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GOVERNANCE PROJECT**

**REPORT ON THE STATUS
OF FISCAL
DECENTRALIZATION IN
MONTENEGRO**

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Table of Contents

Introduction	3
1. Criteria for measuring fiscal decentralization	3
1.1 Internationally-accepted definition and elements of fiscal decentralization	3
1.2 European Union Charter of Local Self-Government	4
1.3 Ministry of Justice municipal government reform agenda	5
2. Progress in fiscal decentralization.....	5
2.1 Preconditions for decentralization	5
2.2 Other requirements for fiscal decentralization	7
2.3 Fiscal decentralization element 1 – elected municipal councils.....	7
2.4 Fiscal decentralization element 2 – locally-appointed municipal officials.....	8
2.5 Fiscal decentralization element 3 – significant municipal discretion to raise revenues	9
2.6 Fiscal Decentralization decentralization element 4 – significant municipal expenditure responsibilities.....	12
2.7 Fiscal decentralization element 5 – municipal budget autonomy ...	13
2.8 Fiscal decentralization element 6 – hard municipal budget constraint	14
2.9 Fiscal decentralization element 7 – transparency.....	15
2.10 Fiscal decentralization element 8 – freedom from excessive central government-mandated expenditures	16
2.11 Fiscal decentralization element 9 – unconditional central government transfers	17
2.12 Fiscal decentralization element 10 – municipal borrowing powers	18

Tables

Table 1. Comparison of three standards for fiscal decentralization and progress in Montenegro.....	1
Table 2. Municipal revenue growth during fiscal decentralization	1
Table 3. 2003-2004 Municipal revenue growth for responding municipalities.....	1
Table 4. Publication dates for 2004 and 2005 municipal budgets	1
Table 5. Publication dates of annual municipal financial statements for 2003 and 2004	1
Table 6. GLG project survey of municipal communal service fee publication in eight municipalities	1
Table 7. Municipal contracting practices with municipal communal service companies.....	1
Table 8. Reported municipal arrearages as percentage of actual 2004 revenues	1
Table 9. Proposed Fiscal Decentralization Reform Objectives and Activities.....	29
Attachment 1. Municipal responsibilities described in laws.....	1
Attachment 2. References.....	1
Table of Contents	

Introduction	3
1. Criteria for measuring fiscal decentralization	3
1.1 Internationally-accepted definition and elements of fiscal decentralization	3
1.2 European Union Charter of Local Self-Government	4
1.3 Ministry of Justice municipal government reform agenda	5
2. Progress in fiscal decentralization	5
2.1 Preconditions for decentralization	5
2.2 Other requirements for fiscal decentralization.....	7
2.3 Fiscal decentralization element 1 – elected municipal councils	7
2.4 Fiscal decentralization element 2 – locally-appointed municipal officials	8
2.5 Fiscal decentralization element 3 – significant municipal discretion to raise revenues	9
2.6 Fiscal Decentralization decentralization element 4 – significant municipal expenditure responsibilities.....	12
2.7 Fiscal decentralization element 5 – municipal budget autonomy	13
2.8 Fiscal decentralization element 6 – hard municipal budget constraint ..	14
2.9 Fiscal decentralization element 7 – transparency.....	15
2.10 Fiscal decentralization element 8 – freedom from excessive central government-mandated expenditures	16
2.11 Fiscal decentralization element 9 – unconditional central government transfers	17
2.12 Fiscal decentralization element 10 – municipal borrowing powers	18

Tables

Table 1. Comparison of three standards for fiscal decentralization and progress in Montenegro	20
Table 2. Municipal revenue growth during fiscal decentralization	26
Table 3. 2003-2004 Municipal revenue growth for responding municipalities ..	26
Table 4. Publication dates for 2004 and 2005 municipal budgets	27
Table 5. Publication dates of annual municipal financial statements for 2003 and 2004	28
Table 6. GLG project survey of municipal communal service fee publication in eight municipalities	29
Table 7. Municipal contracting practices with municipal communal service companies	30
Table 8. Reported municipal arrearages as percentage of actual 2004 revenues	31
<u>Table 9. Proposed Fiscal Decentralization Reform Objectives and Activities</u>	<u>29</u>
Attachment 1. Municipal responsibilities described in laws	35
Attachment 2. References	38

REPORT ON THE STATUS OF FISCAL DECENTRALIZATION IN MONTENEGRO

Introduction

This paper is an assessment of the status of fiscal decentralization in Montenegro through September 2005, prepared as part of the USAID financed Good Local Governance (GLG) Project. The assessment measures the progress of the process of implementing fiscal decentralization by comparing it to three sets of benchmarks. These benchmarks are based on:

- an internationally-accepted standard definition of fiscal decentralization and internationally-accepted elements or criteria for progress in fiscal decentralization;
- the fiscal decentralization provisions of the European Union Charter of Local Self-Government; and
- Ministry of Justice (“MoJ”) objectives for local government reform.

Recommendations and priorities for activities which can accelerate the rate of progress in fiscal decentralization are discussed under each of ten fiscal decentralization elements. Table 9 provides in summary suggested indicators by which the Government of Montenegro (“GoM”) can monitor that progress.

1. Criteria for measuring fiscal decentralization

Fiscal decentralization in Montenegro can most usefully be measured against three standards:

- internationally-accepted definition and elements of fiscal decentralization;
- the European Union Charter of Local Self-Government; and
- the Ministry of Justice (“MoJ”) objectives for local government reform.

1.1 Internationally-accepted definition and elements of fiscal decentralization ¹

Boex (2001, p. 3; see Attachment 2) defines fiscal decentralization as “[t]he assignment of fiscal decision-making powers and management responsibilities to lower levels of government.” The fiscal decentralization process includes creating systems for local political accountability, financial decision-making and the financing of local activities.

Bahl (1999, p. 6) identifies seven essential and three desirable elements that together build a system of fiscal decentralization. The essential elements include:

- locally-elected municipal councils;

¹ Dr Roy Bahl and Dr. Jamie Boex of Georgia State University, School of Policy Studies, USA, have analyzed decentralization processes throughout the world and written extensively on the subject. Their definitions are well accepted in international academic circles.

- locally-appointed municipal officials;
- significant municipal discretion in raising revenues
- significant municipal expenditure responsibilities;
- municipal budgeting autonomy;
- a fixed balanced budget requirement (a so-called “hard budget constraint”); and
- transparency in municipal roles, responsibilities, and decision-making.

The desirable elements of fiscal decentralization include;

- freedom from excessive centrally-mandated municipal expenditures;
- unconditional central government transfers to municipal governments; and
- municipal government authority to borrow.

