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**CENTRALIZED AND DECENTRALIZED APPROACH TO
ECONOMIC DEVELOPMENT POLICY WITH PARTICULAR
EMPHASIS ON THE REPUBLIC OF MACEDONIA**

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***Abstract:** The possible more central or more decentral arrangements of development economic policy are located between two polar cases: at one pole, we have an arrangement where only the central level of government is responsible for overall economic development policy and at the other pole, neither any subcentral unit of government, which are to be supported to have any serious influence for creating effective subcentral economic policy using relevant own instruments to achieve the given goal. The paper is evaluating the consequences of a decentralization vs. centralization in the field of development economic policy so, in the sense that the current allocation of jurisdiction is changed in the direction of decentral arrangement. Special considerations in this approach are manifested in R. Macedonia as a small and developing economy with relatively high centralized economy which opens the process of economic decentralization.*

***Keywords:** development policy, centralization, decentralization.*

1. Introduction

The public economic literature of the past century is characterized by a traditional paradigm that ascribes little attention to the spatial dimension. This limitation is reflective of the difficulty arising from the integration of territory-specific factors into a higher level of abstraction required by marginal calculus. However, contemporary globalization requires that researchers and economists expand their perspectives to consider space conceptualization. What is required in the 21st century is a richer and more realistic framework that broadens existing concepts of socio-economic analysis while overcoming narrow national borders. Although national governments will remain prominent performers

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in the global market, regional and local governments cannot be ignored because citizens worldwide are exerting greater self-determination in influencing government decisions. Most democracies today have sub-national governments, and countries worldwide are providing political, fiscal, and administrative powers to sub-national tiers of government. Unfortunately, sometimes decentralization is implemented haphazardly, resulting in central decision makers losing control of the decentralization process. In particular, local frameworks are often ignored when models of decentralization from other countries are adopted without any modification.

Theoretically speaking, globalization can enhance diversity of local policy preferences¹ while simultaneously reducing the benefits of being part of a larger political union. In other words, on one hand we should expect demands for decentralization to increase while on the other hand opposition to decentralization is also likely to increase. This theory is supported by market literature that examines international investors' preferences for more political decentralization as horizontal competition among regions² increases. Salmon (1998) addressed the unrealistic descriptions of competition models in economics and pointed out that "This by no means excludes, at a different level of abstraction or generality, the detailed examination of an almost infinite variety of interactions, not all of them competitive. For Breton, it is clear that the same approach or strategy should be adopted to study government" (p. 125).

A large part of literature focuses on the positive effects of both vertical and horizontal competition among governments while some experts consider the decline in government power which results from increasingly footloose tax base. The expected results³ have spread across countries along different spectrums and with varying levels of development. Some empirical evidence underscores the need to create appropriate conditions for achieving the objectives of fiscal decentralization.

Conversely, Garrett and Rodden (2000) emphasized the fact that many regions increase their demand for fiscal centralization in order to obtain a stronger central government that can protect them against sudden economic downturns and cover their needs through fiscal transfers. Therefore, market integration seemingly generates incentives for both centralization and decentralization within the same socio-economic systems. Yet a country's particular political institutions must be considered when fiscal centralization is being implemented in response to trade integration (Garret and Rodden as cited in Deeg, 2001).

This dichotomous generation of incentives for both centralization and decentralization within the same system indicates that even if resource allocation and linked benefits of a decentralized government are unquestioned (Tanzi 1996), the multiplicity of

¹ For a detailed analysis on how global economic integration increases regional diversity, see Deeg (2001), p. 51.

² Deeg (2001) clearly highlights that "Investors would then expect higher levels of subsidies for their investment, whether through direct cash transfers, lower taxes, wage suppression, or other market friendly policies".

³ Such as to enable efficient allocation of resources, improve governance, accelerate economic growth, reduce poverty, achieve a gender balance and empower weaker sections of society.

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government functions raises substantial problems for macroeconomic control at the national level. Therefore, it seems “that the actions of decision-makers in the real economic world should be studied ... in the light of the capacity of the human mind to frame problems, and to represent reality in innovative ways, in an endeavor to reduce their uncertainty and ignorance” (Egidi and Marengo, 2002: 11). In this scenario, new disciplines could help to investigate “the classic yet still unresolved questions of human creativity ... and their relationship with the evolution of institutions” ensuring the migration from the conventional systems to adaptive complex systems (Egidi and Marengo, 2002: 11).

