

FISCAL DECENTRALIZATION AND MUNICIPAL SERVICE DELIVERY: EVIDENCE FROM NORTH MACEDONIAN MUNICIPALITIES

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Abstract The impact of decentralization on municipal service delivery has is an area of growing interest, yet existing research remains limited and predominantly based on macro-level evidence. This paper contributes to the literature by examining the relationship between fiscal decentralization and municipal service delivery using a representative panel dataset of municipalities in the Republic of North Macedonia for the period 2015–2024. The econometric results indicate that fiscal decentralization, measured through the share of municipalities' own-source revenues as an indicator of local fiscal autonomy, has a statistically significant positive effect on service delivery. However, the findings also reveal that inadequately managed operating expenditures can constrain future improvements in service efficiency. Moreover, greater financial independence, lower operating costs, and a controlled level of intergovernmental transfers enhance municipalities' capacity to invest in long-term profitable projects. The results have important policy implications, particularly regarding the need to strengthen local revenue mobilization. The paper's main contribution lies in its focus on service delivery efficiency rather than political outcomes, which have dominated prior studies.

Keywords: fiscal decentralization, municipal service delivery, public finance, North Macedonia

1 Introduction

The process of decentralization represents the transfer of governmental responsibilities, authority and fiscal autonomy from the central government to the local government (Saini, 2025). Depending on the degree and type of transfer, decentralization can be classified as administrative, fiscal or political (OECD,2023). Political decentralization refers to granting greater decision-making power to citizens at the local level and to their elected representatives (Sujarwoto, 2023). Its goal is to strengthen democracy by enabling citizens and local representatives to participate more actively in the formulation and implementation of policies at the local level. It is widely believed that decisions on local issues made by the local population are of higher quality and more effective than those made at the central level (Kyriacou & Roca-Sagalés, 2011). Administrative decentralization, on the other hand, encompasses the transfer of operational responsibility for planning, financing, and managing public functions to the local level. Fiscal decentralization is the most comprehensive and certainly the most visible form of decentralization, as it is directly related to the relocation of resources from the central to the local level of government. For decentralization to be implemented effectively, according to Otoo and Danquah (2021), local governments must have an adequate level of revenues, whether collected locally or transferred from the central level, as well as the authority to make decisions on local expenditures (Cvetanovska Gugoska,2024). In doing so, several factors are taken into account, such as regional equality, resource availability, and the fiscal management capacity of the local government.

Over the past few decades, more than 75 countries have initiated fiscal decentralization reforms, although the underlying motives are different (Sanogo, 2019; Sow & Razafimahefa, 2015). In many countries around the world, fiscal decentralization has been introduced in order to increase transparency, strengthen citizen participation, and improve public spending (Shah, 2007). In another group of countries, decentralization emerge as a response to uneven municipal development, with the aim of stimulating the financing of poorer municipalities. In the countries of Eastern Europe and the former Soviet states, decentralization is an inevitable part of the process of transition to a market economy and democratization (World Bank, 2004). Last but not least, accession to the European Union requires fiscal decentralization as a prerequisite for compliance with European standards. Although the motives are diverse and

vary depending on the historical, economic and political development of a country, improving public municipal services remains as an implicit goal of most decentralization efforts.

Regardless of the specific motives, the process of fiscal decentralization must address the following fiscal challenges. First, expenditure responsibilities must be appropriately assigned to the local level as they have a direct impact on the delivery of public services, particularly in cases where there is an overlap between expenditure and financing responsibilities. Second, to establish a solid base of own sources of financing by granting municipalities the authority to collect local taxes, fees and charges (Saini, 2025). In this way, municipalities will be incentivized to strive for more efficient service delivery using their own sources of financing rather than relying on transfers or bailouts from higher levels of government which may weaken budget constraints. Some countries have gone a step further by considering the possibility of introducing a so-called dual taxation system, central and local, allowing municipalities to set local tax rates and broaden the tax base. Third, an efficient system of intergovernmental transfers must be implemented, especially in cases where municipalities' own tax sources are insufficient for timely fulfillment and delivery of public services. Finally, the principles of rational budgeting and continuous monitoring of operational and capital expenditures are essential. Municipalities must invest in capital projects that generate future financial benefits, while at the same time rationalizing operating costs, particularly in periods of financial unpredictability and instability.