Bahl also describes political decentralization as a necessary pre condition to fiscal decentralization. In his description, “political decentralization” means the establishment of semi-autonomous sub-national government bodies that have a corporate charter empowering them to hold property, generate revenue and incur expenditures and that are politically accountable to the local electorate.

These elements of fiscal decentralization can be found in the first column of Table 1, presented in the Table Section at the back of this paper.

1.2 European Union Charter of Local Self-Government

In addition to the internationally-accepted definition and criteria for fiscal decentralization described in Section 1.1, above, fiscal decentralization in Montenegro must conform to the European Charter of Local Self-Government, adopted by the Council of Europe in October 1985² (the “Charter”). The Charter contains ten core articles that provide for:

- the legal establishment of municipal governments;
- the definition of municipal government;
- the scope of municipal government activities;
- protection of the territorial integrity of local governments;
- the freedom of municipal governments to establish their own administrative structures;
- establishing the conditions for compensation of elected municipal representatives;
- appropriate levels of central government supervision of municipal governments;
- a requirement of access to financial resources and credit sufficient for municipal government functioning;
- the freedom to form municipal government associations and enter into cooperation agreements; and
- Access to legal protection of municipal governments.

² The State Union of Serbia and Montenegro signed the Charter on 24 June 2005 but has yet to ratify it.

While it presents some elements of fiscal decentralization, the Charter focuses mainly on the elements of political decentralization that Boex establishes as preconditions for fiscal decentralization (see Section 1.1, above). The Charter's fiscal decentralization elements are mapped against Bahl's and shown in the second column of Table 1.

1.3 Ministry of Justice municipal government reform agenda

In December 1999, the Ministry of Justice published its "White Book" listing 17 objectives for reform (the "MoJ reform objectives"). Those 17 objectives are shown in the third column of Table 1, mapped against Bahl's criteria for fiscal decentralization and the core articles of the Charter. As can be seen in Table 1, many of the MoJ reform objectives relate to establishing the political preconditions that Bahl describes as necessary for fiscal decentralization to take place. These "White Book" pre-conditions include:

- establishment of a system of municipal government;
- democratization of municipal government;
- creation of local government property rights;
- promotion of systems of cooperation and association among municipal governments; and
- building a legal system to protect municipal governments.

These elements generally match Bahl's preconditions, with the notable exception that the MoJ pre-conditions do not include Bahl's pre-condition of political accountability. As will be shown throughout this report, the necessary systems of municipal government administrative, political and financial accountability have not been fully planned or implemented during the initial implementation of fiscal decentralization in Montenegro.³

2. Progress in fiscal decentralization

Progress in fiscal decentralization in Montenegro can be measured according to the internationally-accepted preconditions for, and elements of, fiscal decentralization shown in the first column of Table 1 and the corresponding elements of the Charter and the MoJ reform objectives shown in the second and third columns of Table 1. Proposed fiscal decentralization reform activities aimed at achieving these objectives are described in the following Sections 2.1 – 2.12, and are summarized in Table 1.

2.1 Preconditions for decentralization

Boex (2001, p. 3) identifies several preconditions that should be met prior to undertaking a fiscal decentralization process. These include establishing and incorporating "... semi-autonomous sub-national governments that have a

³ See also, Report on the Status of Reforms and the Political-Administrative Decentralization of Local Government in Montenegro, prepared by Đorđijje Blažić, Ph. D., for USAID/Montenegro and the GLG project (June 2005).

corporate charter (they should be able to hold property, generate revenue and incur expenditures) and that are politically accountable to the local electorate”

Several of the preconditions for fiscal decentralization identified by Bahl (see Section 1.1, above) have not been met or have been only partially met in Montenegro:

Corporate charter - The corporate charter that Bahl mentions is not the same as the “municipal statute” that municipal assemblies are presently developing in compliance with the Law on Local Governance (Official Gazette 42/03) (“LLG”). A municipal charter is usually adopted by popular referendum and is not easily modified. It establishes a long-term set of principles to guide elected assemblies in policy-making and executive bodies in implementing policies set by the assembly. However, the municipal statute in Montenegro is adopted only by a simple majority of the municipal assembly and can therefore be considered as an easily-modified, short-term set of operating procedures.

Municipal property ownership - While Montenegrin municipalities can and do own some property, the issue of municipal property ownership is far from settled. Most governmental property is still legally owned and controlled by the central government, not municipal governments. For instance, most municipalities do not own their municipal office buildings. While municipalities may own the water distribution systems under the roads, they do not own the roads themselves. Recent efforts to transfer ownership of core properties (such as municipal office buildings, parks, and city construction land) to municipal ownership have stalled. Continued central government control of municipal property undermines municipal authority to plan and control its own development, acquire and dispose of property as it wishes, and otherwise provide services the electorate requires. This situation violates the principles of self-determination espoused by the Charter. Future fiscal decentralization activities should establish, as an urgent priority, municipal property rights as well as a complete property inventory and transfer it to municipalities.

Electoral accountability - Assemblies do not fully meet the precondition of electoral accountability. While mayors have begun to be directly elected for five-year terms, municipal assemblies are elected only through party lists. Municipal assembly members are therefore only directly accountable to their political parties, not to the electorate. Recent interviews with members of some municipal assemblies found members constrained by the control of political parties that were perceived as directing members when and how to vote. Members interviewed said they would prefer to be directly elected.

Revenue management - Municipalities presently meet the preconditions for collecting revenue and spending it. As will be shown below, however, their performance in budgeting, collecting revenue, and controlling expenditures is uneven and unsatisfactory.

2.2 Other requirements for fiscal decentralization

Right to associate - While not listed by Bahl as a precondition for fiscal decentralization, both the MoJ reform objectives and the Charter call for the right of municipalities to associate within Montenegro and with foreign counterparts. The Union of Montenegrin Municipalities, the Association of Montenegrin Water and Wastewater Authorities, and the Forum of Municipal Tax Officers are examples of existing or emerging associations. This requirement is in the process of being met.

System of legal protection and accurate reporting - The Charter and MoJ reform objective 17 require the creation of a system of “legal protection” for municipalities to protect themselves from arbitrary decisions by the central government. This system is in place in Montenegro, as evidenced by numerous court cases brought (often successfully) by municipalities against the central government. However, these systems of protection against arbitrary central government decisions do not address the internal systems required to ensure sound municipal decision-making and the provision of full and accurate reporting to citizens. Typically, the protection of citizens from arbitrary local government decisions relies on a system of internal checks and balances combined with external administrative and/or judicial review. This requires a municipal assembly to provide essential policy-setting, monitoring, and evaluation functions which, at present, they generally fail to do. For example, as discussed in Section 2.7 below, municipal assemblies are not meeting their statutory obligations in budgeting, periodic budget execution review, and annual budget execution reporting. Requirements to enhance assembly performance in budgeting and financial review, in order to fulfill the objectives of electoral accountability will be addressed more fully in Section 2.7, below.