The ultimate goal of this research is to help local and central authorities in the country to improve the system for financing local government. Given that the process of decentralization needs to improve the quality of life in the country, it is no sustainable financial system, which will monitor the responsibilities of local government in the country.

Special focus is given on investigating the possibility critical review and analyzing the evolution of fiscal processes and evaluating the usefulness of new optimizing procedures for the governance of decentralization particular in the Republic of Macedonia. The first section of this paper explores positive and normative issues related to centralization and decentralization in the country as well as the fundamental role of increased interdependence in power sharing among jurisdictions. In the second section are giving some critical remarks and suggestions so far been done in this area.

Finally, this paper concludes with an exploration of how a form of intermediate coordination between fully centralized and fully decentralized systems could provide the best outcome. Such an intermediate form of coordination applied to a framework with several agents (each of which has exclusive control over more than one but less than all elements), seems to be the best solution for fully decentralized decision processes that are a hindrance in cases of congruent jurisdictions or cases involving strong interdependencies.

This paper is made by the common categorization of major pillars of the process of fiscal decentralization:

- Transfer of jurisdiction;
- Structure of revenues;
- Intergovernmental transfers;
- Issues related to financial management.

Each section deals with the conceptual principles that should be taken consideration when we look at this issue, together with the assessment of the current condition.

2. Centralization and Decentralization in a Globalized Framework

The issues related to centralized and decentralized systems in economic production have long been debated in economics literature. First, Coase pointed out how economic agents incur an unseen cost when they rely on decentralized markets; Hayek then argued that “decentralized systems have information processing advantages since economic agents acting on local information could process more information than a central coordinator” (as cited in Williams, 2000: 1).

2.1 Centralization

Economic integration seems to increase the credibility of secession threats in countries with high levels of income inequality between regions. In this case, it may well be possible to forestall secession by instituting a decentralization program, which allows local governments' greater freedom over local schools and cultural institutions. Such devolution need not translate, however, into a shift of fiscal resources into the hands of local governments. Therefore, even if fiscal federalism could increase economic competition among regions and it is likely to justify smaller governments, the more integrated economies are exacerbating the demands for governmental redistribution of wealth and powerful regions pushing across centralized systems of taxing and spending, rather than decentralized ones.

Following the economic logic of fiscal decentralization and with the political logic of centralization, Garrett and Rodden (2000) empirically showed that globalization increases demand for fiscal centralization. In their study of 60 countries from 1978- 1997, Garret and Rodden concluded: globalization may have made [centralization] possible for smaller political units to break away from larger extant nations. But it has also empowered regions that choose to stay within countries to push for fiscal arrangements that better mitigate market risk for citizens within their borders. And it is centralized systems that achieve this objective. Finally, these authors show that the vertical organization of the public sector is much more than an efficient institutional response to shifting demands of voters and investors (2000: 21). In fact, these agents perceive that globalization strictly increases the volatility and aggregate economic risk therefore they look for a national insurance schemes which can only be handled by central government that, having tax authority and power for geographical distribution of expenditures, ensures that this scheme should work through pro-cyclical subnational spending.

More, the globalization process increases also the aggregate social utility of automatic interregional tax-transfer insurance schemes. An additional consequence of economic integration, as suggested by Krugman (1991), is the regional specialization that increases the vulnerable export-oriented jurisdictions, referred to as "export clusters," with relatively undiversified economies. Obviously this fiscal centralization logic holds in countries where regional business cycles are not highly correlated; therefore, these issues seem most plausible in large and diverse nationstates.

These contrasts suggest that important issues linking globalization and the movement of authority between different levels of government remain not only unresolved but are also increased by the cross-border activities which give rise to struggles among different jurisdictions at the lower level. These struggles lead to strong interdependence and cause crises of the traditional modes of operation.

