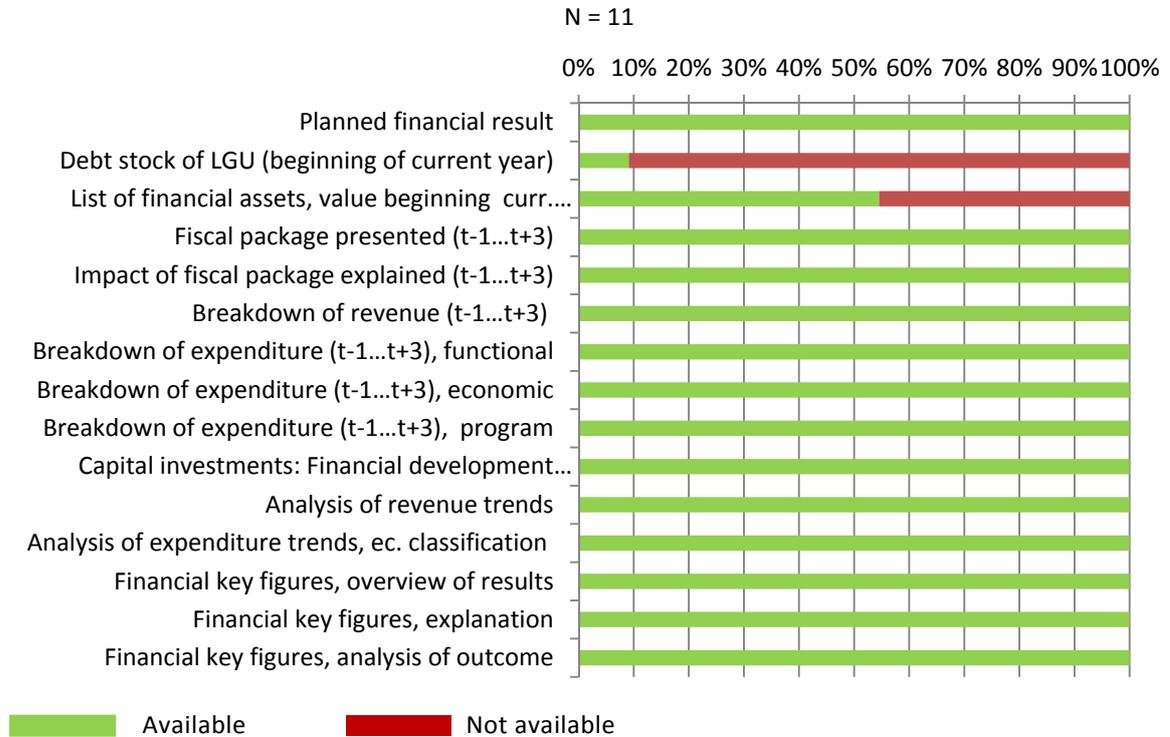


For three elements, there is room for improvement: the inclusion of shared functions (and conditional grants), the systematic identification of planning risks and the monitoring concept for SDP and MTBP implementation. According to common PFM standards, shared and delegated functions must be included in the expenditure side of the budget as well as conditional grants on the revenue side. Currently, there is some ambiguity whether to include these activities in local budgets in Albania mainly because of lacking predictability of conditional grants, when the MTBP is prepared. However, from a PFM standpoint in line with good governance, the right answer to this discussion is to include these activities in the local budgets and to improve predictability of conditional grants. This inclusive approach is required by Pefa as well (see: PI-8, 12 and 23). There is still time to further elaborate the monitoring approach for SDP and MTBP implementation. The MTBP was prepared by the coached LGUs for the first time in accordance with the SDPeMTBP approach; therefore, monitoring of the implementation was not yet relevant in the first MTBP; it becomes important in the current year only and reporting will be needed at the end of 2013 and in the MTBP for the planning period 2014-16.

(ii) Financial information

Comprehensiveness of financial information in the MTBPs of the coached LGUs is quite good, most of the required elements are there (see figure 5). In principle, there is room for improvement regarding the information on the debt stock of LGUs at the beginning of each year covered by the MTBP, as well as on the asset position at the beginning of the planning period and of planned asset changes in the medium-term. One can argue that debt is not a relevant issue for Albanian LGUs; currently, they are not entitled to make debts. However, it is discussed that a number of LGUs are in arrears with payments. De facto, the accumulated arrears are debts, and their magnitude should be disclosed (See Pefa, PI-4).

Figure 5: Availability of financial information in the MTBP

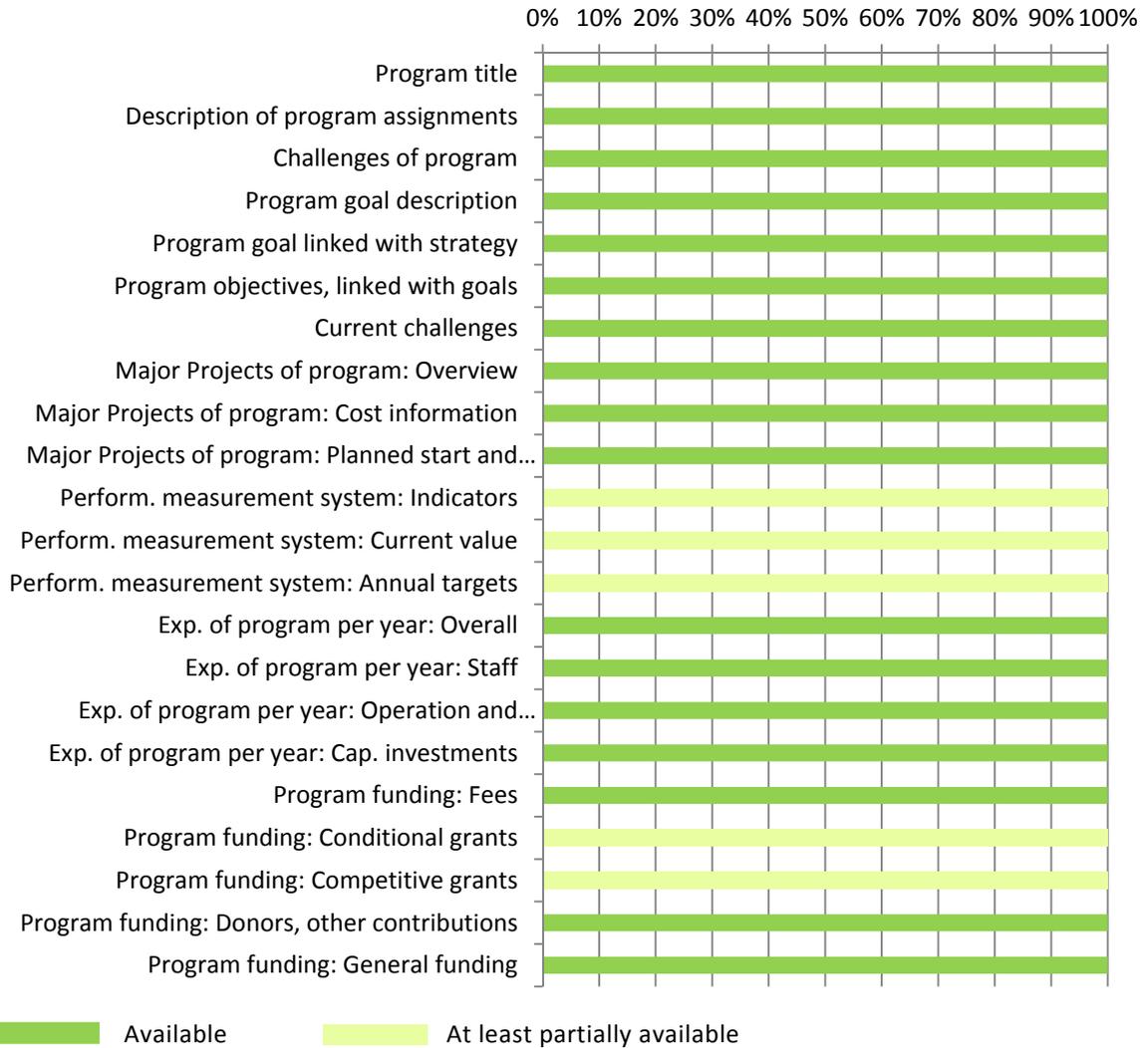


Source of information: Coplan, 2013 & ISB, 2013

(iii) Availability of program information in MTBPs

The MTBPs of LGUs, coached by dldp, provide very substantial information per program. The required pieces of information are all there, at least in part; these MTBPs meet the formal standards of good PFM practices to a high extent. However, two aspects can still be improved, the performance measurement system and the comprehensiveness of program funding regarding conditional and competitive grants. Without comprehensive funding information, the relative share of programs and of capital investments cannot be assessed. Decision making on resource allocation in LGUs is based on incomplete information and therefore biased. However, it is a great step forward that LGUs start thinking for each program not only on how much it costs but also how to finance it taking also into consideration the contribution of fees.