2.3 Fiscal decentralization element 1 – elected municipal councils

Ministry of Justice reform objective 4 requires “[c]onstitution of a representative body in the units of local self-government on the principles of free, direct (secret ballot) elections.” Municipal assemblies have been elected and new nationwide assembly elections have been scheduled for the spring of 2006. In international best practice, the term “direct elections” refers to elections of representatives by constituency, not by party list, and a “direct” election does not refer to a secret ballot (although this is also an essential element of democratic decentralization). As previously mentioned, municipal assembly elections are indirect, through party lists.

As will be shown below, however, having (directly or indirectly) elected members does not automatically mean that municipal assemblies will meet their fiscal responsibilities in budgeting, budget execution reporting, or setting revenue and expenditure policies. Until recently, there has been virtually no municipal assembly member training. Some poor performance may be attributed to poor training and/or the lack of assembly member accountability to their constituents.

Future efforts in reforming municipal assemblies should strive for direct election of assembly members, development of formal assembly member training programs, and enhancing the role of the assembly as an effective check and balance against the authority of the mayor and appointed officials.

2.4 Fiscal decentralization element 2 – locally-appointed municipal officials

The position of municipal administrator has been established by the Law on Local Governance. Some municipalities have begun to fill this position.

Ministry of Justice reform objective 5 also calls for “[c]reation of preconditions for democratic election of executives and creation of preconditions for them to carry out their duties in a responsible and professional manner.” This objective has begun to be met with mayors having been elected in Kotor, Žabljak, Budva, Kotor, Mojkovac, Cetinje and Nikšić. The remaining mayors are scheduled to be popularly elected in 2006.

It has also been observed that the process of appointing senior municipal officials is sometimes significantly delayed in order to achieve consensus among political coalition partners in the municipal assembly following municipal elections. This delay has an adverse effect on municipal management, including financial management. For example, Kotor elected its current Mayor in January 2005 but she was not able to secure appointment of the key departmental secretaries until September 2005. In the meantime, the municipal budget could not be passed nor could the treasury management system be fully implemented, as required by the Law on Local Government Finance (Official Gazette 44/03(“LLGF”). The current mayor of Budva was elected on 21 May 2005 and the key staff appointments were only completed on 25 August 2005. The new mayor of Nikšić was elected on 13 March 2005. Although some appointments were made on 11 May 2005, as of the date of this report the Secretary of Finance has not yet been appointed.

The awarding of key appointed positions according to political patronage is a long-standing local government tradition in many countries. Yet the practice should be avoided where possible and the development of professional staff and open, merit-based competition for positions should be established.

Future reforms should focus on developing a non-political process for recruiting and appointing senior municipal staff on the basis of merit. Such hiring can make use of screening committees that would recommend finalists, following an open recruitment process. Success can be measured by the number of municipalities that adopt open hiring processes for senior staff. The enhanced hiring procedures can be followed by adoption and implementation of objective employee evaluation procedures that would reduce the likelihood of politically-motivated dismissal, demotion, or being passed over for promotion.

2.5 Fiscal decentralization element 3 – significant municipal discretion to raise revenues

Ministry of Justice reform objective 12 requires “[p]rovision of reliable and adequate internal revenue sources and system for the control of their usage.” As shown in Table 2, total municipal revenues have risen by almost one-third since 2002, the year preceding the implementation of fiscal decentralization reforms. While municipalities have some discretion under existing law to raise revenues, that discretion is being gradually reduced by central government decisions and is limited by the administrative complexity of current municipal own-source revenues and difficulties in enforcing collections.

Prior to implementation of the Law on Local Government Finance, municipalities relied heavily on a 3% surcharge on local salaries as their primary revenue source. The LLGF replaced this with a 10% municipal share of the personal income tax (“PIT”) and a locally-imposed personal income tax surcharge (“PITS”) which together now account for over 25% of total municipal revenues. Municipal charges have doubled over the past three years and include municipally-imposed administrative fees and communal fees⁴.

Municipal revenue-raising capacity has been reduced by central government actions that have removed municipal own-source revenues from the tax base or have limited those revenue sources; the failure of municipal assemblies to adopt timely budget and own-source revenue decisions; and by weak municipal administration and enforcement of revenue collection, especially with regard to individual taxpayers. In the case of utility firms (i.e., those providing telecommunications, electricity and other services), many municipalities are selectively and punitively enforcing collection by frequently blocking taxpayers’ accounts. There are complaints from businesses, especially some utility companies, that municipal communal fees are adopted and imposed primarily on businesses without the fee payer having recourse to legal protest. For example, according the General Manager of Telecom, municipal charges levied on Telecom have risen in the past year from € 700,000 to over € 2,000,000 in the aggregate, and now total over 4% of gross revenues. Over objections from municipalities, the Government has just passed to Parliament in February 2006 a new Law on Local Communal Fees which in Article 11 caps fees to be set by municipalities for electric power transmission facilities, use of telecommunication facilities, installation of TV and radio transmitters and receivers, and use of the coast for business purposes, effective until January 1, 2008.

The central government has reduced or failed to implement several revenue sources promised to municipalities by the LLGF. Legislation adopted in 2003

⁴ A separate report by the GLG project describes multiple taxes, charges, and fees imposed by municipalities on essentially the same tax base and calls for the consolidation of such taxes, charges, and fees to eliminate this duplication, reduce administrative costs for municipalities and taxpayers, and increase own-source revenue collections.

and 2004 removed the tax on games of chance and the tourism tax as municipal own-source revenues, as provided in the LLGF⁵. The tax on transfer of real estate reduced the revenue potential of the municipal real estate tax when GoM mandated the unfunded continuation of transitional real estate exemptions that were set to expire⁶.

Limited central government assistance or cooperation further limits municipalities' ability to raise revenues. Municipalities routinely claim that they do not receive real estate data in readable format from the Real Estate Directorate (as required by law) which prevents municipalities from fully and fairly implementing the real estate tax. Nonetheless, municipalities have increased their revenues from the real estate tax and from fees for city construction land since 2002, as shown in Table 3. Sixteen municipalities reported that their real estate tax billing grew by 12%, between 2003 and 2004. Thirteen municipalities reported that their billings for the fee for the use of city construction land grew by 14% over the same period. Overall, the real estate tax as it now exists is too complex for municipalities to effectively administer. In May 2005, the GLG project published a study titled _____ containing recommendations for real estate tax simplification.