2.2 Decentralization

The traditional framework for fiscal decentralization is drawn from the contributions of Stigler, Musgrave, Buchanan and Oates. The classic argument in favor of decentralization is that local governments are more efficient and responsive to the needs of citizens as well as being held to a higher level of accountability than national government structures. In spatial considerations, subnational governments become a necessary conduit for setting up an efficient solution for equating benefits and cost. Yet new perspectives on

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economic integration and the vertical distribution of governmental authority reveal a basic trade-off between the benefits of large jurisdictions and the costs of heterogeneity in large populations (Alesina and Spolaore, 1997; Alesina and Wacziarg, 1998). Benefits seem to be derived from the availability of more efficient forms of taxation, common defense, free trade within the country, economies of scale, and the decreasing per capita costs of non-rival public goods; however, these benefits must be compared to the costs of satisfying people with heterogeneous preferences and income levels across regions. The costs and benefits of maintaining a large jurisdiction thus affect the demands for secession, in accordance with the number and size of nations. As in the Musgrave-Oates formulation, sufficiently high levels of heterogeneity generate demands for decentralization or even secession. Many countries stopped this secede demand, opting instead for a fiscal decentralization scheme (Alesina and Spolaore 1997). In fact, “any benefits of decentralization that might be obtained in a world with several nations may also be achieved within a unified nation by replicating the administrative structure of the world with several nations and implementing a suitable degree of decentralization of authority among the regions” (Bolton and Roland, 1997: 1057-58).

The Leviathan monolithic government hypothesis (Brennan and Buchanan, 1977, 1978, 1980) asserts that massive migration would be the result in the case a particular jurisdiction attempt to exploit citizens in a Tiebout situation, “any attempt on the part of one jurisdiction to exploit its citizens would cause massive out-migration to an alternative, non-exploiting jurisdiction (intergovernmental competition)”. Goodspeed (1998) underlined that “the horizontal tax competition can result in an efficient allocation of resources if the taxes used are benefit taxes. If taxes do not reflect benefits, however, Oates (1972) suggests that externalities are created so that tax prices diverge from social marginal cost”. Therefore, this decentralization hypothesis assumes implicitly that fiscal decentralization (and fragmentation) automatically implies increased levels of horizontal competition among jurisdictions (Atkinson 2006) thereby decreasing the ability of Leviathan to extract resources from the private sector⁴. Therefore, an increase in fiscal decentralization will lead to less total government spending and restrict government intrusion into the economy, *ceteris paribus*, and will extend taxes and expenditures of decentralized institutions. However, it is possible that as decentralization occurs, the component governments in a federal system may collude to organize a cartel-like arrangement in order to circumvent the competitive influences of fiscal federalism. Brennan and Buchanan (1980) explained, “within a constitutionally designed federal structure, one would predict that there would be constant pressure by competitive lower-level governments to secure institutional rearrangements that would moderate competitive pressures” (Shadbegian, 1999: 262 - s).

3. Evolution of economic decentralization in R. Macedonia

Macedonia after its independence on September 8, 1991, highly centralized, making it one of the most centralized countries in Europe. The high degree of centralization followed competencies that are responsible local authorities and depending financially local authorities. Macedonian municipalities in the financing were found a long time period at

⁴ For an interesting and deep discussion about the empirical relationship evidence that supports both Brennan and Buchanan hypotheses, see Shadbegian (1999).

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the bottom of Europe after nearly all parameters. Create high submission to local authorities on central government institutions.

To have a real and genuine decentralization, we must have fiscal and decentralization in the country. In the first period, from 1990 to 1996, there is no specific law municipal funding. Funding to municipalities governed by more laws and regulations, which creates an uncertainty transparency of their funding. Mostly transfer funds come from the central budget and ministries, which in rule politicized and subjectively established principle of the division of financial resources in the country.

During this period all budgets of the municipalities in the country accounted for not more than 0.5% of the GDP. The system of financing municipalities was serious negative indicator of great centralization of the Republic of Macedonia.

The administration of taxes and fees that are transferred to local authorities carried out the central financial institutions, represented by Ministry of Finance and the Public Revenue of the Republic of Macedonia.