**Figure 6: Availability of program information in the MTBP**

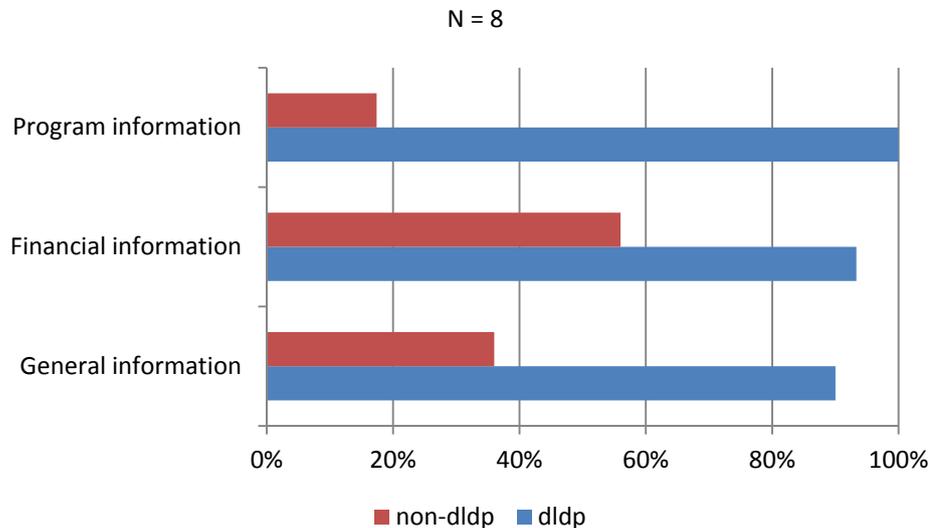


Source of information: Coplan, 2013 & ISB, 2013

(iv) Crosschecking and comparing the findings on the comprehensiveness of the MTBP

The directorate on intergovernmental fiscal relations of the MoF carried out an identical analysis on the comprehensiveness of MTBPs comparing four LGUs supported by dldp with 4 LGUs without PFM support. For each supported LGU included in this analysis, a similar LGU was identified regarding size of population and extent of the budget for the comparative analysis. Figure 7 presents the main findings of this analysis in a condensed way.

Figure 7: Findings of the crosschecking and comparative analysis at a glance



Source of information: Brahim, 2013

It is noticeable that LGUs supported by dldp fulfil the requirements on the comprehensiveness to a great extent. The analysis of the MoF identifies certain weaknesses in the identification of planning risks in the MTBPs (general information), information on the debt stock (financial information), while the program information is considered as complete. These findings are fully in line with the findings from the self-assessments; they confirm the analysis presented in section (i) to (iii) to a large extent.

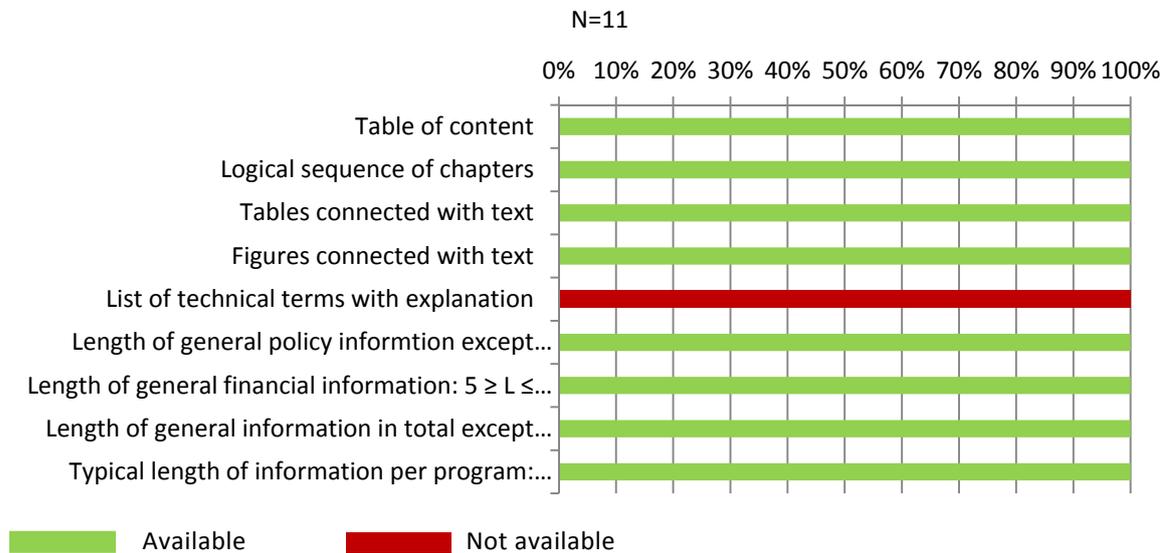
In the absence of a baseline regarding the comprehensiveness of the MTBP, it is not possible to compare the formal quality of MTBPs over time in order to assess the impact of the dldp intervention. For practical reasons, it wouldn't have been possible to conduct a baseline survey; the MTBP was elaborated for the first time in a comprehensive and integrated manner by LGUs in Albania. For this reason, a comparison with non-supported LGUs was made by the MoF. Although the sample for this comparison is small, the result is striking. MTBPs prepared by non-supported LGUs provide a certain quality of information in financial issues; in contrast, information on programs is very poor and general information on the main points of the MTBPs is insufficient in LGUs without support. The MTBPs in these LGUs have not yet reached a level where financial and policy planning goes hand in hand and is presented in a comprehensive manner to the public. The conclusion made in the analysis of the MoF is that dldp-supported LGUs have elaborated MTBPs that are fully in compliance with the law while non-supported LGUs have either drafted very formal MTBPs or have no MTBP at all. This comparison confirms that the dldp intervention was successful in improving the comprehensiveness of MTBPs in LGUs with active dldp partnership.

### 2.3.1.2. Communicative quality of MTBP presentation

The MTBPs should be presented in a comprehensive, coherent and concise manner. The length of the different elements of the MTBP should be appropriate, i.e. enough room should be given for the presentation of the main points; however, information overflow by too lengthy documents should be avoided; the document should be absorbable for council members and other interested citizens. If MTBPs are not presented in an appropriate manner, there is a risk that the information is just ignored. If this were the case, MTBPs would be useless.

Figure 8 gives evidence that all supported LGUs were in a position to publish the MTBP (short version) in an attractive and handy manner. What was missing is a glossary of technical terms used in the document. This feature could be included in future in order to facilitate the correct understanding of the planning paper for external stakeholders.

Figure 8: Layout features and legibility of MTBPs in dldp supported LGUs



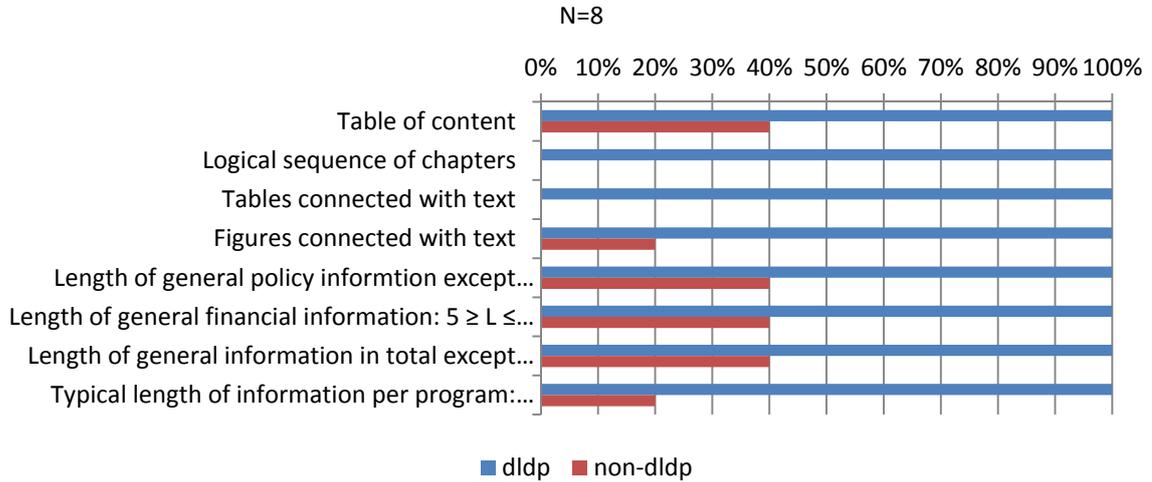
Source of information: Coplan, 2013 & ISB, 2013

In order to assess the impact which dldp support had on the communicative quality of MTBPs, the directorate of inter-governmental fiscal relations of MoF compared a sample of MTBPs of dldp supported LGUs with MTBPs of LGUs without support. At the same time, this analysis can be considered as a crosscheck of the findings from the self-assessment carried out by the local consultants and presented above. The findings of the MoF assessment are presented in figure 9.