Decentralization in the Republic of North Macedonia, as a process that began with the adoption of the Law on Local Self-Government (2002) and its implementation in 2005, has had a significant impact on the functioning of municipalities. Nevertheless, the effects of decentralization in solving municipal problems and improving the quality of public services have been mixed and appear to depend on several factors (Ministry of Finance of the Republic of North Macedonia). In the RSM, the economic benefits of fiscal decentralization cannot be expected to be the same as in more developed economies; therefore, fiscal decentralization should be carefully calibrated and designed to take into account the specific structural and institutional specificities of the RSM.

In light of all previously mentioned, the main objective of this research is to address the following question: Has fiscal decentralization improved service delivery and fiscal discipline at the local level in the Republic of North Macedonia? To achieve this objective, the study examines the relationship between local fiscal structure and municipal capital investments using a mixed-effects model for the period 2015-2024.

This paper represents one of the first attempts to deepen the understanding of fiscal decentralization and its relationship with municipal service delivery using a representative sample of municipal-level data.

The contribution of this paper is further reflected in its explicit focus on the relationship between fiscal decentralization and the efficiency of public service delivery, rather than on political outcomes, which have been more commonly examined in previous research.

2 Literature overview

The quiet revolution known as fiscal decentralization is increasingly taking hold in countries around the world (Broadway & Shah, 2009). However, the reforms implemented within the decentralization process have generated mixed perceptions among the general public. This is largely because it is accepted that decentralization simultaneously solve many issues, such as a dysfunctional public sector, limited citizen participation and greater inefficiencies in the delivery of public services. At the same time, however, it may also give raise to a number of challenges in terms of macroeconomic management, particularly in a presence of weak fiscal discipline and corrupt behavior at the local government level. (Ivanyna & Shah, 2010).

According to the IMF (2016), fiscal decentralization can improve the delivery of public services only if certain criteria are met. One of the key requirements is the implementation of adequate expenditure decentralization accompanied by an increase in municipalities' own revenues. When this condition is not fulfilled, fiscal decentralization may, in some cases, have a negative impact on the quality of public services.

Consistent with this view are the findings from a research based on budgetary data for all 216 municipalities in Ghana. Otoo and Danquah (2021), conducted one of the first studies to analyze the impact of the degree of fiscal decentralization on the quality of municipal public service delivery. Their results show that greater financial autonomy, measured by the share of own revenues, contributes to more efficient municipal performance. In contrast, the results also indicate that transfers from higher levels of government do not contribute to improved service delivery. Moreover, fiscal decentralization has been shown to strengthen local government autonomy and to have a positive impact on the growth of property tax revenues, which indirectly improves the quality of public service delivery. (Bird & Slack, 2004; Slack, 2013; Affroumou, 2025)

Cross-country analysis further emphasize the importance of fiscal decentralization in shaping the quality of local service delivery. Studies covering a broad range of developed, developing and emerging economies demonstrates that decentralization of municipal expenditures needs to exceed an indicative threshold of more than 35% in order to contribute to improved public service delivery (Sow & Razafimahefa, 2015; Boex et al., 2015; Baskaran et al., 2016), corroborating the results reported by OECD (2019). These findings are further complemented by recent research showing that the greater the ability of local governments to adapt decentralization, the greater the potential for investment in capital projects that support future municipal economic growth can be. This also could be used it to their advantage by responding to local preferences and fostering innovative public service provision. (Brahimi et al., 2025).

Fiscal decentralization in the Republic of North Macedonia

The process of fiscal decentralization in Republic of North Macedonia began on July 1, 2005, following a series of amendments to key financing-related laws, such as: the Law on Property Taxes (2004), the Law on Communal Fees (2004), and the Law on Administrative Fees (1993/2011). During the first phase of fiscal decentralization, certain competencies were transferred to municipalities, however the financing of these competencies was largely carried out through transfers from the central government rather than through municipalities' own revenues.