In 1996, the second phase, the adoption of the Law on Local governments are predicted specific provisions in this law, which regulating sources of funding to municipalities in the country. It is predicted that municipalities will be financed from the following sources:

- Part of sales tax on goods and services, as specified by law;
- Property tax, inheritance tax and gift tax on the transfer of property and rights;
- land tax, utility fees and income from services;
- Revenue from personal property;
- Income from donations received from the country and abroad;
- Income from public enterprises and public services as established by unit local government;
- Part of the profits realized by state-owned enterprises, which have spilled in local government units for different reasons, in accordance with law;
- Revenue from penalties for non-compliance of local government;
- Other income transferred to the budgets of local governments in various grounds, in accordance with law.

The administration of all taxes was the responsibility of the central financial institutions, then after a certain formula has transferred funds to municipalities. The departments that administer taxes which were intended for local authorities, largely insufficient capacity to administered them. Most of the funds are expected to be transferred to local authorities from the sales tax on goods and services (current VAT), but, unfortunately, from 1996 to 2005, it did not happen. It furthermore, the state-owned enterprises that had their regional offices in municipalities, never once occurred to transfer money budgets municipalities. This system of financing local government was false powerful, but in reality proved inapplicable in general, because almost all taxes and fees in accordance with the Local Government Act supposed to be serious and sufficient sources of revenue to municipalities, unfortunately, not be implemented in reality. Municipalities in that period independently administering the fee for construction land. In certain municipalities independently or in cooperation with the Public Revenue administrated so-

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called city rent, which after 2001 had no legal basis the adoption of the Law on Construction Land in the Parliament, where the same law as the city rent income LGUs, simply was deleted existed.

The third period started from July 1, 2005. During 2004 adopted the Law on Financing of Local Self-Government, which began apply from 1 July 2005, the so-called first phase of fiscal decentralization. In 2005, substitution or addition of other laws that further regulate financial system units local government. The Law on Financing of Local Self, a systematic way to regulate the sources of funding and authorities responsible for the financial system of local government with this Law stipulates that municipalities are funded from multiple sources, including:

- Revenue source for municipalities that are completely in charge of their administration, and these source income, before local taxes, local fees and administrative fees, income from property, income from contribution, local fees, income from donations, revenues from fines and similar revenue source;
- Revenue from personal income tax, which is charged with administering central financial administration; grants from the budget of the Republic of Macedonia and state funds, as: revenues from value added tax, earmarked, block grants, capital grants and grants for delegated jurisdiction. The distribution of these grants is made according to predetermined criteria that are mostly transparent and objective.

The Law on Financing of Local Self-Government and other laws of different financial areas, making a real effort to greater financial autonomy of municipalities from the central government. will provides fiscal decentralization, which are expected to increase and responsibilities to local authorities. This Law is predicted transfer officials from the Ministry of Finance and the Public Revenue, which worked in the administration of municipal taxes and utility and administrative fees. Besides the transfer of employees, execute and transfer of movable and immovable things that are necessary to operate the transferred officers.

The fourth period, pursuant to the financing of local governments began to July 1, but actually started from September 1, 2007. Government, based on the recommendation of Commission for monitoring and assessment of ELS and the Ministry of Finance and the the basis of certain criteria, a list of 42 local governments who can enter second phase of fiscal decentralization. The second phase of fiscal decentralization includes the transfer of block grants to municipalities that met the requirements to enter this phase of fiscal decentralization.

4. Structure and scope of jurisdiction of local authorities in Republic of Macedonia

Local Economic Development (establishing the development and structural priorities, keeping local economic policy, support the development of SMEs and entrepreneurship local level and, in this context, participation in the establishment of local network of institutions and agencies and promote the partnership);

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Besides the mentioned source powers, the Act provides delegated competencies, with bodies of state administration may delegate performance of certain activities of the mayor, according to the law.

According to the Law on Financing of Local Self-Government Sources funding the municipality includes: own sources of revenue, grants from budget of the Republic of Macedonia and the budget funds. Own sources of revenues of the municipality are:

- Local taxes established by law (property tax, inheritance tax and gift set by law, sales tax, real estate and other taxes, established by law);
- Second local taxes, as stipulated by law (utility fees, administrative fees and other local taxes established by law);
- Local charges laid down by law (fees for arranging land, compensation for communal activities, benefits from spatial and urban plans and other local fees determined by law);
- income from property (rental income, interest income and income from the sale of property);
- Income from donations;
- Revenue from fines, determined by law;
- Income contribution;
- Other income determined by law.