Municipalities also complain of poor central government cooperation in monitoring their receipts from the municipalities' 10% share of PIT payments and of PITS payments, both of which are collected by the central government. Because municipalities are unable to confirm central government payments for PIT and PITS for central government employees located in the municipality, many municipalities have become suspicious that they are not receiving the full payments to which they are entitled. . Collection of the PIT and the PITS is further compromised by the GoM practice of setting off its unpaid bills to corporations against unpaid corporate PIT and PITS obligations. These off-sets often include unpaid municipal PIT and PITS obligations. Municipalities also bitterly complain about the failure to receive 30% of forestry concession fees called for by the LLGF and about the loss of taxable land to semi-autonomous (and non-taxable) central government agencies such as the Coastal Protection Agency and the Forestry Directorate.

The failure of GoM to complete adoption and harmonization of sub systemic and special laws necessary to implement the LLGF further limits municipal revenues. For instance, the Law on Forestry prescribes only a 10% share of

⁵ Article 15 of the Law on Games of Chance (Official Gazette 52/04) declared revenues from games of chance to belong to the Republic, contradicting Article 5 of the LLGF. Article 8 of the Law on the Tourist Fee (Official Gazette 11/04 and 13/04) mandated that 80% of the fee be remitted to local tourist organizations and 20% to finance the Republic tourist agency.

⁶ Article 22 of the Law on the Tax on Real Estate Transfers (Official Gazette 69/03) extended the transitional partial exemptions on the real estate tax that were intended to end in 2004. These partial exemptions provide owner-residents real estate tax relief of up to 50% on their municipal real estate tax bills.

the forestry concession fees be shared with municipalities, while Article 28 of the LLGF provides that 30% of the concession fees be transferred to municipalities. These laws have not yet been harmonized.

As shown in Table 3, municipal collection rates for taxes, fees and charges are quite low. Random field samples collected by the GLG project during the summer of 2004 found that many communities had real estate tax collection rates for individuals that were often only about 30%. There is little municipal effort to enforce collections against individuals but frequently they make substantial efforts to enforce collections against corporate taxpayers. Generally, it is easy (although illegal) to block corporate bank accounts without a court order and difficult to obtain judicial decisions enforcing collections against individuals.

Irregular municipal billing cycles and the failure of municipal assemblies to adopt real estate tax rate decisions further impede collections. By law, real estate tax bills should be issued by 31 May of each year. As of 20 September 2005, however, at least five municipal assemblies (Mojkovac, Nikšić, Pljevlja, Ulcinj and Cetinje) had not yet adopted the tax decision required before real estate tax bills could be issued.

Ministry of Justice reform objective 3 also calls for a system for the control of the “use of revenues”. There is a rising and disturbing trend of municipal governments delegating revenues to subsidiary organizations to reduce reported municipal revenues. Fees for the improvement of city construction Land (impact fees) and fees for the use of city construction land are now frequently recorded as revenues of nominally independent municipal development agencies (e.g., in Kotor, Berane, and Podgorica). One reason (discussed further in Section 2.11, below) appears to be that the current equalization grant system rewards municipalities with poor collection rates and that under-report revenues, in part by delegating revenues to municipal bodies whose revenues municipalities are not now required to report. International best practice requires that all revenues attributable to the municipality or any body owned or controlled by the municipality must be included in the municipal budget, monitored by the municipal financial management system, and reported in consolidated municipal budget execution reports. In May 2005, GLG published a study titled *Proposals for 2005 Equalization Grant Rules and Calculations*, containing recommendations to improve the transparency and equalizing affect of the equalization fund allocation procedures.

Future efforts in municipal revenue reform can be measured by the degree to which all revenues attributable to the municipality are received, recorded, and expended through the municipal treasury management systems; the degree GoM implements promised municipal revenues and provides full compensation of centrally-mandated municipal revenue reductions. Municipal own-source revenue collection rates should be publicly reported locally and to the central government. Collection rates for municipal taxes and fees should be the basis for awarding incentive grants. The target collection rates for

incentive awards could vary according to region and the size of the municipality.

Overall municipal revenue sources should be reviewed and dramatically consolidated, with the goal of maintaining municipal revenue levels but increasing municipal administrative capacity, improving the predictability of billing cycles, basing fees and charges on the cost to deliver services, and to increase taxpayer protections and rights of appeal. To improve revenue transparency, all municipal fees, charges and taxes should be adopted during the annual budget adoption process.

2.6 Fiscal Decentralization Element 4 – significant municipal expenditure responsibilities

Ministry of Justice reform objective number 3, which required the specification of locally-provided services, has been partially met by the LLG. However, Articles 32 and 33 of the LLG assigns only expenditure responsibilities to municipalities, with the exception of fire protection (see Attachment 1). Additional responsibilities such as entrepreneurial development, development of community affairs, and managing and disposing of municipal property are compromised by the failure of GoM to establish clear municipal property rights. The Law on Roads (Official Gazette 42/04) assigns significant responsibilities to municipalities for state roads that pass through a municipality – that is, all state roads (see Attachment 1). These responsibilities include street lighting, traffic lights and signs, sidewalks, and painting of safety lines. Additional municipal responsibilities can be found in laws concerning spatial planning, child protection, census, and vital records, to name a few. There has been no recent effort to estimate the costs to municipalities of these mandated services, in order to make it possible to test municipal capacity to finance and satisfactorily provide these services.

In other countries, municipal responsibilities frequently include public safety (municipal police) and primary (and sometimes secondary) public schools. Although there have been some efforts to expand municipal responsibilities in the education sector through revisions to the Law on Education, it has taken the form of unfunded mandates for school buildings constructed by the municipality⁷.

Most municipalities have begun to improve the recording and reporting of their expenditures through the implementation of municipal treasury management systems, as mandated by the LLGF. A few municipalities, however, are compromising these systems through the rise of off-budget agencies such as the Podgorica, Berane and Kotor development agencies, which are allowed to incur expenditures and pay for them without those flows being recorded in the municipal treasury management system. Others, such as Bijelo Polje, have not adopted consolidated accounts and allow numerous secretariats to raise revenues and expend them independently.

⁷ This form of decentralization actually punishes municipalities for voluntarily taking on new responsibilities and will probably discourage municipalities from making further investments in schools and result in increasing demands on central government resources.

Future progress in municipal expenditure assignments can be measured by the number and significance of new responsibilities that are assigned to municipalities; the degree to which those new expenditure assignments they are adequately funded with new or existing municipal revenue sources; and the degree to which all municipal expenditures are administered and reported through the treasury management system.

