



What determines the transparency of the LSGUs: the budget characteristics, the political factors or the environment?

The budget transparency of local self-government units (LSGUs) is significant both in terms of informing the taxpayers whose money ends up in the municipal budget, as well as in terms of informing the citizens about the manner in which the funds are being spent. Fiscal transparency is identified as a reform priority in the Public Financial Management Reform Programme of the country. Budget transparency is mainly determined by the institutional characteristics of the LSGUs, with more significant impact from the budget factors and a moderate impact from the political factors. However, for the overall transparency, the environmental factors are equally important. The LSGUs that have lower dependence on the central budget, smaller share of parafiscal charges in the total revenues, and an increased realization of the planned amounts, contribute to increasing budget transparency.

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The budget transparency of the LSGUs can be increased by strengthening the budgetary and political characteristics of the LSGUs. Hence, the LSGUs should mandatorily disclose the budgetary documents set out as a legal requirement, as well as the documents referring to increased realization of the planned budgets. More significantly, there is a need of a thorough change in the quality of the capital expenditure structure; increased information on parafiscal charges and their optimization; and reduced dependence on the central budget.

PROBLEM

The Government of the Republic of North Macedonia has set the transparency of public institutions as a policy priority, thus obliging the public institutions to align themselves with the requirements arising from the Law on Free Access to Public Information. The budget transparency of local self-government units (LSGUs) is significant both in terms of informing the taxpayers whose money ends up in the municipal budget, as well as in terms of informing the citizens about the manner in which the funds are being spent. Fiscal transparency is identified as a reform priority in the Public Financial Management Reform Programme of the country. Despite recent increase in the level of transparency on national level, the LSGUs did not follow the pattern.

However, there are LSGUs that neither publish their annual statements, which is a minimum legal requirement, nor do they disclose basic information on how the money is being spent. At the same time, while certain emphasis is put on the transparency of expenditures, the transparency of the revenue side is completely ignored, especially in terms of the adoption and collection of parafiscal charges as a significant source of own revenues for the LSGUs. The Economic Reform Programme 2022-2024¹ identified the need for consolidating the parafiscal charges as a structural reform measure (Ministry of Finance, 2022). The analysis of Finance Think showed that the list of public services with characteristics of parafiscal charges

¹ Available at https://finance.gov.mk/wp-content/uploads/2022/01/ERP-2022-2024_MKD.pdf?x_tr_sl=mk&x_tr_tl=en&x_tr_hl=en-US&x_tr_pto=wapp

is extensive. However, only 9 per cent of the identified parafiscal charges are related to services on municipal level (Petreski & Petreski, 2019). This indicates that the parafiscal charges on municipal level are still a “black box”, including a non-transparent price setting methodology, scarce information on who (sector, taxpayer, company size, etc.) is most exposed to such expenditures, and absence of any plan for their optimisation and rationalisation.

The analysis of the key factors that have an impact on the transparency of the local government will help in developing suitable policies for increasing the transparency and accountability of municipalities, as well as their accountability in terms of spending citizens' money.

PURPOSE

The purpose of this brief is to examine the factors arising from the institutional nature, as well as the environmental factors that have an impact on the transparency of the local government.

WHAT IS TRANSPARENCY, WHY IS IT IMPORTANT AND WHICH FACTORS ARE KEY?

Transparency is a broad concept which is related to the availability of information (supply side of transparency) and the access and usability of this information by citizens and stakeholders (demand side of transparency) (Araujo and Tejedo-Romero, 2016).² Such definition encompasses active

transparency, i.e. proactive disclosure of information by public institutions, and passive transparency, where the disclosure of information is initiated by external demand (through the right of information request).

Transparency is a means for improving policy effectiveness of public institutions. Namely, transparency has an impact on four different domains: (1) reducing corruption; (2) increasing participative decision-making; (3) increasing the efficiency of institutions; and (4) creating better context for economic development through better governance (Sol, 2013). Firstly, increased transparency minimises the moral hazard by stimulating public oversight which results in lower corruption levels.



² Kaufmann and Kraay (2002) give a broad definition of transparency as an increased flow of timely and accurate economic, social and political information, available to all relevant stakeholders.

Secondly, transparency drives the democratic processes by engaging citizens in decision-making and creating responsive governance. Thirdly, transparency improves the allocation of resources by disincentivising policy-makers from pursuing lucrative goals. Finally, reducing the leeway for corruptive activities creates a positive climate to work and plan responsibly.

The determinants of transparency in municipalities can be divided in two groups: institutional and environmental (Bolivar et al., 2013). The former are related to the management of organizations and their need to be accountable in the use of public financial resources, whereas the latter refer to pressures

and requests for information from citizens, which can be related to population and income. In general, the institutional factors encompass, for example, the financial condition of municipalities, the dependence on other levels of government, and the political competition, whereas the environmental factors include the size of municipalities and the income of citizens.