The second phase of fiscal decentralization started on July 1, 2007, and applied only to those municipalities that fulfilled specific eligible criteria. These criteria referred to adequate staffing of municipalities and strengthening financial capacity, after which municipalities gained responsibilities in the areas of culture, social protection, primary and secondary education, and primary health care.

In the Republic of North Macedonia, there are a total of 80 municipalities, including the City of Skopje as a separate unit of local self-government (Law on the Territorial Organization of Local Self-Government in the Republic of Macedonia, 2004). The local government structure is dominated by urban municipalities (46), compared to 34 rural municipalities, according to the national municipal classification, reflecting a territorial organization characterized by significant differences in demographic and economic potential (IPARD, 2016). Urban municipalities generally have higher population density, a more developed economic structure, and a stronger tax base, which enables them to generate higher own-source revenues, particularly from property taxes, local fees, and charges. In contrast, rural municipalities are characterized by low population density, limited economic activity,

weak revenue-generating capacity, and a high level of dependence on transfers from the central budget. These structural differences create pronounced fiscal and developmental disparities among municipalities, which further complicate the effective implementation of fiscal decentralization and increase the need for carefully designed equalization mechanisms and targeted financial support (Cvetanovska Gugoska, 2024; Gruevski & Gaber, 2023; CEA, 2024). For nearly two decades, fiscal decentralization in Republic of North Macedonia has been presented as a key reform for strengthening local self-government and bringing public services closer to citizens. Nevertheless, reality depicts a different picture. The majority of municipalities remain heavily dependent on transfers from the central budget (Mazllami, 2021). Their own-sources of revenues, property taxes, local fees and charges, are insufficient and in many cases not even fully administered, while some local governments face huge amounts of debts that further limits their financial independence.

This financial dependence implies that many strategic municipal decisions are conditioned by the central government, rather than being shaped according to local needs and priorities. As a result, uneven development among municipalities persist, accompanied by deficiency in the quality of public services, especially in smaller and economically weaker municipalities. Insufficient accountability also remains significant challenge, as inadequate transparency in public spending, reduces citizens' thrust in local authorities. Furthermore, there is often a mismatch between assigned competencies and available resources, which leads to transferred obligations but lack of sufficient funds to fulfill them. This results in a prioritizing political projects over strategic long-term investments that could bring sustainable local development. For fiscal decentralization to evolve into an effective tool for true local development, targeted measures are required, such as strengthening own-source revenues, increased accountability for public spending, equity in the distribution of financial resources and promoting complete depoliticization of local self-government.

Relationship between fiscal decentralization, own source revenues, unconditional transfers, capital public investment and municipal operating expenses

Substantial number of studies link the volume of municipal capital investments within the decentralization process to the method of revenue distribution from the central government, the amount of the municipality's own revenues, the level of operating expenses and the rate of economic growth (Järnberg & Värja, 2023).

Municipal own revenues represent a key driver for financing development and public services, particularly through capital investments (IMF, 2017).

Empirical evidences constantly show that greater the share of own revenues of municipalities, the greater the volume of capital expenditures that provide additional revenues will be. This further supports the quality of public service delivery (Andini et al., 2022). We expect the following:

H1: An increase in own source revenues has a positive impact on capital expenditures leading to improved municipal service delivery.

On the other hand, the results of other studies indicate that the increased budgeting of operating expenses, which is imposed as an inevitable part of the fiscal decentralization process, negatively affects the amount of municipal capital expenditures (Lhutfi et al., 2020). Thus, we expect the following:

H2: Increase in operating expenses reduces the level of capital investments, thereby hindering improvement in municipal service delivery.

In addition to their own sources of funding, municipalities also finance their activities through unconditional and targeted transfers from higher levels of government. Such

additional financing plays a significant role, especially in the financing of local infrastructure (Local Public Sector Alliance & World Bank, 2023). Thus, we expect the following:

H3: Transfers from higher levels of government have a significant impact on municipal capital expenditures.