2.7 Fiscal Decentralization Element 5 – municipal budget autonomy

Municipal budget autonomy, or the ability to independently set and implement municipal policies and budgets, is specified in the European Charter but is absent from the list of MoJ reform objectives. Even though municipal budget autonomy is called for by law (Article 2(2) of the LLGF; Article 5 of the Law on Budget (Official Gazette 40/01)), municipal budgets are generally poorly implemented. Effective budgetary autonomy requires timely budget preparation; meaningful public review; prompt adoption; reliable enforcement; and complete and accurate public reporting. It also requires the municipal assembly to be an informed and active participant.

In 2005, only 8 of 21 municipal assemblies adopted 2005 budgets by 31 December 2004, as required by law. Only six additional municipalities adopted their budgets within the grace period of 31 March 2005, as permitted by law. As of 20 September 2005, two municipal assemblies (Žabljak and Budva) still had not adopted budgets for 2005 (see Table 4). Municipal assembly performance in adopting budgets for 2005 is even worse than in adopting budgets for 2004, when 16 assemblies published their budgets by March 2004 and every budget was approved by October 2004.

Given the difficulties in adopting budgets, many municipal assemblies are not prepared to receive regular budget reports to allow them to make sure their budget policies are being implemented by the mayor and the municipal staff. This would require municipal assemblies to form finance or budget committees (which most have not yet done) and to have the training and capacity to review budget and audit reports (which most do not yet have).

The failure of municipal assemblies to adopt budgets by the deadlines set by law leads to municipal assemblies also failing to meet the deadline for the adoption of the annual municipal financial statements. These annual statements are due by 30 May of the following year, in accordance with Article 56 of the LLGF. As shown in Table 5, only eleven municipal assemblies had adopted their 2004 financial statements as of 27 September 2005; of these, only two were adopted by the required deadline. As of November 2005, four municipal assemblies – Pljevlja, Plužine, Kotor, and Budva – had failed to adopt their 2003 financial reports.

Anecdotally, interviews with members of two municipal assemblies revealed that they had not received any training and were lacking a basic understanding of their statutory obligations and of municipal financial management. In ____2005 and early 2006, the GLG project

undertook to deliver such training to a limited group of municipal assembly members in ___ municipalities. Much more is needed.

Future progress in municipal budgeting, monitoring, and reporting can be measured by the formation, training, and regular convening of municipal assembly finance or budget committees, and by the timely adoption of annual budgets and financial statements by municipal assemblies. Voluntary assembly member training programs, including testing and certification, should be developed and delivered. Training topics should include an introduction to policy-making and budgeting; budget review, monitoring, and evaluation; statutory obligations of municipal assemblies; municipal assembly fiscal obligations; and municipal assembly procedures. Additional measures of progress include the formation of a central government unit to enforce timely municipal budget adoption and reporting, review reports. Publication of municipal budgets, budget execution reports, and annual financial statement on the Ministry of Finance (“MoF”) web site and in other publications would support comparisons of municipal performance and increase public involvement in the municipal budget process.

2.8 Fiscal decentralization element 6 – hard municipal budget constraint

A “hard budget constraint” is a requirement that municipalities strictly adhere to a balanced budget. This principle is not mentioned in the Charter or in the list of MoJ reform objectives, although it is required by the Law on Budget. While a hard budget constraint is a necessary element of fiscal decentralization, it is not by itself sufficient to ensure balanced municipal budgets, adequate municipal debt management, and adequate control of municipal borrowing. A central authority must be able and willing to enforce these requirements. As of the date of this report, there has been inadequate enforcement of the municipal financial reporting requirements and no effective hard budget constraint.

Indeed, as of the date of this report there is no firmly established system of regular and consistent municipal financial reporting, nor is there a single unit within GoM that is responsible for receiving, verifying, and making publicly available municipal financial data (annual budgets, periodic budget execution reports, or annual financial statements). In fact, three different MoF departments have partial responsibility to receive municipal financial data: the Treasury is tasked to ‘monitor’ municipal financial performance under Article 54 of the Law on Budget; the Budget Department is assigned to collect municipal budgets, budget execution reports, and annual financial statements under Articles 55-58 of the LLGF; and the Tax and Customs Systems Department collects its own municipal financial data for purposes of calculating equalization grant allocations and annual adjustments.

This fragmentation of reporting responsibilities results in municipalities developing and submitting budgets in non-standardized formats. Virtually every municipality waits until the end of the year to perform required adjustments to their budgets and/or waits until the following year to record its

unpaid bills. In the past two years, only one municipality – Kolašin – has submitted an adjusted budget to the MoF prior to the end of the fiscal year.

Under the LLGF, the mayor is allowed to expend the permanent and annual reserves without municipal assembly approval. This is inconsistent with international best practice. Reserves are set aside for unplanned, emergency expenditures and are released only with the prior approval of the municipal assembly. In Montenegro, in contrast, it is common practice for mayors to exercise their discretion to expend budgeted reserves entirely each year, without municipal assembly approval.

Future progress in adopting a hard budget constraint can be measured by the number of timely municipal budget execution reports and mid-year budget revisions submitted to MoF; establishment of a single MoF department to enforce municipal financial reporting requirements and receive and review reports; and the number of municipalities that require of municipal assembly approval for expenditures of annual and permanent reserve funds.

2.9 Fiscal decentralization element 7 – transparency

Transparency is achieved through genuine public consultations and hearings, public and objective decision-making and providing meaningful and complete reporting on performance. Ministry of Justice reform objectives 6-10 and 14 focus on developing the tools for transparent municipal operations. These tools include establishing productive working relationships within the municipal administration and between the municipal administration and municipal communal service organizations; creating a municipal civil service system; implementing modern management methods; and implementing information technology (IT) systems to support good decision-making and reporting.

Progress toward achieving transparent municipal operations has been facilitated by the adoption of municipal treasury management systems and consolidated treasury management departments in 17 of 21 municipalities. However this advance has been severely compromised by the emergence of “off-budget” activities. Increasingly, municipal revenues are being diverted to off-budget departments such as development agencies or municipal service corporations. Revenues that were once widely reported, such as the fee for the use of city construction land, are now rarely included in municipal financial reports. Full budgeting and reporting of all municipal departments, enterprises and agencies would significantly increase transparency and foster public accountability.

The design and implementation of the equalization transfer formula rewards under-reporting of municipal revenues and the over-estimation of projected expenses. This incentive undermines transparency because municipal budgeting and reporting is almost universally designed to maximize equalization grants and reduces the budget’s utility as a planning and reporting tool. Adoption of neutral equalization funding criteria would enhance budgeting transparency (see Section 2.11, below).