The assessment of the directorate for intergovernmental fiscal relations fully confirms the results from the self-assessments. The communicative quality and legibility of the MTBPs presented by the dldp supported LGUs are quite good. In contrast, the MTBPs elaborated by non-supported LGUs do not provide the necessary communicative quality. Their suitability as a relevant policy paper is therefore limited. At the same time, the assessment of the directorate confirms indirectly that the dldp intervention also mattered regarding the presentation of MTBPs (see figure 9). Brahim (2013, p.12) comes to the following conclusion: “The analysis of these units highlights the fact [that] these units have only completed these two tables [on expected revenues and expenditures] formally without drafting a project-budget according to the procedures required by such a process. In

addition, this analysis testifies the lack of capacities in these units.” The way how dldp-supported LGUs have presented their MTBPs could be used in trainings as good practice examples for other LGUs in the next years.

Figure 9: Layout features and legibility of MTBPs - dldp supported LGUs compared with LGUs without support



Source of information: Brahimji, 2013

### 2.3.2. Outcome of the SDPeMTBP intervention

The comprehensive thematic evaluation of Antonin Braho (2013) was dedicated to the outcome goal (1) and (2) of dldp:

- (1) Municipalities and communes in Shkodra and Leze Qark have improved their governance structures, capacities and selected local services.
- (2) Good practices are shared at national level in cooperation with strengthened associations, thus impacting law and policy-making and their implementation at national level.

More specifically, the evaluation assessed the following six governance aspects:

Outcome Goal	Governance Aspects / outcome dimensions	Outcome Indicators
(1)	1. Policy-based budgeting	OCI-1 & 2
	2. Predictability of budgets	OCI-3 - 5
	3. Transparency and participation in policy planning and budgeting	OCI-6 - 9
	4. Vertical integration of SDPs	OCI-10
	5. Capacity enhancement on SDPeMTBP in LGUs	OCI-11 - 15
	6. Presence of SDPeMTBP in LGUs	OCI-16 - 20
(2)	7. Influence at national level and knowledge transfer	OCI-21 - 22

For the assessment of the governance aspects 1 – 3, the evaluation used (modified) Pefa indicators where possible. In analogy with the Pefa indicators, a scoring methodology was used for the assessment: A = highest possible score; D = lowest possible score. Detailed information on the 23

indicators, the methodology of measuring, the scoring requirements and the sources of verification for each indicator can be found in Braho (2013, p. 23ff.).

Following, the results of the thematic evaluation are presented in a condensed manner and made anonymous for each governance aspect or outcome dimension.

### 2.3.2.1. Policy-based budgeting

The two indicators on policy-based budgeting consider two aspects. OCI-1 shows the number of strategic projects for each LGU for the last four years including the current year. In contrast, OCI-2 shows the relative expenditure share of strategic projects in the budgets of the eleven LGUs over the same time period.

Figure 10: Number of strategic projects

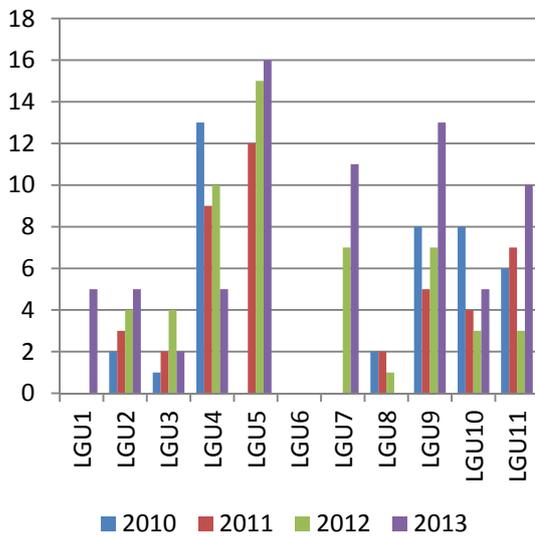
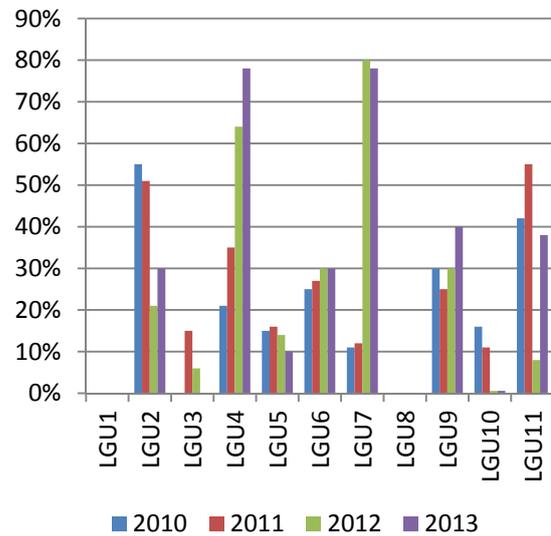


Figure 11: Expenditure share of strategic projects



Source of information: Braho, 2013

It is noticeable that currently, LGUs are in a position to implement strategic projects; this was also the case in the past three years. However, it is difficult to see a clear trend behind the findings presented in figure 10 and 11. There is no continuity in LGUs to implement strategic projects, whether we consider the number of projects (figure 10) or the expenditure share (figure 11). For both figures, we see a great deal of fluctuation. The reason for this fluctuation is LGU’s high dependency on conditional and competitive grants regarding the financing of strategic projects. This means that de facto, the key for the implementation of a local development strategy lies in the hands of the ministries of central government (conditional grants) or of the Regional Development Fund (competitive grants) for each LGU in every year.

Unfortunately, information was not available for all LGUs. However, it is worth mentioning that a big number of strategic projects do not always imply a huge expenditure share (see: LGU 5); not all strategic projects are capital investment projects.

In some cases (LGU 4 and 7), the expenditure share of strategic projects is particularly high. It is likely that in these cases, the budget for recurrent expenditure is rather low. When this is the case

and then large scale expenditure programs are carried out, capital investment expenditure can amount a multiple of the recurrent expenditures of a LGU.

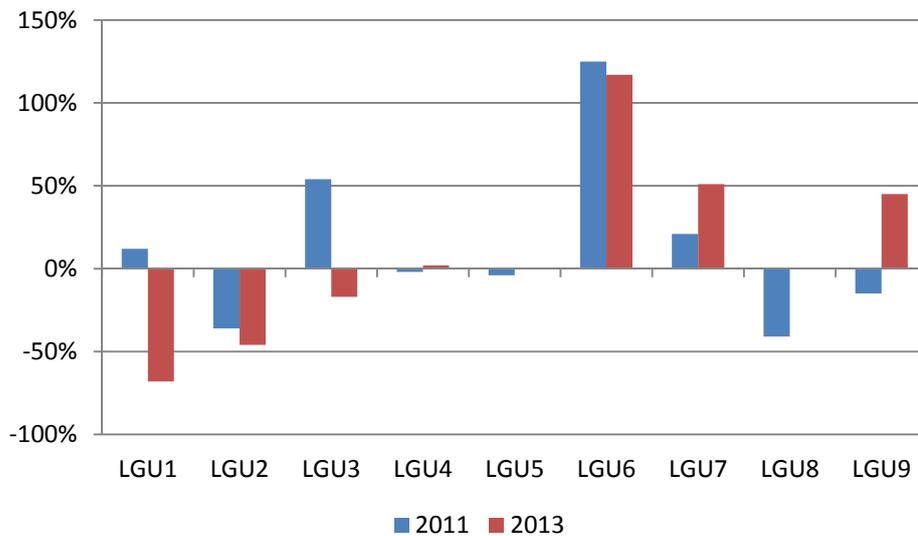
**2.3.2.2. Predictability of budget**

Financial predictability of the budget for the next year was still low, when the MTBP was issued. This is true for the expenditure side (OCI-3) as well as for the revenue side (OCI-4). There is no difference between the results for the two indicators because, in the past, Albanian LGUs could not make debts and used all money they had received in each year.