Besides marked revenue, according to the said Act, municipalities have personal income tax collected in the current year and 3% from personal income tax personal income from salaries of individuals collected in the municipality where they are registered domicile and residence, as well as 100% of the income tax of individuals who are dealing with the craft. Municipalities and 3% tax value added in the previous fiscal year, which is allocated to municipalities according to criteria established by the Decree of methodology for allocating revenue from property tax is adopted Government. Municipalities can impose and contribution through referendum determined by the decision of the municipal council. Municipalities receive grants from central budget, such as a dedicated, capital, grants and block grants delegated powers.

In view of the Law on Financing of Local Self-evident is the need for increased resources municipal revenues and especially through the redistribution of budget resources between the central government and municipalities on behalf of municipalities and not by introducing new public duties. This, above all, taking into account economic conditions, and the ability to introduce new taxes to public appeared to distrust and even resistance to the process of this decentralization. But for this, detailed comments can be made regarding the economic sphere.

Based on the research in this area, in addition to giving following recommendations, which could be discussed and disputed in future:

- Does the country should be only unique model of municipalities or future need to consider a complex model of municipalities, about different types of communities also exist different scale of competencies;
- In the future it can be expected to re-open the question of territorial organization of the Republic of Macedonia, with a tendency possible to reduce the number of municipalities;

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- Better definition of jurisdiction between the City of Skopje and Skopje municipalities, or to a greater extent to increase jurisdiction of the City of Skopje, so the city of Skopje alongside is responsible for the general urban plan to be responsible for detailed urban plans and issuing building permits which are currently responsible Skopje municipalities;
- Implementation of the institute "delegated authority" with necessary amendments to the substantive laws of areas that can be delegated to local authorities;
- It is necessary to make the analysis of the possibility for the state to delegate certain jurisdictions, at least in the municipalities with greater capacity.

According to the European Charter of Local Self-Government (Council of Europe) which Republic of Macedonia has ratified and is an integral part of the Macedonian legislation, sources of funds for financing local authorities must have appropriate competencies for responsible local authorities. One of the sources for financing of local authorities should come from local taxes, fees and charges, which in accordance with national legislation, local authorities themselves determine the rate and sources of funds, which they will be sufficiently numerous and flexible to meet the needs of local authorities. The biggest novelty introduced in the beginning of decentralization a new authority which received local governments to administer local taxes, fees and expenses, which increased multiple responsibility in the process of administering local, custom source income.

According to the research about the source, their income local government to recommend increasing the share of local taxes and fees in the total budget Municipal; establish mechanisms to improve accountability of local authorities before the citizens for the overall financial management municipality; improving the service we offer local self government; to encourage local governments that have conduct an assessment or reassessment of property in their territory to do the same as soon as possible; possibility of introducing additional sources of financing units of local government, as part of income tax, etc.

With the start of the decentralization of 1 juli 2005, more extent changed the rules of the game in the field of finance in local government units in the country. If before beginning of decentralization bills of local government were in commercial banks, beginning with the decentralization introduce treasury system of work, which the municipality account migrated from commercial banks to the National Bank of the Republic of Macedonia.

In this sense can be recommended to perform better education of municipal administration responsible for financial management in the following areas: budget calendar in the budgeting process; proper planning revenue and expenditure budget; method of determining fiscal capacity of the municipality etc. Further, it is necessary to increase the level of transparency of the budget ELS process with greater participation of participatory approaches in budgeting and to amendment to existing legislation and introduce penalties and fines to disregard the budget calendar; not presenting the quarterly reports to the public; not preparing annual report and non-compliance of internal audit in the municipalities.