Municipal communal service charges are being adopted and charged without prior publication. In an October 2005 survey of eight municipalities, the GLG project found that only one municipality (Mojkovac) had published the charges of its municipal communal service corporation and that only one other (Budva) is in the process of publishing those charges. Recently, the Constitutional Court required the publication of all municipal charges. In some countries, it is municipal practice to adopt all communal service charges at the time the annual budget is adopted. This practice should be implemented in Montenegro.

Contracting for municipal communal services is frequently not transparent. In its October 2005 survey the GLG project found that only three municipalities (of the seven that responded to the question) had formal contracts with their municipal communal service corporations. One municipality (Mojkovac) publishes a decision on communal services. The three largest municipalities (Bar, Budva, and Podgorica) do not have contracts with their municipal communal service corporations.

Future reforms to promote transparency should focus on budgeting and reporting on all municipal financial activities, whether they are performed by departments, agencies, institutions or enterprises – so-called single entity budgets. Comprehensive budgeting and reporting of all activities is the only way a municipality's complete financial condition can be evaluated by municipal decision-makers and be presented to the public for meaningful review and evaluation. Staff of the mass media should receive training similar to the proposed municipal assembly member training (see Section 2.7. above) to ensure that they are able interpret municipal budgets and financial reports correctly and that they are familiar with municipal budgeting and reporting procedures. Reforms in this area should also include a requirement that all municipal communal service charges be reviewed and approved at the same time the annual budget is approved. Municipalities and their municipal communal service corporations should be required to have contracts describing their financial and administrative roles and responsibilities, how communal service charges will be set, the required level or quality of communal services, and how compliance with contractual obligations will be monitored and enforced.

2.10 Fiscal reform element 8 – freedom from excessive central government-mandated expenditures

Avoiding central government-mandated expenditures is related to MoJ objective number 15 which calls for “the establishment of adequate relationships between central and local organs”. Article 3 of the LLGF embodies this principle by stating:

“The funds for performing tasks devolved and delegated to a municipality shall be provided from the state budget, in compliance with regulations on devolving, i.e. delegating tasks.”

However, GoM is increasingly promoting legislation that mandates municipal expenses or curtails municipal revenues that are called for by the LLGF. Examples are described in Sections 2.5 and 2.6, above.

Future reforms should include publishing in advance the estimated costs and associated revenues of legislation affecting municipal expenditures; i.e., fiscal impact analyses. Although there is some effort to include such information in the explanations of some proposed legislation, the methods for calculation of these estimates are generally not explained and usually have not been subject to adequate public review. Regular reviews of legislation should be periodically performed to verify initial fiscal impact analyses and identify the required amounts and sources of funding to cover the actual costs to municipalities of complying with such legislation.

2.11 Fiscal decentralization element 9 – unconditional central government transfers

This principle is related to establishing adequate relationships between central government and municipalities referred to in Sections 2.9 and 2.10, above. While the Charter establishes the need for central government supervision to ensure compliance with the constitution and legislation, the MoJ reform objectives emphasize municipal authorities and independence, and are silent on the central government's role in supervising municipalities.

Decentralization requires strong central government involvement. One area that requires significant central government oversight is the administration of the equalization transfer system. This first requires uniform municipal accounting, budgeting, and financial reporting systems that are established and enforced by the central government to provide consistent and reliable information that is accepted by both the central government and municipalities and is available to the public and the media. In addition, equalization transfers should be distributed according to allocation criteria and methods which do not distort municipal revenue and expenditure estimation and reporting practices or encourage off-budget municipal financial flows (see Section 2.9, above).

The administration of equalization transfers in Montenegro has been severely compromised by the lack of adequate central government oversight of municipal accounting, budgeting, and financial reporting and by an allocation method that rewards poor municipal revenue generation and collection and unrealistic municipal budgeting. The Local Government Finance Committee ("LGFC") further obscures its basis for distribution of equalization transfer funds by using projected municipal financial data, not published historic data. Theoretically, this projected data is updated on a rolling basis throughout the year and then adjusted at year-end for discrepancies from projections. In practice, municipal reporting is so infrequent and poor that intended adjustments will not be made and excessive transfers to unqualified municipalities will likely result that can not later be recovered.

Without a single department given sole responsibility for collecting and verifying municipal financial data, MoF has been unable to penalize municipalities which do not furnish timely or accurate financial reports. As of the date of this report, there is no consensus within MoF on 2004 municipal expenditure and revenue data, despite numerous requests to municipalities to provide this data. Efforts by the GLG project to support the introduction of a municipal budget preparation regulation that would generate consistent and comprehensive “single entity” municipal budgets (see Section 2.9, above) and to introduce a uniform municipal budget execution reporting regulation have not yet been successful.

Despite the lack of reliable municipal financial data, the LGFC has developed an equalization fund allocation formula and an allocation mechanism that rely on (unreliable) municipal financial data rather than on objective and easily verifiable proxies for that financial information that estimate municipal revenue and expenditure assignments, adjusted for relevant municipal conditions (e.g., population, area, region, etc.), and measures the “fiscal gap” – that is, the difference between potential municipal revenue and estimated municipal expenditures – that should be reduced by equalization transfers. Despite GLG project recommendations to use such proxy data to measure the “fiscal gap” the LGFC has elected to maintain the current equalization transfer allocation formula and mechanism.

Progress in the equalization transfer system should be measured by the extent to which municipalities provide uniform, timely, reliable, and comprehensive financial data to a single collection point in MoF, and the extent to which the current equalization transfer allocation formula and allocation system are changed to reflect the “fiscal gap” of municipalities.

2.12 Fiscal decentralization element 10 – municipal borrowing powers

Municipal access to credit to finance capital investments is listed as the Ministry of Justice reform objective 13: “Use of credits and instruments of financial market in financing local self-government”. Articles 60-65 of the LLGF permit short-term and long-term municipal borrowing provided that total municipal debt service obligations do not exceed 10% of total prior year revenues. However, the calculation of this debt ceiling does not take arrearages (a form of borrowing from vendors, suppliers, and employees) into account.. A recent GLG project review showed that 20 municipalities reported a median ratio of arrearages to prior year revenues of 13%. Twelve of these twenty municipalities began the year with arrearages that should have made them ineligible to incur any additional debts or arrearages. The survey results are presented in Table 8. Since this information is not collected by GoM, there was no central government action taken to restrict further borrowing by these twelve municipalities.

Future reforms should lead to a better definition of municipal borrowing that includes arrearages; closer monitoring of municipal borrowing and accumulated debt; and a more sophisticated, market-oriented central government approach to setting limits on municipal borrowing.

[There needs to be a summary conclusion paragraph and reference to Table 9 which summarizes all the recommended next steps.]

[Insert TABLES SECTION divider between the body of the report and all the tables.]