In six of the cases, the budget for 2013 had to be reduced (when the budget was prepared in 2012) compared with projections of the last year MTBP for 2013; in these cases, the MTBP was considered to be over-optimistic. In seven cases, the budget was higher or even much higher than what was expected by the MTBP one year before; in these cases, the MTBP was considered to be too pessimistic. Only in 5 cases, there was no sensible adjustment of the budget made and the MTBP was considered to be realistic.

In the past, only in 27% of the cases (five MTBP estimations out of 18) were considered as realistic. This hit ratio is certainly not sufficient. The Pefa performance measurement framework points out that accurate forecasting of revenue is a critical factor in determining budget performance, since policy implementation depends on this forecast. External shocks may however occur, that could not have been foreseen (Pefa, 2013, p. 14a). Nevertheless, the credibility of the MTBP depends to a large extent on the accuracy of revenue (and expenditure) forecasts. It is true that in the period of 2009 to 2013, Albania was affected by external shocks from the European economy which had its effects on grants awarded to LGUs. However, these negative external circumstances cannot explain why half of the deviations were on the negative and half of them on the positive side. There is certainly a need to improve revenue forecasting at the local level in Albania, including own revenues and all classes of grants. The current findings can be used as a baseline. However, they cannot be used to assess the impact of the PFM support of dldp, because the first MTBPs supported by dldp were elaborated for the period 2013 to 2015 only, i.e. later than what was assessed by OCI-3 and 4.

Figure 12: Deviation budget from MTBP last year: expenditures and revenues



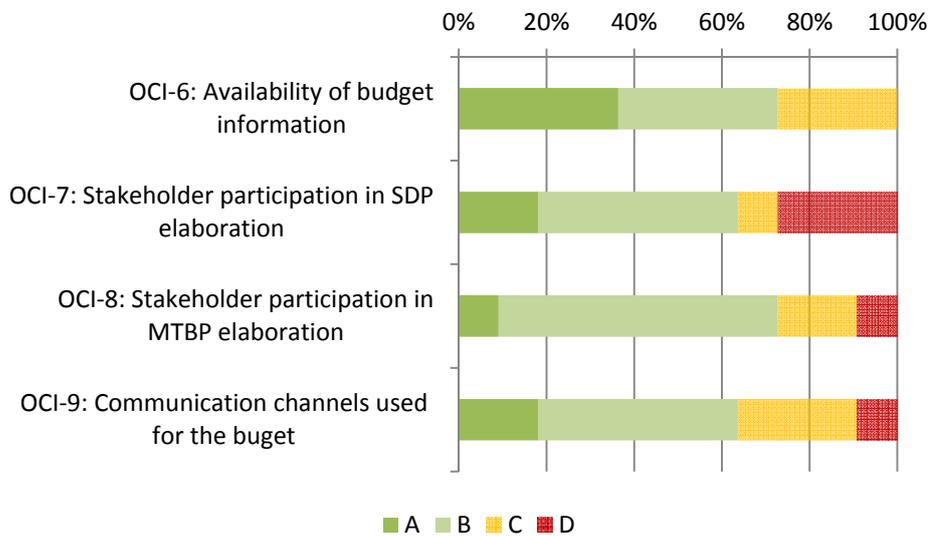
Source of information: Braho, 2013

OCI-5, i.e. the break-down of the expenditure deviation at program level, was not assessed because of the fact that the program structure is introduced only now. For this reason, it's too early for this assessment.

**2.3.2.3. Transparency and participation in policy planning and budgeting**

The results from the thematic evaluation for transparency in policy planning and participation are good or even excellent for more than 60% of the LGUs (rating A or B). Figure 13 shows the results for the year 2013. Certainly, the practice supported by dldp can be used and further improved in future policy planning and budgeting cycles.

Figure 13: Transparency, participation and communication



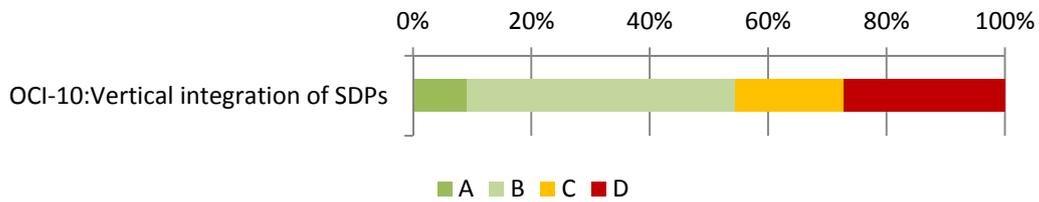
Source of information: Braho, 2013

**2.3.2.4. Vertical integration of SDPs**

The indicator OCI-10 reflects, whether and to which extent SDPs of LGUs consider national and regional strategies for building up their own local development strategy. LGUs are not operating in isolation; it is required that they take into account strategic intentions at higher government level.

The thematic evaluation on strategic development planning reveals that dldp partner LGUs have at least started with considering national and regional strategies when they elaborate or update their strategic development plans (14). However, in half of the LGUs, there is still much room for basic improvements.

Figure 14: Vertically integrated SDPs

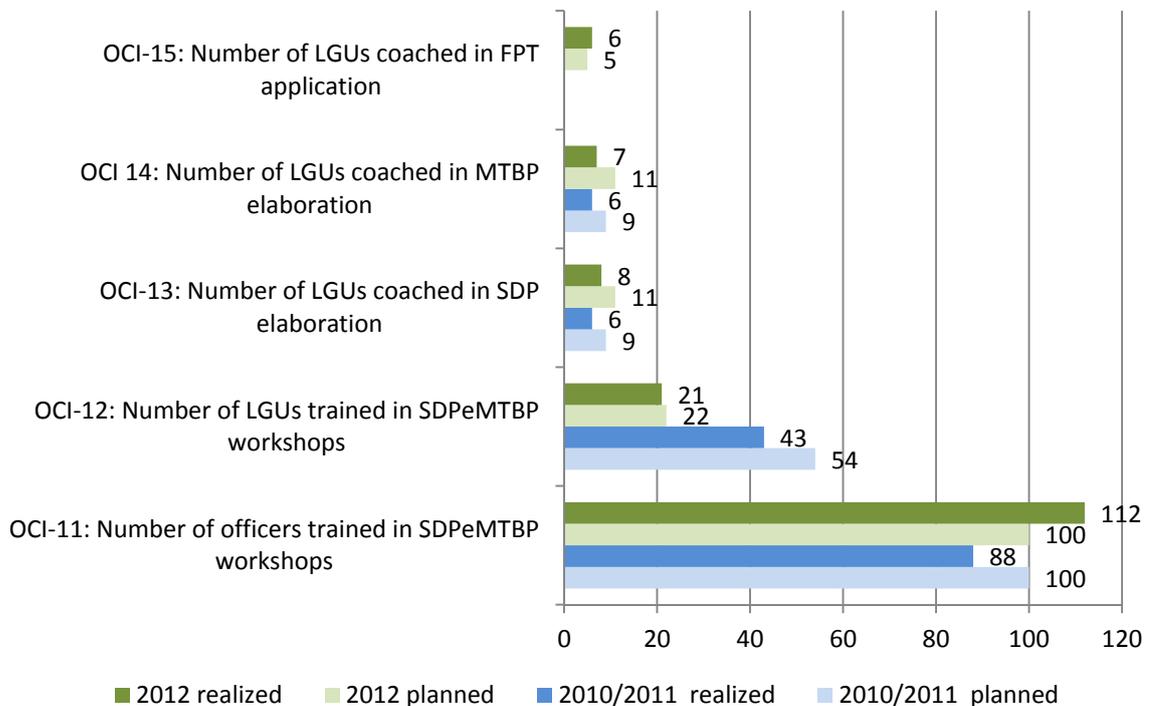


Source of information: Braho, 2013

### 2.3.2.5. Capacity enhancement on SDPeMTBP in LGUs

The dldp approach on PFM capacity building is based on two pillars, trainings and coaching. When we compare the number of trained and coached LGUs, we see that only a fraction of the trained LGUs could receive coaching as well (figure 15). Certainly, coaching was a crucial success factor for the elaboration of improved financial plans and comprehensive MTBPs by making use of the FPT at the same time. However, resources for coaching are limited. This limitation must be considered when a broader roll out of the SDPeMTBP approach is envisaged. Following the dldp approach and bearing in mind how public sector modernization at the local level took place in other countries, we must bear in mind that this process needs time; it is difficult to support the introduction of improved governance procedures in many places at the same time. Following the fast-track has some advantages when we can benefit from the reform momentum. Nevertheless, we should not forget to care for a sustainable PFM reform which needs a thorough understanding of PFM reform procedures at all levels of (local) governments.