3 Research

The empirical analysis was conducted using panel data from 16 municipalities in North Macedonia covering the period 2015–2024, yielding a total of 160 observations. The data include information on key fiscal indicators related to municipal finance, namely capital expenditures, own revenue share, intergovernmental transfers, and operative expenditures.

Dependent variable (Y):

Capital Expenditures – representing the share of municipal spending dedicated to long-term investments in infrastructure, public facilities, and development projects.

Independent variables (X):

Own Revenue Share – ratio of own-source revenues (local taxes, fees, and charges) to total municipal revenues, reflecting fiscal autonomy.

Transfers – share of intergovernmental fiscal transfers received from the central government.

Operative Expenditures – share of current and administrative expenditures in total spending, reflecting routine service and maintenance costs.

The data were cleaned and verified for completeness; no missing observations were recorded across variables.

To examine the relationship between local fiscal structure and capital investment, two linear mixed-effects model was estimated using XLSTAT. The mixed model approach allows for both fixed effects (shared across all municipalities) and random effects (within-municipality variation across time), thus accounting for the repeated measures structure of the panel dataset.

The general form of the model is expressed as:

$CapitalExp_{it} = \beta_0 + \beta_1(OwnRevenueShare_{it}) + \beta_2(Transfers_{it}) + \beta_3(OperativeExp_{it}) + u_i + \epsilon_{it}$
where:

- i indexes the municipality ($i=1,2,\dots,16$ $i = 1, 2, \dots, 16$),
- t indexes time (year 2015–2024),
- u_i represents unobserved municipality-specific effects, and
- ϵ_{it} denotes the idiosyncratic error term.

A compound symmetry covariance structure was specified, assuming constant correlation within repeated measures for each municipality. The confidence level was set at **95%**, and parameters were estimated using the restricted maximum likelihood (REML) procedure. This data structure implies the presence of intra-subject correlation, making mixed models more appropriate than ordinary least squares (OLS) regression, which assumes independence of observations.

This baseline model (Model 1-random effect) included only a fixed intercept and a random repeated factor accounting for within-subject dependence. It serves as a benchmark for assessing how much variance is explained solely by subject-level heterogeneity.

This extended model (Model 2-fixed effect) incorporated three fixed effects representing potential explanatory variables (independent variables) for capital expenditures (dependent variable). The repeated factor structure was retained to ensure comparability with the intercept-only model.

All models were estimated using restricted maximum likelihood (REML), which provides unbiased estimates of variance components in mixed models. Table 1 presents the

goodness-of-fit statistics for both the intercept-only model (random effect)) and the full model containing three fixed predictors (Model 2-fixed effect). Substantial improvements are observed across all information criteria when predictors are introduced.

Table 1. Model Fit Comparison

Statistic	Model 1	Model 2	Better Model
-2 Res Log Likelihood	-39.689	-198.202	Model 2
AIC	-35.689	-194.202	Model 2
AICc	-35.613	-194.126	Model 2
BIC	-29.539	-188.052	Model 2
CAIC	-27.539	-186.052	Model 2

Across all measures, Model 2 demonstrates clear superiority, with substantially lower (more negative) AIC, AICc, BIC, and CAIC values. These differences far exceed the conventional interpretive thresholds ($\Delta AIC > 10$ indicates decisive evidence), indicating that the inclusion of the explanatory variables produces a considerably better-fitting model.

In addition to the information criteria, a nested-model likelihood ratio test was conducted. The LR statistic is computed as follows:

$$LR = (-2LL_{Model 1}) - (-2LL_{Model 2}) = (-39.689) - (-198.202) = 158.513$$

The degrees of freedom correspond to the difference in the number of fixed effects:

$$df = 3 - 0 = 3$$

The resulting chi-square statistic of 158.51 ($df = 3$) yields $p < 0.0001$, indicating that Model 2 provides a significantly better fit than Model 1.

Model 1 yielded a subject-level variance of 0.044, which decreased to 0.016 in Model 2. This reduction indicates that the inclusion of predictors explains a considerable portion of the between-subject heterogeneity. The residual variance (σ) remained close to zero in both models, consistent with minimal unexplained within-subject noise.