Table 1. Comparison of three sets of related standards for fiscal decentralization and progress in Montenegro

Elements of Decentralization	EU Charter of Local Self-Government	Ministry of Justice Reform Objectives	Progress
<p>Preconditions: "...an important precondition of fiscal decentralization is political decentralization ... by establishing semi-autonomous sub-national government bodies that have a corporate charter (they should be able to hold property, generate revenue and incur expenditures) and that are politically accountable to the local electorate."</p>	<p>Article 3. Concept of Local self-government. "...local authorities ... manage a substantial share of public affairs...in the interests of the local population."</p>	<p>1. Creation of a territorial organization and a system of local self-government (one-level or multi-level, one-type or multi-type, territorial and functional</p>	<p>Established by legislation. Municipalities are able to independently generate revenues and incur expenses.</p>
	<p>Article 3 – "This right shall be exercised by ... assemblies composed of members freely elected".</p> <p>Article 4 – Scope of local self-government, "Public responsibilities shall generally be exercised... by those authorities which are closest to the citizen"</p>	<p>2. Democratization of relationships in local self-government through broader participation of the population – citizens in direct and indirect forms of decision-making process when vital interests of the local community are concerned as well as through different forms of public control of activities of different organs of local self-government</p>	<p>Not fully established. Election of assemblies through party lists prevents citizens from directly voting for their representatives. At recent training programs members of two municipal assemblies readily admitted that they are instructed by the parties how to vote.</p>
	<p>Article 4 – "Powers given to local authorities shall normally be full and exclusive."</p>	<p>11. Adequate treatment of the property of the organs of local self-government</p>	<p>Not established. Municipal property rights not established. Municipal control over the planning and development of city construction land is also compromised by state authority.</p>
	<p>Article 10 – Local authorities' right to associate</p>	<p>16. Creation of favorable conditions for cooperation and linking of the units of local self-government, for creation of domestic associations as well as cooperation with international organizations of local self-governments.</p>	<p>Enabled by legislation. Municipal association formed as well as associations for water, local tax officers and finance officers.</p>

Elements of Decentralization	EU Charter of Local Self-Government	Ministry of Justice Reform Objectives	Progress
	Article 11 – Legal protection of local self-government, “Local authorities shall have the right of recourse to a judicial remedy in order to secure free exercise of their powers and respect for such principles of local self-government...”	17. Creation of a complete and efficient system of legal protection of local self-government	Legal recourse established and demonstrated by active court proceedings against central government by a number of (opposition) municipalities. However, municipal institutions also need to be protected through a formal working system of checks and balances and accountability. Local election of assembly members by party lists removes member accountability to the electorate and it compromises assembly role as an effective check and balance on the mayor. Assemblies are presently not effective check on mayoral power.
1. Elected local council	Article 3 – “This right shall be exercised by councils or assemblies composed of members freely elected by secret ballot on the basis of direct, equal, universal suffrage...”	4. Constitution of a representative body in the units of local self-government on the principles of free, direct (secret ballot) elections	Direct elections not established, elections are made through party lists, with members accountable to parties not electorate. Assemblies generally not fulfilling their budgeting, reporting and fee setting responsibilities (See prin. 3, 4, and 5 below for poor assembly effectiveness).
2. Locally appointed chief officers	Article 6 – Appropriate administrative structures and resources for the tasks of local authorities, “...local authorities shall be able to determine their own internal administrative structures ...The conditions of service of local government employees shall be such as to permit the recruitment of high-quality staff ...”	5. Creation of preconditions for democratic election of executives and creation of preconditions for them to carry out their duties in a responsible and professional manner	Direct election of Mayors (Kotor, Budva, Tivat, Nikšić, and Žabljak) position of Municipal Administrator established by law.
3. Significant local discretion to raise revenues	Article 9 – Financial resources of local authorities, “Local authorities shall be entitled...to adequate financial resources of their own... Local authorities' financial resources shall be commensurate with the[ir] ...Part at least of the financial resources of local authorities shall derive from local	12. Provision of reliable and adequate internal revenue sources and system for the control of their usage	Not fully implemented. Some own-source revenues that were identified and promised in Law on Local Government Finance (“LLGF”), including tourism tax and tax on games of chance were not provided by secondary laws to municipalities. Some shared revenues that were identified in LLGF were not implemented, including 30% municipal share of forestry concession fees. Additionally, municipalities complain that GoM (i.e., MoF) does not provide them with reports detailing personal income tax

Elements of Decentralization	EU Charter of Local Self-Government	Ministry of Justice Reform Objectives	Progress
	<p>taxes and charges of which, within the limits of statute, they have the power to determine the rate.</p>		<p>(“PIT”) and PIT surtax (“PITS”)(contributions for GoM employees. As a result municipalities cannot verify that all payments due have been received.</p> <p>The GoM practice of swapping unpaid corporate PIT and PITS obligations for unpaid GoM obligations (such as electric or phone bills) further reduces municipal revenues. When such swaps (compensating balances) are negotiated, municipalities 10% share of PIT and PITS is reduced.</p> <p>Local revenues that are provided by law are frequently poorly implemented by municipalities. As of 21 September 2005, real estate tax decisions for 2005 had not been adopted by at least five municipalities and they have not begun to issue 2005 real estate tax bills.</p> <p>There are widespread complaints by the business community of predatory municipal communal fees, particularly those imposed on utility companies such as Telekom and the Electric Power Company.</p> <p>As mentioned below in Principle. 4, the proliferation of autonomous municipal agencies and institutions, such as the development agencies in Podgorica and Kotor, limit the ability of municipalities fully to implement consolidated municipal accounting and compromise municipal expenditure controls.</p>
<p>4. Significant local government expenditure responsibilities</p>	<p>Article 3 – “Local self government denotes the right and the ability of local authorities ... to regulate and manage a substantial share of public affairs under their own responsibility and in the interests of the local population..... Article 9 – “Local authorities shall be entitled...to adequate financial</p>	<p>3. Specification of services provided by local self-government based</p>	<p>Not fully established. The most common local expenditure responsibilities typically include education, police and fire services. In Montenegro only fire protection has been fully assigned to municipalities, in addition to municipal services such as water. The proliferation of semi-autonomous municipal agencies which do not appear on the budget or operate through the municipal treasury accounts also limits municipal expenditure responsibilities. These agencies can be found in Berane, Podgorica and Kotor.</p>