Figure 15: Capacity building in SDPeMTBP



Source of information: Braho, 2013

### 2.3.2.6. Presence of SDPeMTBP in LGUs

The results presented in Table 1 provide evidence that the SDPeMTBP approach is increasingly used in the LGUs of Shkodra and Leze: New SDPs were elaborated or updated with support of dldp (OCI-16 and 17), the formal quality of the MTBP improved considerably (OCI-18); in addition, the financial planning tool FPT was finalized and successfully used (OCI-19 and 20). However, the number of LGUs of Shkodra and Leze Qark which actively use the SDPeMTBP approach is still small.

Table 1: SDPeMTBP presence in LGUs of Shkodra and Leze Qark

	2010-11		2012-13	
	planned	actual	planned	actual
OCI-16: New SDP developed	3	2	1	1
OCI-17: SDPs updated	6	4	5	5

OCI-18: MTBs elaborated in Qark of Shkodra and Leze respecting recommendations of dldp	before 2010				2012-13		
	A	B	C	D	A	C	D
	0	0	5	4	7	1	3

	2012-13	
	planned	actual
OCI-19: FPT finalized	yes	yes
OCI-20: Medium-term financial plans elaborated, making use of the FPT	5	5

Source of information: Braho, 2013

### 2.3.2.7. Influence at national level and knowledge transfer

Unfortunately, no results can be found in the thematic evaluation on OCI-21 and 22. OCI-21 would have been dedicated to the adopted practice recommendations of dldp / inter-LGU expert group by the national level in guidelines, regulations, by-laws, laws, etc. or in relevant national practices. OCI-22 would have questioned the extent of adopted practices promoted by dldp in partner LGUs by neighbour municipalities of Shkodra and Lezha Qark. Both outcome indicators refer to the outcome goal 2 regarding the influence at national level and knowledge transfer.

Despite of this lacking results for OCI-21 and 22, it is well known that dldp has established excellent contacts with the national level especially (but not only) in the area of local PFM, and dldp is highly respected for the quality of its conceptual contributions for improving PFM processes at the local level and for its support activities. Dldp is regularly consulted by the directorate of inter-governmental fiscal relations of the MoF before the budgeting guidelines are issued, and the input of dldp is taken into consideration in many cases. Furthermore, the MoF fully stands behind the financial planning tool FPT, and is promoting its application at the local level countrywide. Finally, the directorate for intergovernmental fiscal relations crosschecked and supported the finalization of the training handbook on strategic development planning and performance-based budgeting in the medium-term.

In addition to continuously delivering training workshops on PFM issues, dldp contributed with three PFM related publications, case-studies and the publication of good practice examples of SDPs and MTBPs to the knowledge dissemination in the area of SDPeMTBP. As these publications were

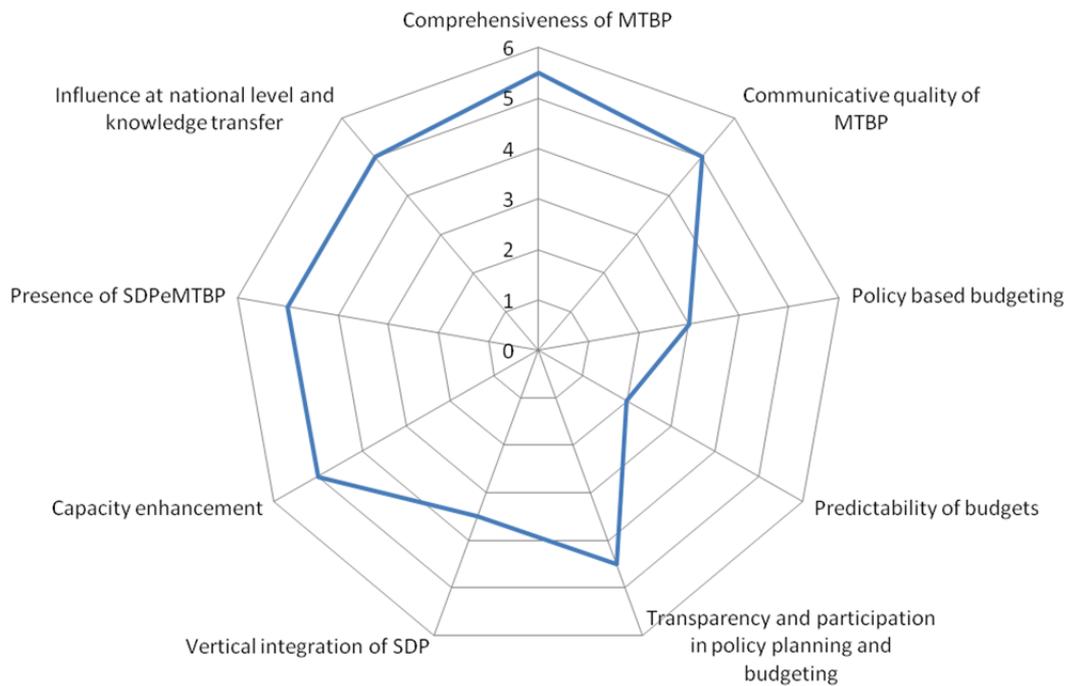
only published recently, it's probably too early to assess the adoption of the SDPeMTBP approach or of elements of it by not directly supported LGUs.

### 2.3.3. Synthesis of the formal analysis of MTBPs and thematic evaluation

Figure 16 presents a synthesis of the major findings from the formal MTBP analysis and from the thematic evaluation; it reveals the strengths and relative weaknesses of the current state of SDPeMTBP implementation. This synthesis is prone to a certain degree of subjectivity and it doesn't reflect the still limited outreach of the SDPeMTBP application in the ddp project area.<sup>1</sup>

Major strengths of the current state of SDPeMTBP implementation are the comprehensiveness of the MTBP and the communicative quality of its presentation, furthermore, the presence of the SDPeMTBP approach including the FPT, the capacity enhancement in supported LGUs as well as the influence at national level in the area of local financial planning and medium-term budgeting. However, the implementation still offers room for improvement mainly in three areas: (i) policy based budgeting, (ii) revenue predictability and (iii) vertical integration of SDPs.

Figure 16: Strengths and weaknesses of the current state of SDPeMTBP implementation and its dissemination



- (i) Regarding policy based budgeting, it is noticeable that there is a very high level of dependency on national grants for the implementation of local strategies through strategic projects. In the past four years, there was no continuity in LGUs on implementing strategic projects, it could be relatively high in one year and low the next year.
- (ii) In the past four years, accuracy of revenue forecasts of the MTBP proved to be low. In some of the cases, revenues were completely overestimated, in others, they were underestimated. Only

<sup>1</sup> Please, consider also the summary of findings from the thematic evaluation, presented in the annex!