Overall, the results provide strong evidence that Model 2 outperforms Model 1. The improvement is both statistically significant and substantively meaningful. Therefore, Model 2 is retained as the preferred specification for interpreting the effects of the predictors on capital expenditures.

The model showed excellent overall fit, as indicated by the Akaike Information Criterion ($AIC = -194.202$), Schwarz Bayesian Criterion ($SBC = -188.052$), and -2 Restricted Log-Likelihood (-198.202). These values suggest that the mixed model adequately captures the variance structure of the data with minimal overfitting.

The estimated variance of the repeated factor was low (0.016), while the within-group covariance ($\Sigma = 0.000$) indicated limited correlation between time-series observations for individual municipalities.

The Type I, II, and III tests of fixed effects revealed that two independent variables were statistically significant determinants of municipal capital expenditures: Own Revenue Share and Operative Expenditures (Table 2). Intergovernmental Transfers, on the other hand, did not exhibit a statistically significant effect.

Table 2. Determinants of municipal capital expenditures: Mixed-model results

Effect	F-statistic	p-value	Significance
Own Revenue Share	22.692	<0.0001	Significant
Transfers	—	—	Not significant

Operative Expenditures	261.823	<0.0001	Significant
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Table 3. Estimated effects of independent variables on municipal capital expenditures

Variable	Coefficient	Std. Error	t-value	p-value	95% CI
Intercept	-0.541	—	—	<0.0001	—
Own Revenue Share	+1.520	—	—	<0.0001	—
Transfers	+1.173	—	—	n.s.	—
Operative Expenditures	-0.696	0.043	-16.18	<0.0001	[-0.781, -0.611]

4 Discussion

The coefficient of Own Revenue Share, presented in Table 3, ($\beta_1 = 1.520$, $p < 0.0001$) indicates that municipalities with a higher proportion of own-source revenues allocate significantly more resources to capital investments. Based on the obtained results and their high statistical significance, Hypothesis H1: “An increase in own-source revenues has a positive impact on capital expenditures, leading to improved municipal service delivery” is accepted. This confirms that strengthening the local revenue base represents a key prerequisite for increased investment activity and for improving the quality and availability of public services at the municipal level (IMF, 2016; IMF, 2017; Boadway & Shah, 2009; OECD, 2019). This result implies that municipalities which generate a larger share of their revenues from own sources, such as property taxes, communal fees, and local charges, allocate significantly more resources to capital projects compared to municipalities that rely more heavily on transfers from the central government (Bird & Slack, 2004; Slack, 2013; Affroumou, 2025). Own-source revenues provide greater predictability and stability in financing, which is particularly important for capital investments that are typically multi-year in nature and require continuous funding (Bird & Slack, 2004; OECD, 2019). As a result, municipalities with a low share of own revenues often postpone or completely abandon capital projects, especially in periods of fiscal uncertainty.

Furthermore, a higher share of own-source revenues can also be interpreted as an indicator of more developed administrative capacity and more efficient local governance (Kyriacou & Roca-Sagalés, 2011; IMF, 2016). Municipalities that successfully collect local taxes and fees usually have better organized financial departments, a higher level of fiscal discipline, and greater accountability to citizens. This creates a favorable institutional environment for the planning and implementation of capital projects aimed at improving local infrastructure, public services, and overall quality of life.

In the context of the Republic of North Macedonia, this relationship is particularly pronounced due to the limited fiscal space of most municipalities and their high dependence on central government transfers. Municipalities that manage to generate higher own-source revenues, primarily through property taxes, communal fees, and local charges, are those that demonstrate greater financial autonomy and a stronger capacity to initiate and implement capital projects (Mazllami, 2021; Cvetanovska Gugoska, 2024).. Given that a significant number of municipalities face structural constraints, weak tax bases, and challenges in revenue collection, the ability to mobilize own revenues becomes a critical determinant of investment activity. In such an environment, municipalities with stronger local revenue bases are better positioned to invest in roads, water supply systems, kindergartens, schools, and communal infrastructure, while municipalities with limited own revenues remain largely constrained to covering basic operational needs. This further reinforces the importance of strengthening local revenue mobilization as a key policy priority for enhancing municipal investment capacity and improving public service delivery in North Macedonia.