5. Transfer of jurisdiction

With the Local Government Act 2002, largely increased jurisdiction of local government in the country. We have many new jurisdiction for local authorities who are responsible of 1 juli 2005, when real and began to implement the new competencies provided by the Local Government Act 2002. Since the country exist many different types of communities that are vary according to the number of population, territory size, financial and human resources, natural resources and others, the transfer of jurisdiction largely depended on the existing infrastructure had regional ministries that are decentralized, i.e. jurisdiction for which they are responsible and their process of decentralization execution is transferred to local authorities. However, based on the analysis can be concluded that the level of performance of jurisdiction, pursuant to the list of jurisdiction of the Local government (Article 22) is different and that in any area not fully competence of performance. Also worth mentioning that all yet not a single case of delegation of authority by state authorities of mayors.

The area for the transfer of jurisdiction under the research, giving the following conclusions and recommendations:

- To increase the level of execution of jurisdiction municipalities, especially in the field of urban planning and issuing building permits, and utilities, taking into account the fact that "the issue exemption permits building "municipalities had these powers before adoption the new Law on Local Self-Government;
- From the survey results, indicate the need for transfer of state land owned municipalities or transfer of management of the same, especially concerning the implementation of local economic development, which is partly run by the municipalities;
- The data show large disparities between municipalities regarding the sufficiency of funds for completely implementing powers, indicating the urgent need the financial position of the municipalities, while taking into account existing arrears faced municipalities.

Much of the revenue raised by local governments country come from so-called government transfers through dedicated grants, block grants, capital grants and other transfers (VAT) that perform certain government institutions of local self-government Republic of Macedonia. Dependence on government transfers is large, and before everything in the smaller municipalities in the country, where many times they are expected to able to pay ongoing operation costs for administration municipality.

In the future make-depth analysis of intergovernmental transfers, and the need to pay particular attention to their structure and scope and to make a serious nationwide survey on the amount costs necessary for the so-called new powers responsible municipalities tend costs that create municipalities in the implementation of jurisdiction, with emphasis to improve the quality of services. Also, local governments can strengthen their capacities for tax administration and management of financial resources at their disposal. During the allocation of taxes to eliminate subjective influences and political interests. As for block grants that will be transferred to the LGUs, to monitor fate of

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earmarked grants, which had much less transferred money than before decentralization actual costs to perform these jurisdiction.

6. Conclusion

This approach points out that dividing up a complex system into independent self-optimizing decision-making patches increases the efficiency of research for optimal welfare because each subunit of the decision is subject to fewer inefficiencies of information transfer. On the other hand, there are costs of decentralization where the jurisdictions are not congruent. Innovation in institutional design seemingly can be handled by patching, the size of which depends on the relationship between the borders of the patch and the spillover effects among the single elements. This suggests that decentralized decision-making systems like competitive system need one efficient method of finding optimal configurations of a problem-solving algorithm which seems to crucially depend on the relationship between spillover effects within-jurisdiction and between-jurisdiction. Hence, the above described methodology seems one of the possible tools useful to redesign the map of institutional sharing power in an era of globalization, considering that it allows to catch Pareto improving in the level of welfare. In particular, as Frenken (2001b) suggests, "intermediate levels of centralization are to be preferred to balance the number of local optima and coordination costs at the one hand and the time-efficiency of search on the other hand" (16). In this scenario, a form of intermediate coordination between fully centralized and fully decentralized will provide the best outcome; because an intermediate form of coordination applied to a framework with several jurisdictions solves the problem of fully decentralized decision process that are disadvantageous where jurisdictions are congruent or where the interdependences are strong like in the case of globalized world.

The ultimate goal of this research is to help local and central authorities in the country to improve the system for financing local government. Given that the process of decentralization need to improve the quality of life in the country, it is no sustainable financial system, which will monitor the jurisdiction of local government in the country. In that direction it is the need for increased resources municipal revenues and especially through the redistribution of budget resources between the central government and municipalities on behalf of municipalities and not by introducing new public duties. This, above all, taking into account economic conditions, and the ability to introduce new taxes to public appeared to distrust and even resistance to the process of this decentralization. According to the research about the source, their income local government to recommend increasing the share of local taxes and fees in the total budget Municipal; establish mechanisms to improve accountability of local authorities before the citizens for the overall financial management municipality; improving the service we offer local self government; to encourage local governments that have conduct an assessment or reassessment of property in their territory to do the same as soon as possible; possibility of introducing additional sources of financing units of local government, as part of income tax, etc.

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