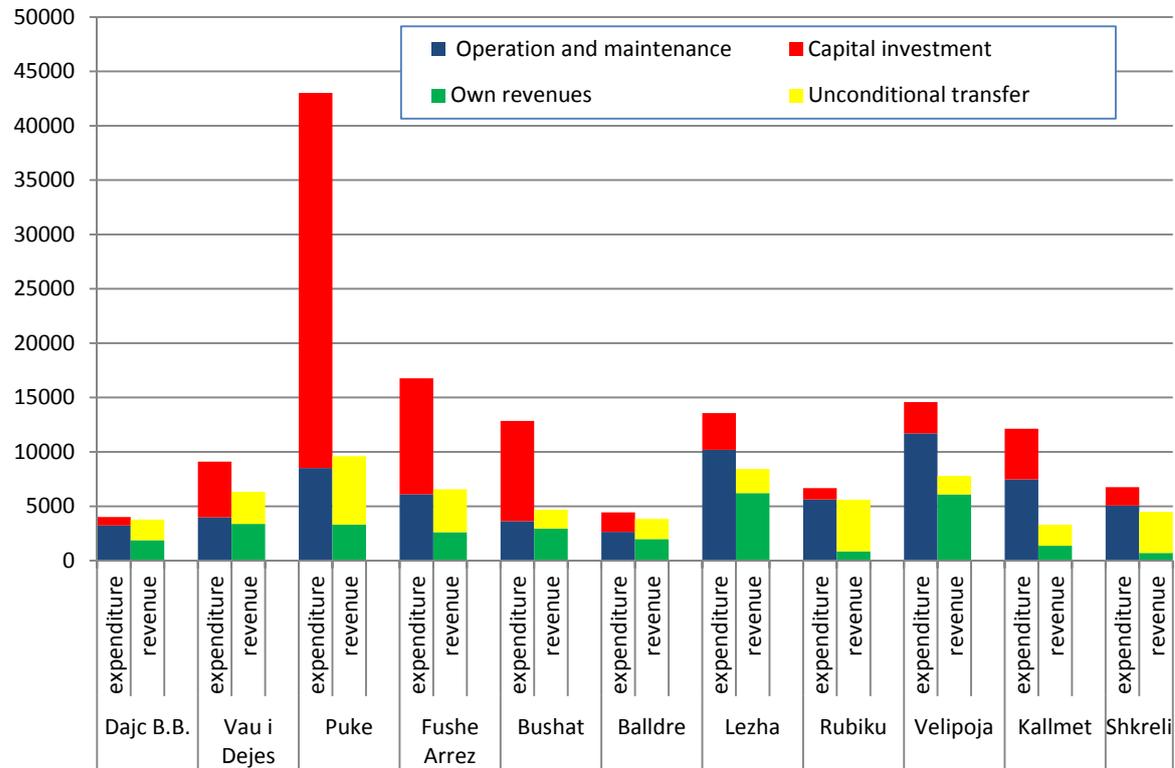
in about one of four cases, revenue forecast of the MTBP was correct. This weakness can be explained by the insufficient predictability of conditional and competitive grants from a three year perspective on the one hand and by lacking experience in estimating the own revenues on the other hand.

- (iii) The deficiencies regarding the vertical integration of the SDP are explained by the absence of a clear analysis of the opportunities (or limitations) of national and regional strategies in a considerable number of LGUs, when SDP is elaborated.

### 2.3.4. Current characteristics of local finances and policy making in coached LGUs

When we consider a comparison of the expenditures and revenues per capita for the directly supported LGUs in 2012 (figure 17), we see that in most LGUs, revenue presented in the budget is not sufficient to cover the projected expenditure, consisting of operation and maintenance costs (recurrent) and capital investment costs. The reason for this mismatch is that conditional and competitive grants are missing in this overview. In most cases, the presented revenue, i.e. own revenues and unconditional transfers are just enough to cover the operation and maintenance costs<sup>2</sup>. This implies that financing of capital investments in LGUs fully depends on conditional and competitive grants.

Figure 17: Break down of expenditures and revenues per capita in 2012



Source of information: Coplan, 2013 & ISB, 2013

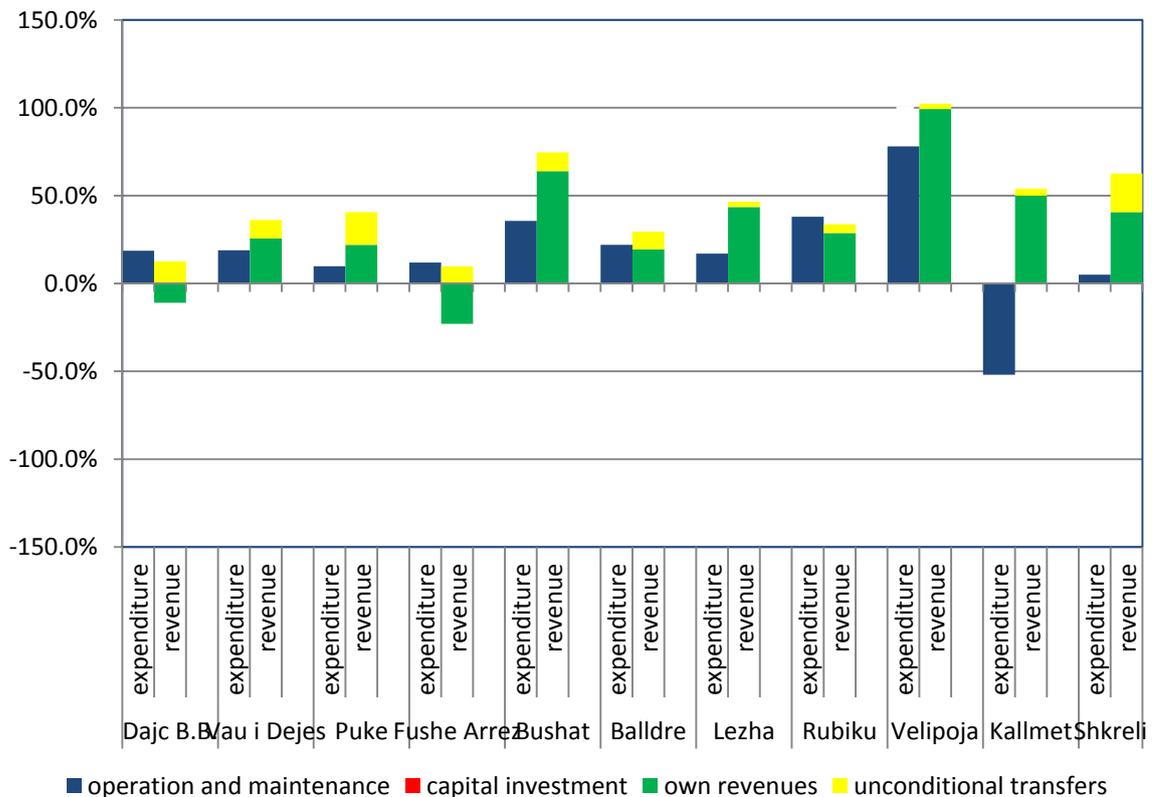
<sup>2</sup> In the case of Lezha, Velipoja and Kallmet, the projected own revenues together with unconditional transfers are not sufficient to cover the projected recurrent costs.

It is noticeable that recurrent expenditures per capita are substantially higher than average in Leza and Velipoja (LGUs with an urban or touristic character) as well as in Puke and Fushe Arrez (LGUs located in mountainous areas). Even more striking is the huge capital investment disparity per capita between LGUs. Relatively high levels of investments are planned in the mountain communes of Puke and Fushe Arrez. However, if the number of inhabitants is low, capital expenditure per capita for a certain investment is relatively high. It could be worthwhile to further explore the reasons for the local expenditure disparities per head and analyze the cost drivers and unused potentials of economies of scale by further inter-LGU cooperation.

Moreover, it is remarkable that the highest combined revenue of own sources and unconditional grants is projected in Puke. While Puke has relatively high own revenues, this is not the case in Rubiku and Shkrel'i. However, thanks to the unconditional grants and its equalization mechanism, these two LGUs reach an average level of this combined revenue per head.

Figure 18 presents the projected financial trends for 2015 compared with 2011. It is noticeable that a number of LGUs assume that capital investments will be considerably smaller than in recent years or will have a limited growth potential in the medium-term. The big exception is Velipoja with a projected capital investment increase of 1843% (!) compared with 2011. This is outstanding; it goes far beyond the scope of figure 18.