This finding is consistent with the results of numerous empirical studies showing that fiscal decentralization and increased fiscal autonomy of local governments have a positive effect on public investment and service delivery. Research conducted in developing countries as well as in transition economies indicates that municipalities with stronger fiscal capacity and a higher share of own revenues have better access to infrastructure investments and provide local services more efficiently. In the context of transition economies, this result is particularly important, as it suggests that formal decentralization alone is not sufficient to stimulate local development. A key role is played by effective fiscal autonomy, that is, the ability of municipalities to actually generate and manage their own revenues. Only under such conditions can local governments design sustainable investment policies and implement capital projects that have long-term developmental effects (Otoo & Danquah, 2021; Bird & Slack, 2004; Affroumou, 2025; IMF, 2016).

Conversely, Operative Expenditures exhibit a strong negative association ($\beta_3 = -0.696$, $p < 0.0001$) with capital expenditures (Table 3). This suggests a crowding-out effect, where higher current spending on operations and administration reduces the fiscal space available for capital investments (IMF, 2016; IMF, 2017). This result implies that municipalities which allocate a larger share of their budgets to operational functioning have limited resources available for financing infrastructure projects and development investments, which has negative consequences for long-term local development (Lhutfi et al., 2020; Boex et al., 2015). This finding is consistent with the theory of “soft budget constraints,” according to which local authorities facing high pressure from current expenditures and expecting support from the central government lack sufficient incentives to rationalize costs and invest in productive capital projects (Ivanyna & Shah, 2010; World Bank, 2004). Instead, priority is often given to short-term political and social obligations at the expense of strategic investments that have the potential to improve the efficiency of public services and the quality of life of citizens.

Empirical research in the field of public finance indicates that excessive growth in current expenditures is associated with lower levels of public investment and weaker infrastructure quality, particularly at the local level. Studies conducted in transition and developing countries show that municipalities with high administrative costs and inefficient expenditure structures have limited capacity to implement capital projects and improve public services (Lhutfi et al., 2020; Järnberg & Värja, 2023). In the context of the Republic of North Macedonia, this result is particularly relevant, given the high rigidity of municipal budgets and the significant share of wages and current expenditures in total spending (Mazllami, 2021; Cvetanovska Gugoska, 2024). Under such conditions, any additional increase in operating expenditures directly reduces the ability to invest in roads, water supply and sewage networks, schools, kindergartens, and other public facilities that are essential for improving municipal service provision. Therefore, the obtained negative coefficient clearly confirms that an increase in operating expenditures represents a serious constraint on municipal investment activity and directly hinders the improvement of public services. Based on these results, Hypothesis H2: “An increase in operating expenditures reduces the level of capital investments, thereby hindering the improvement of municipal service delivery” **is accepted.**

The coefficient of Transfers ($\beta_2 = 1.173$), presented in table 3, was positive but statistically insignificant, implying that intergovernmental transfers may not effectively stimulate capital formation at the municipal level—possibly due to their conditional or earmarked nature. One of the main reasons for this outcome lies in the structure and purpose of intergovernmental transfers. In most cases, transfers are conditional, earmarked, or legally tied to current functions such as wages in education, social protection, or the maintenance of

basic services (World Bank, 2004; Local Public Sector Alliance & World Bank, 2023). Under such circumstances, municipalities have no real discretion to redirect these funds toward capital projects, even when there is a clear need for infrastructure investment. Rather than functioning as a development instrument, transfers often serve as a mechanism for covering current obligations and stabilizing budget balances.

In addition, reliance on transfers may weaken incentives for independent investment initiatives. When municipalities depend heavily on resources from the central budget, they tend to adjust their budgetary policies toward securing funding for current expenditures rather than planning long-term development projects (Sow & Razafimahefa, 2015; Boex et al., 2015; OECD, 2019). This leads to a situation in which transfers indirectly reinforce a focus on operational functioning instead of stimulating capital investment.