METHODS AND DATA

In this brief we apply regression analysis with limited dependent variables due to the characteristics of the variables that we use to measure the transparency of municipalities. We measure budget transparency by

creating a binary variable, where 1 denotes that the LSGU has disclosed: an annual statement, a budget plan and a series of budgets before 2017, whereas 0 denotes that it lacks at least one of these indicators. In addition, we use the 2020 Index of Active Transparency that covers access to information in three areas: obligations arising from the Law on Free Access to Public Information; information on competences and services; and information in the area of budget and fiscal transparency, in order to analyse the factors that have an impact on the overall transparency.³ Table 1 summarises the defined model and the group of factors included in the model, as well as their impact on the transparency of the LSGUs.



³ The Index has been developed by the Center for Civil Communications (2021). It is calculated on the basis of data obtained through structured questionnaires, where scores are allocated to each question. The Index ranges between 0 and 100 percent, where higher value means higher transparency. For more details on the methodology of the Index, please see <https://www.ccc.org.mk/images/stories/akt21.pdf>

Table 1: Model of transparency

Dependent variable: (1) Budget transparency and (2) Index of Active Transparency			
Factor	Variable	Expected impact	Explanation
Institutional factors			
Dependence on the central budget	Share of transfers from other levels of government in the overall revenues	-/+	Greater dependence on the central budget means a limited capacity of the LSGU to collect own revenues, stimulating inefficient spending and disincentivising transparency. On the other hand, the central government can influence the dependent LSGUs in order for them to increase their transparency.
Share of parafiscal charges	Share of tax revenues from specific services and non-tax revenues in the total revenues	-	Revenues from parafiscal charges are often used for expenditures for unintended purposes. Also, there is lack of information on the tax burden.
Effectiveness (realisation)	Ratio of the incurred versus the planned expenditures	+	Institutions with low realisation level have bigger motives to remain closed for the public
Capital investments	Share of capital expenditures in the total expenditures	+/-	Bigger investments in capital projects mean long-term orientation of the management and a desire for greater transparency. On the other hand, in capital projects, the expenditures classified under “other types of expenditures” are dominant, which points out to possibilities for opportunism and corruptive deals.
Size of the institution	Logarithm of expenditures for basic salaries per capita	+	Larger LSGUs have the capacity to invest in transparency mechanisms.
Institutional (political) factors			
Political ideology	Two binary variables: 1 if the mayor comes from a right-wing party, 0 in all other circumstances; and 1 if the mayor comes from an independent list, 0 in all other circumstances (after the elections in 2017)	-	The literature review shows that left-wing parties have higher sensitivity to transparency (Sol, 2013).
Political competition	The Herfindahl-Hirschman Index calculated in line with the number of seats per party/coalition in the municipal council (after the elections in 2017)	-	The concentration of power at local level means lesser threat to the management and “freedom” to work irresponsibly and remain closed for the public.
Political accountability	Voter turnout percentage in the first round of local elections in 2017	+	Higher citizens’ interest in politics means higher demand for accountability and transparency
Environmental factors			
Size of the municipality (population)	Logarithm from the number of inhabitants	+	Bigger municipalities control bigger amounts of public funds, thus they are under bigger pressure to be careful with how they spend those funds.
Covid-19 impact	Percentage change in the revenues of the LSGUs in the Covid-19 crisis	+	The Covid-19 crisis undermined the capacities of the LSGUs and has a negative impact on their transparency
Gender of the mayor	Binary variable: 1 if the mayor is a man, 0 in all other circumstances	-	Women mayors are inclined towards higher transparency and they proactively engage citizens in the decision making by stimulating participation and communication (Stanic, 2018)

Data sources for the established variables include: the annual statements of the LSGUs; the budget proposals; the web-sites of the municipalities with published budgetary information for the period between 2009 and 2017; the State

Statistical Office and the State Election Commission. The budget variables refer to 2020. In order to estimate the coefficients of the model, we use two different statistical methods depending on the variable. Firstly, we regress the budget transparency

values to the given factors by applying a probit regression model. In addition, we regress the overall transparency values to the given factors by applying a beta regression model. The models are calculated with robust standard errors.

RESULTS

Table 2 summarises the impact of the factors on the budget transparency and on the overall transparency. Due to the existence of a potential issue of multiple correlations, we have also developed an additional model (Model 2) where we have excluded the Population variable.

Budget transparency is mainly determined by the institutional characteristics of the LSGUs, with more significant impact from the budget factors and a moderate impact from the political factors. However, for the overall transparency, the environmental factors are equally important.

Regarding the first group of institutional budget factors, the dependence on the central budget and the share of parafiscal charges in the overall revenues are significant only for the budget transparency, but not for the overall transparency, whereas

the size of the LSGU is significant for the overall transparency, but not for the budget transparency. Therefore, it can be noted that higher dependence on the central budget has a negative impact on the budget transparency. This outcome can be explained in two ways. Firstly, the funds received from the central budget are based on an established schedule of transfers which does not include transparency parameters, but is rather linked to other indicators, such as number of students, number of children in kindergartens, etc., hence, the motive for transparency of the LSGUs towards the local taxpayers is low. Secondly, LSGUs with higher dependence have higher probability of running into debts. The practice of supporting LSGUs to settle their debts creates a moral hazard and has an impact on the transparency. Namely, the share of parafiscal charges in the overall revenues has a negative impact on the budget transparency.