Figure 18: Expected percentage changes: 2015 compared with 2011



Source of information: Coplan, 2013 & ISB, 2013

According to the projections, recurrent costs will be higher in most LGUs in 2015 compared with 2011; partially, this can be explained by inflation. However, in a number of LGUs, a real cost

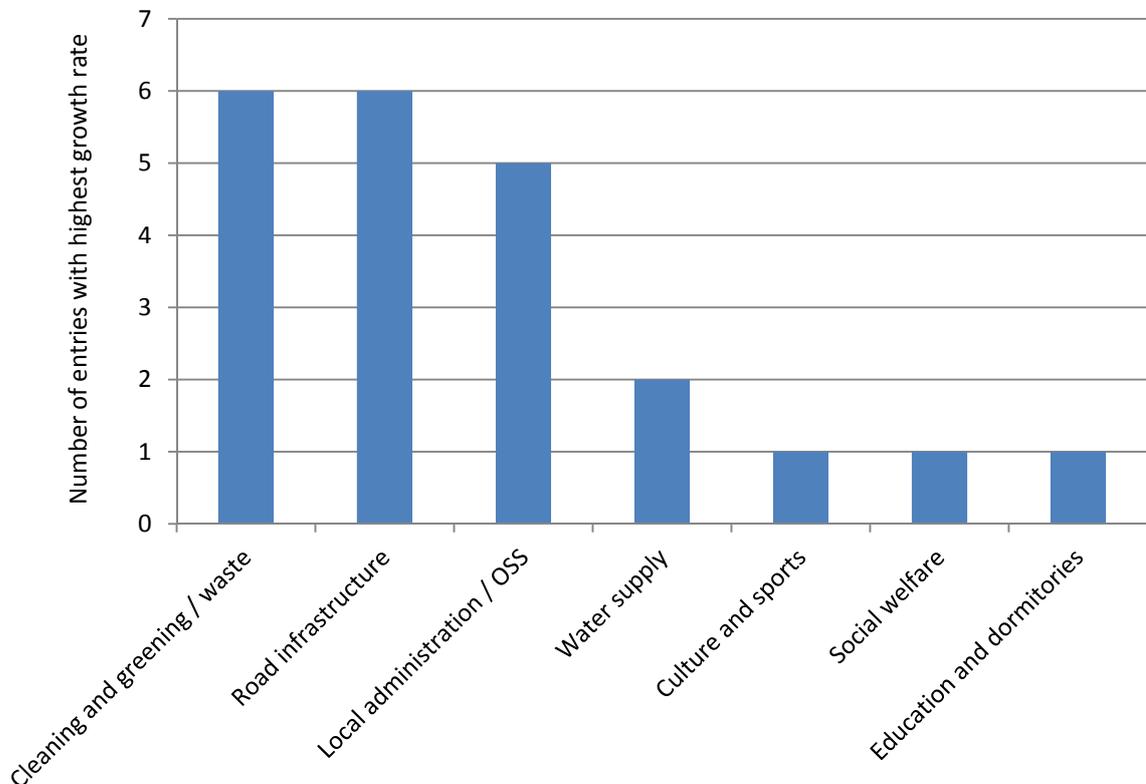
increase is expected which must be justified by better service delivery. There is one exception, Kallmet, where it is expected that recurrent costs can be halved (!) by 2015.

A number of LGUs are quite optimistic about the future growth rates of own revenues. Bushat, Kallmet and Shkrel expect own revenues to increase by around 50% while Velipoja even expects an increase of 100%. In contrast, it is expected that unconditional transfers will be adjusted to inflation only. The cases of Kallmet and Shkrel are particular. In both cases, the combination of own revenues together with unconditional transfers are expected to increase, while recurrent costs remain stable or decrease.

Braho (2013, p. 14) pointed out in his thematic evaluation that in the past, revenue and expenditure forecasts were inaccurate in many cases. This could have a negative effect on the sustainability of public finances. When we compare the projections for the different LGUs of our sample, it is difficult to detect a general trend. There is a lot of variation from one LGU to another. It could be highly beneficial if financial experts of the LGUs would sit together and discuss the different budget projections of their LGUs.

If we consider the functions with the two highest growth rates over the next three years in the eleven LGUs supported by dldp, this is cleaning and greening together with waste management on the one hand and road infrastructure on the other hand; furthermore spending increases are projected in the area of local administration with the implementation of one stop shops (see figure 19).

Figure 19: Functions with highest growth trends 2013-2015



Source of information: Coplan, 2013 & ISB, 2013

#### **2.4. Favourable and unfavourable factors influencing the local PFM reform**

There are at least two strong favourable and two adverse factors influencing the the local PFM reform. As supporting factors, it is worth mentioning (i) the remarkable dedication and intrinsic motivation of LGU authorities and staff and (ii) the extrinsic motivation of becoming a candidate for EU accession. At the negative side, (iii) the current economic crisis and (iv), the unfinished decentralization reform are important influencing factors.

- (i) Without having the local authorities and staff behind the PFM reform, it wouldn't be possible to make the reform sustainable. The reports from Coplan and ISB give clear evidence that there exists a lot of dedication and motivation within the LGUs to go further with the PFM reform. However, there is still a need to better include the local Councils in the reform process and foster their understanding on how to use the strategic and medium-term planning instruments and influence policy making more strategically.
- (ii) The Albanian state has a strong aspiration to become a candidate for EU accession. The European Union will open accession negotiations when the European Commission has assessed that Albania has achieved the necessary degree of compliance with the membership criteria. For this purpose, the European Commission appraises regularly progress made to meet these standards. In the progress report of 2012, the European Commission (2012, p. 67) comes to the conclusion that "preparations for financial and budgetary provisions are at an early stage". This statement implicitly includes the local level as well. In addition, the European Commission (p. 66) points out that further progress is needed in the area of internal financial control and external audit.
- (iii) The Albanian economy is affected by the economic crisis in Europe and particularly in Southern Europe. As Braho (p.5) pointed out, the economic forecasts were revised downwards at the beginning of 2013. The latest IMF forecasts (April 2013, p. 153) for real GDP growth in Albania are 1.8% for 2013 and 2.5% for 2014, i.e. less than half of the average real growth rates of around 6% for the years 1995 to 2008. The sluggish economic growth will also affect public revenues at central and local level. Unfortunately, it is less attractive to introduce PFM reform procedures in times of cash shortages and strict budgets.
- (iv) PFM reform and decentralization reform are highly intertwined. Proper PFM processes are needed at local level as a prerequisite for a successful decentralization. However, PFM processes in conformity with good governance require clear assignments of functions and relatively stable and predictable finances for the local level. Unfortunately, the precondition of stable and predictable finances for the local level is not yet sufficiently fulfilled. LGUs still depend to a large extent on national grants; only part of these grants can be reliably estimated when the MTBP is prepared. In addition, the right to collect own revenues is limited for LGUs. These deficiencies undermine policy based budgeting and the credibility of the budget in the short and medium term; they could have negative effects on the effectiveness and efficiency of budget implementation and on the sustainability of public finances at the local level.

### 3. Considerations for further PFM support by dldp

Dldp with its SDPeMTBP approach is certainly on the right way to support the PFM reform in conformity with good governance requirements at the local level. The validity of this approach was confirmed by the reports of Coplan, ISB, the directorate on intergovernmental fiscal relations of MoF, and the thematic evaluation of A. Braho; furthermore, many statements at dldp's national conference of 8 April 2013 were also made in favour of this approach. However, it was mentioned as well that it needs time to make the improved PFM procedures understandable for the major actors in a LGU. Therefore, dldp should continue with supporting the implementation of the SDPeMTBP approach.

The strength and weaknesses of the current status of SDPeMTBP implementation was summarized in section 2.3.3 (figure 16). In the short and medium term, dldp can rely on the strong points of the implementation and, at the same time, try to overcome the existing implementation obstacles. In addition to that, one should bear in mind that the SDPeMTBP approach covers only the upstream processes of the PFM cycle; furthermore, until now, only a limited number of LGUs were coached in the application of the SDPeMTBP approach in two areas of Northern Albania.

Table 2 presents an overview of further dldp support opportunities in the short and medium term.

**Table 2: Overview of further PFM support opportunities for dldp**

<b>Further possible support activities</b>	<b>Considerations</b>
(1) Improving the revenue estimations in the MTBP	A starting point could be the comparison and in-depth discussion of the existing revenue estimations for the medium term of LGUs with well prepared MTBPs. This discussion could take place in the Inter-LGU-Expert Group on Local Finances. The estimation discrepancies could be analyzed and lessons could be learned. In a second step, fiscal packages could be analyzed and techniques developed for improving the forecasting methodology. Finally, these improved techniques should be applied together with the FPT.
(2) Improving policy based budgeting	Currently, major projects of LGUs are financed by conditional grants and competitive grants. For these grants, LGUs depend on decisions taken at central level (ministries) or at the RDF. To improve the situation for better policy based budgeting, LGUs would need a higher share of stable revenues (own or shared) and more predictability of the conditional and competitive grants. Certainly, these are reform issues reaching beyond the scope of dldp. However, they directly affect PFM performance of LGUs. Therefore, dldp should foster the process of further decentralization wherever possible.