This finding is consistent with numerous empirical studies showing that general, non-targeted transfers have a weak or unstable effect on public investment and, in some cases, even crowd out local investment effort. Research in developing and transition economies indicates that transfers are often used to cover current expenditures and social obligations rather than capital projects, particularly when local authorities face pressure to ensure short-term social stability (Otoo & Danquah, 2021; Sow & Razafimahefa, 2015).

In the context of the Republic of North Macedonia, this result is expected, given the high dependence of municipalities on block grants and earmarked transfers, especially in the sectors of education, culture, and social protection. These funds are strictly designated and cannot be used for infrastructure investment, which means that despite their volume, they do not directly contribute to increasing capital expenditures. As a consequence, transfers play a limited role in stimulating local development and do not generate a sufficient investment impulse at the municipal level (Mazllami, 2021; Cvetanovska Gugoska, 2024).

Therefore, the statistically insignificant result clearly indicates that transfers from higher levels of government do not represent a key driver of capital investment at the local level. Based on these findings, Hypothesis H3: "Transfers from higher levels of government have a significant impact on municipal capital expenditures" **is rejected**.

The results align with findings from fiscal decentralization and local finance literature, which emphasize that greater financial independence enhances municipalities' ability to invest in long-term infrastructure and services. The insignificance of transfers supports the argument that central government funding often lacks performance-based incentives or flexibility to stimulate local development. Moreover, the negative impact of operative expenditures confirms that municipalities facing high administrative or recurrent costs tend to prioritize short-term operational needs over capital projects. This trade-off represents a structural challenge for sustainable local development and efficient public investment management.

5 Conclusions

Large number of countries dissatisfied with the centralized approach to public service delivery are looking for solutions through the decentralization of responsibilities to local levels of government. Correct and balanced application of fiscal decentralization can lead to economic growth and achievement of economic goals that generate tangible economic benefits. At the same time, fiscal decentralization is significant because it allows lower levels of government to independently determine their expenditures and revenues,

The results indicate a positive relationship between fiscal decentralization and municipal own source revenues. This confirms the important role of lower levels of government, which are established to improve the citizens' quality of life by deciding on the provision of local public services close to the place of delivery and to service users. Improved education, social and health services and infrastructure, contributes positively to the

municipal economic growth. Conversely, the negative impact of the transfer from higher levels of government confirms the view that local units must possess greater autonomy over “own” tax revenues and the ability to decide on the level of tax rates in order to be able to deliver public services efficiently. These findings highlight the need for strengthening the local financial authority in revenue collection in order for gradual decreases in funding through transfers. The negative correlation between municipal operating and capital expenditures points to the need for closer coordination between operating and capital budgeting cycles, especially in cases where capital investments have clear and unambiguous positive implications for future service improvements.

Fiscal decentralization in North Macedonia can become a true driver of local development and democratic processes, but only if it is freed from political considerations and supported by a real financial and institutional framework. Municipalities must be encouraged to operate independently and responsibly, rather than relying on the transfers from the higher levels of government as a primary source of financing.

Improving the municipal revenue side inevitably requires strengthening own sources of revenues through timely and regular collection of property taxes and local fees, as well as through the development of public-private partnerships for completing capital projects. In addition, financial incentives should be provided for municipalities that are responsible and transparent in public funds. Successful administration and collection of own revenues would ensure more financially independent local self-government units.

Such fiscal autonomy would expand the scope of local activities and provide additional resources for financing existing public services. At the same time, it would create the necessary preconditions for accelerated economic development and growth of the local level.

Further progress also requires deeper cooperation between municipalities, the central government and other stakeholders particularly in the development of municipal economic zones and attracting investments, as well as in providing additional financial and institutional support to enterprises.

Improving the quality of primary and secondary education is equally important, as it directly accelerates the socio-economic development of local self-government units. Addressing this challenge is closely related to the efforts to promote inclusive education, interculturalism, and building of a modern, democratic, and pluralistic society in the Republic of North Macedonia.

Finally, future research should focus on improving the system of financing and strengthening the fiscal autonomy of local self-government units in the Republic of North Macedonia, in order to further enhance the impact of fiscal decentralization on economic growth and promote more balanced regional development.

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