This outcome is in line with the theory of fiscal illusion where taxpayers are not able to perceive how the money they pay for different charges is being channelled; therefore, the LSGUs are motivated to remain non-transparent. This is also confirmed by the conclusion drawn from the data on parafiscal charges on local level, where the revenues collected from these charges are predominantly used as general expenditures. In addition, the municipalities with higher share of capital expenditure in their overall expenditure have lower budget transparency and lower overall transparency. Although, at first sight, such a result is unexpected, the share of the item “Other” in the overall capital expenditure is big, thus leaving leeway for financing activities prone to corruption, lack of productivity or absence of argumentation for the development component, despite being classified as capital expenditure.



On the other hand, the LSGUs with better realisation of the planned budget are, as expected, more transparent. Finally, the bigger LGSUs are generally less transparent; however, there is no difference between the big and small LSGUs in the context of budget transparency. This is down to the legal requirement for mandatory disclosure of the annual statements, which is one of the key indicators defining budget transparency.

Regarding the political factors, the political ideology (left- or right-wing) does not impact on whether the LSGU

will be more transparent or not. The most significant factor that has an impact on the budget transparency and on the overall transparency of the LSGUs is the political competition; however, the results are contrary to the expected. The LSGUs with more competitive distribution of the counsellor seats between several parties are less transparent. This outcome might be an indicator of the potential opportunism existing in the party/counsellor lists, which as soon as obtaining a small, but sufficient number of seats in the municipal council, make “irresponsible demands” knowing that the majority

depends on their votes. In addition, higher voter turnout at the local elections means more responsive citizens and it stimulates higher political accountability, which in turn leads to higher (overall) transparency. Finally, the environment also has an impact on the transparency of the LSGUs. The LSGUs with bigger population are more transparent due to the potentially higher pressure from the citizens, although this is not the case with the budget transparency. This could be explained by the fact that the budget transparency is determined by legal requirements for disclosure of budget information.

Table 2: Probit (budget transparency) and beta (overall transparency) regression models

Variables	Budget transparency		Overall transparency	
	Model 1	Model 2	Model 1	Model 2
Institutional (budget) factors				
Dependence on the central budget	-3,119 *	-3,149*	-0,411	-0,271
Share of parafiscal charges	-8,859†	-9,186**	0,631	1,996
Effectiveness	4,238***	4,214***	1,234**	1,296***
Capital investments	-3,470**	-3,401**	-1,062†	-1,255*
Size of the LSGUs	-0,222	-0,252	-0,264**	-0,150†
Institutional (political) factors				
Political ideology (right-wing)	0,456	0,445	-0,253	-0,217
Political ideology (other)	0,070	0,054	-0,208	-0,152
Political competition	7,929***	7,867***	1,291*	1,514**
Political accountability	-0,045	0,095	1,031†	0,529
Environmental factors				
Population	-0,028		0,107†	
Covid-19 impact	0,645	0,619	0,158	0,249
Gender of the mayor (man)	-0,157	-0,152	-0,100	-0,135
Observations	76	76	76	76
Chi-sq	18,95	18,95	40,83	37,44

***, **, * and † denote significance of the level of trust of 1%, 5%, 10% and 15%, respectively
Calculation of the authors

CONCLUSION AND RECOMMENDATIONS

Budget transparency is mainly determined by the institutional characteristics of the LSGUs, with more significant impact from the budget factors and a moderate impact from the political factors. However, for the overall transparency, the environmental factors are equally important. The LSGUs that have lower dependence on the central budget, smaller share of parafiscal charges in the total revenues, and smaller share of capital expenditures in the overall expenditures, have higher probability of having a higher budget transparency. On the other hand, an increased realisation of the planned amounts will increase the budget transparency and the overall transparency. Bigger LSGUs, as institutions, are generally less transparent; however, there is no difference between big and small LSGUs in the context of budget transparency. Nevertheless, the LSGUs with bigger population

are more transparent due to the potentially higher pressure from the citizens, although this is not the case with budget transparency. Regarding the political factors, the most significant factor that has an impact on the budget transparency and on the overall transparency of the municipalities is the political competition, as higher competition in the municipal councils reduces transparency.

Therefore, in order to increase the budget transparency and the overall transparency of the LSGUs, we give the following recommendations:

- The LSGUs should disclose the budget information and other information required by law;
- The Plans and the Annual Statements on the Budgets should be available for a longer time range, and not only for the last few years;
- Data related to parafiscal charges (who, when, how much, and how is being paid) should be transparent and available to the taxpayers, whereas the allocation of collected revenues into earmarked expenditures should be maximised;
- The capital expenditures should be used for development projects, and the non-productive costs (such as procurement of passenger vehicles and furniture) classified as capital expenditure should be reduced to minimum. At the same time, the transparency of the item “Other capital expenditures” (other construction activities) should increase;
- The practice of writing off debts or providing funds from the central budget for the repayment of debts arising from non-productive costs should be abandoned;



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FISCAL Network:

Enhancing dialogue for higher municipal financial transparency, with focus on parafiscal charges



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