(3) Improving the vertical integration of SDPs	It could be helpful to elaborate a short guidance note on vertical SDP integration that explains how to do it and why to do it. New SDPs or updating of SDPs should consider the guidance note.
(4) Clarification of open questions on the scope and process of MTBP	<p>The following questions should be further discussed and a clear answer should be elaborated which should be included in the instructions issued by MoF on the local budgeting process:</p> <ul style="list-style-type: none"> <li>- Scope of the local budget: shared and delegated functions, conditional grants and competitive grants. In accordance with international standards, these areas of local finances should be included in the budget. However, if this is done, a solution must be found to make the adopted budget a reliable document.</li> <li>- It should be clarified, which ceilings must be presented to the Local Council for approval. It wouldn't be appropriate if the Council had to approve all ceilings used with the FPT. It is recommended that the Council approves only the global ceilings while the detailed ceilings are decided by the GSBI. These global ceilings should be specified in the budgeting instructions of MoF as well.</li> </ul>
(5) Elaboration of a simplified SDPeMTBP approach for small LGUs	For small LGUs with limited financial resources, the SDPeMTBP approach may be too ambitious. At dldp's National Conference of 8 April 2013, it was suggested that for small LGUs, a simplified approach should be elaborated. In a first step, a consensus should be reached on what elements of strategic planning, medium-term and short-term budgeting are indispensable for small LGUs. Then, this "PFM light" approach should be tested and good practice examples could be disseminated together with a short practical guide.
(6) Motivation for policy makers (Local Council members and Mayors) to use the SDPeMTBP approach for strategic policy making and foster the understanding of the SDPeMTBP approach	For policy makers, a short version of the SDPeMTBP approach should be prepared and presented to Majors and Council members. The message should focus on the advantages of the approach for policy making and controlling and on the role, Mayors (together with the GSBI) and the Council and its concerned commissions have to play. This training could be combined with a study visit abroad.
(7) Enlarging the PFM reform approach towards downstream processes: procurement, M&E,	A PEFA assessment of the sub-national level could help identifying the major local PFM

reporting, internal control, external audit, public scrutiny.	shortcomings which should be addressed. However, the EC commission already pointed out, that there is a need for reform action in the downstream processes of PFM. This is certainly also the case at the local level. Without addressing and improving these processes, the reform of the PFM cycle remains incomplete. In Annex 3, an overview of the entire PFM cycle is presented together with the potential for participation.
(8) Rolling out of the SDPeMTBP approach to other parts of Albania	Training workshops based on the existing training handbook (5 day training course) could be provided on a broader scale with support of the MoF and additional training institutions. It should be considered whether and under which preconditions the number of participants per workshop could be increased. For the coaching of a limited number of additional LGUs, the “leopard skin technique” could be applied providing support to well-selected and strategically located medium-size LGUs in new regions of Albania. These LGUs should have the (informal) function of a regional centre and could then be used as a role model and multiplier.

### 3.1. Additional areas of PFM support for the remaining time of dldp2

In the remaining eight months of dldp 2, which are interrupted by the process of national elections, there is no time left for opening completely new activities. Dldp should continue with the existing support activities addressing a manageable number of additional LGUs in the two regions of Shkodra and Lezha. For the LGUs which were supported in 2012, more sporadic support should continue with the purpose to consolidate the PFM reform achievements in these LGUs; in addition, a helpline could be established to provide rapid and tailored support where needed. Certain aspects of the MTBP presentation should be improved at the same time (consider figure 4, 5, 6 and 8).

Of the list of eight activities enumerated in table 2, dldp could choose the following additional activities for the remaining months of the second phase of dldp:

- (1) Improving revenue estimation (fiscal package)
- (3) Improving vertical integration of SDP
- (4) Clarification of open questions around the MTBP
- (6) Motivation for policy makers to use the SDPeMTBP approach for steering and controlling [However, if dldp decides to address new regions outside of Shkodra and Lezha with the SDPeMTBP approach (option 8) in the third phase, it would make sense to wait for these new LGUs, i.e. to postpone this activity for dldp3, provided a study visit abroad is included in this activity.]

Certainly, if there is a chance to foster the dialogue on decentralization in order to improve the preconditions for policy based budgeting (activity area 2 in table 2), dldp should not hesitate to use the opportunity also in the remaining months of dldp2.

### **3.2. Key areas of PFM support for dldp3**

The further activities should be reserved for dldp3. This is especially the case for (7) enlargement of the PFM activities towards downstream processes and (8) roll out of the SDPeMTBP approach to other parts of Albania. These two lines of action should be considered as complementary rather than as alternative. At least (8) should not be addressed without (7) but (7) could be chosen without (8) if dldp continues to remain in its homeland, i.e. the Qarks of Shkodra and Lezha.

It would also be better to wait with the elaboration of a simplified version of the SDPeMTBP approach; this approach needs to be discussed first and then tested; only after these steps, a guiding paper should be prepared.

## **4. Annex**

### **4.1. Sources**

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## **4.2. Major findings of thematic evaluation**

**Finding 1-**Currently, in the context of economic slowdown, there is a challenging environment in Albania concerning the development of qualitative strategic approaches of PFM in local level. It has to do with lower financial resources for local government as result of lower transfers from central government, that is hard budget constraints that oblige local administration to cope with the reality of daily choices rather than focus on the strategic processes and PFM related decision making.

**Finding 2-** In spite of hard times, the local government units in dldp programme area are moving towards standardised processes of strategic planning in the field of PFM, whose results seem to point to qualitative decision making for achievable programmes and activities.

**Finding 3-** Nonetheless the deviations remain still large between MTBPs and annual budgets and, in spite of despite improvements, they are open to risk from uncertain revenue sources as result of unpredictable government transfers.

**Finding 4-** Using standard tools of medium terms budget planning increased the quality of producing qualitative MTBPs, therefore the output of developing FTP has been of great benefit for the outcomes of the programme. Nonetheless, there is a need to improve further such tools through introduction of national standards in programmatic classification of expenditures in order to improve the chances of replication in other areas and generate national support for dldp's outputs.

**Finding 5-** Despite the minor progress in the predictability of budget, there remains much to be done in order to increase the soundness of MTBP especially as monitoring tools for budget planning. As there are new developments concerning public debt, the programme needs to consider the possibility of integrating considerations for debt in FTPs and MTBPs that go beyond simple statement of loan amounts.

**Finding 6-** In spite of more or less available information to public in the process of budget preparation, the quality still needs improvement. The growth assumptions are still too simple and not argued for in MTBPs or in SDPs.

**Finding 7-**The inclusion of regional authorities, as stakeholders, in the process of preparation of MTBPs and SDPs seem to be problematic. Also, the regional and national priorities/opportunities seem to be not entirely integrated in local SDPs through a systematic framework of assessment of such opportunities.

**Finding 8-**The quality and the quantity of SDPs has been improved in time. Dldp programme seem to have played an important role here through the process of capacity building activities and the process of Inter LGUs experts consultations. Nonetheless, SDPs generally lack the expression according to an accepted standard for cost estimations of their activities in line with MTBPs developed, monitoring mechanisms, responsible entities for activity implementation, quantification of risks and actions triggered if these risks are materialised. Assessment of environment (SWOT) or similar is present in a few of developed SDPs.

**Finding 9-**The capacity building activities have been implemented according to programme and generally have performed well in line with Log frame. The criteria of gender have been respected, which shows programme awareness and the significance of these criteria for Albanian context.

**Finding 10-** Despite the improvement in the form and quality of SDPs, there is still no reflection or decision making regarding the definite integration of duration of such strategies developed and revision process.

**Finding 11-** The choice of coaching strategy has been very effective in the improvement of quality of MTBPs and SDPs developed.

**Finding 12-** FPT is a very useful tool, which through very analytical steps of budget preparation in medium term has the potential to add clarity and realism to the process of elaboration of SDPs

Source: Braho, 2013, p. 20f.

### 4.3. Overview of the entire PFM cycle combined with the potential for participation

Figure 20 provides an overview of the complete PFM processes together with the opportunities for participation. This table could serve as an guidance when an enlargement of the dldp support towards the downstream PFM processes is envisaged for phase 3.

Figure 20: The complete PFM cycle and opportunities for participation