Elements of Decentralization	EU Charter of Local Self-Government	Ministry of Justice Reform Objectives	Progress
	resources of their own, of which they may dispose freely within the framework of their powers”		Municipal service corporations provide water, solid waste removal. Street cleaning and market management services. These services are often poorly contracted by the municipality and blur lines of financial reporting accountability. For instance, both Šavnik and Plav provide additional funding that directly pays staff service corporation salaries, in addition to payments required by contract.
5. Budget autonomy	Article 4 – “Local authorities shall, within the limits of the law, have full discretion to exercise their initiative with regard to any matter which is not excluded from their competence nor assigned to any other authority... Powers given to local authorities shall normally be full and exclusive. They may not be undermined or limited by another, central or regional, authority except as provided for by the law		Not successfully implemented. Legally, the municipalities have significant autonomy, but in practice municipalities have ineffective and poor budget practices. Municipal assemblies are required to approve budgets, minimally receive quarterly execution reports, and approve year-end financial statements by fixed deadlines. It is the exceptional municipality that honors these deadlines. Only 8 municipal budgets for 2005 were adopted by 31 December 2004 and only 15 were adopted by the extended deadline of 31 March 2005, as provided by law. As of 21 September 2005, two municipalities have not adopted budgets for 2005.
6. “Hard budget constraint”			This requirement exists in the Law on the Budget but it is not enforced. This is demonstrated by the lack of reporting to the central government, routine municipal practice to revise budgets only at the close of the fiscal year, and forwarding of unpaid bills to the following year. As of 21 October 2005, no municipality had provided MoF an amended budget for 2004 or 2005. Only Podgorica had provided the MoF a copy of its budget for 2004 or 2005. The current system of reserve accounts are routinely and unilaterally expended by the Mayor without assembly approval, as allowed by law.

Elements of Decentralization	EU Charter of Local Self-Government	Ministry of Justice Reform Objectives	Progress
<p>7. Transparency</p> <p>“(a) roles and responsibilities in government should be clear; (b) information on government activities should be provided to the public; (c) budget preparation, execution, and reporting should be undertaken in an open manner; and (d) fiscal information should be subjected to independent assurances of integrity.”</p>		<p>6. Establishment of proper relationships between different organs of local self-government;</p> <p>7. Establishment of proper relationships between different organs of local self-government and local public services so that the services be provided efficiently;</p> <p>8. Creation of service oriented, effective and efficient organs of local self-government as well as provision of legality, transparency and proficiency of their work;</p> <p>9. Introduction of the principle and method of modern management in managing all the levels of local management;</p> <p>10. Creation of employees system of the local self-government which will provide for professionalism, political independence and adequate promotion system (reward system) for employees in the organs of local self-government;</p> <p>14. Planning and building up of the computer systems of local self-government as an integral part of the computers system of the public administration of Montenegro</p>	<p>At the national level, the inter-ministerial committee for decentralization has never been formed. The MoF Coordinating Body met in January, April, and June 2005 but as of 2 November 2005 had not met since then.</p> <p>At the municipal level, the assemblies do not provide adequate check and balance on administrative branch. Budget, budget reporting and annual financial statements are generally not timely adopted by assembly.</p> <p>Relationships between municipality and municipal service corporations are not clearly defined. In at least two municipalities (Plav and Šavnik) municipalities pay the salaries of municipal service corporation employees.</p> <p>In a limited survey of eight municipalities (Andrijevisa, Bar, Berane, Budva, Kotor, Mojkovac, Podgorica, and Tivat) only one, Mojkovac municipal service corporation, published its fees in a gazette, and Budva is in the process of publishing for the first time. The failure to publish fees has been criticized by the Constitutional Court.</p> <p>Real estate tax rates are routinely not adopted on an annual basis by municipal assemblies. The failure regularly to issue tax bills and enforce the collection of taxes and fees further undermines transparency of government. The GLG project estimates that only 30% of municipal fees and taxes imposed on individuals are routinely collected (a few municipalities may approach 50%). However, actual collection rates are not publicly available.</p>

Elements of Decentralization	EU Charter of Local Self-Government	Ministry of Justice Reform Objectives	Progress
8. (desirable) Freedom from excessive central expenditure mandates	Article 4 – “Local authorities shall ... have full discretion to exercise their initiative with regard to any matter which is not excluded from their competence Powers given to local authorities shall normally be full and exclusive. They may not be undermined or limited by another, central or regional, authority except as provided for by the law Local authorities shall, insofar as possible, be allowed discretion in adapting their exercise to local conditions.”	15. Establishment of adequate relationships between central and local organs	Not observed by GoM. Although Article 3 of LLGF prevents unfunded mandates, GoM has violated this principal on numerous occasions since adopting the LLGF in 2002. In 2004, the transitional system of tax relief for real estate taxes was unilaterally extended by Parliament in the Law on Real Estate Transfer. In 2004 the tourism tax was unilaterally removed as a local revenue by the Law on Tourism. The draft Law on Education Decentralization attempted to mandate municipal education expenditures without commensurate municipal authority to raise compensating revenues and, in 2005, required municipalities to absorb all school building maintenance costs for municipally constructed school buildings.
9. (desirable) Unconditional transfers from higher level governments	Article 9 – “As far as possible, grants to local authorities shall not be earmarked for the financing of specific projects. The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction.”		Partially implemented. Equalization grants are generally unconditional but the basis for awarding grants is open to complaints of bias and manipulation. There is no functioning system of common and consistent budgetary reporting by which GoM can allocate and appropriate transfers. Indeed, the municipality of Bijelo Polje as ignored repeated requests by the MoF Budget Department for financial reports, but has been awarded over 20% of the 2005 equalization pool. Consultant efforts to establish objective and verifiable grant criteria have been unsuccessful.
10. (desirable) Borrowing powers	Article 9 – “For the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law.”		Limited borrowing is provided by law but in practice local borrowing is largely uncontrolled and in violation of the legal limits. A GLG survey found that on average municipal arrearages (a form of borrowing) are 13% of total municipal prior year revenues while the borrowing limit alone is 10%.

Table 2. Municipal revenue growth during fiscal decentralization

Revenue source	2002 (€)	2003 (€)	2004 (€)	% change 2002-2003	% change 2003-2004
Personal income tax	16,892,100	18,660,400	9,026,800	10%	-52%
Real estate transfer tax	2,998,500	3,022,600	1,858,100	1%	-39%
Local taxes	1,836,100	4,356,100	20,467,600	137%	370%
Interests and penalties	63,000	134,400	155,600	113%	16%
Local fees	3,668,300	5,284,100	6,030,100	44%	14%
Local charges	10,675,300	16,145,600	19,467,700	51%	21%
Subsidies	1,793,400	6,231,400	9,433,300	247%	51%
Other local revenues	20,986,900	24,460,700	11,129,300	17%	-55%
Total revenues	58,913,600	78,295,300	77,568,500	33%	-1%

Notes: Municipal revenues increased by almost one-third during the first two years following adoption of LLGF. Municipal share of personal income tax and personal income tax surcharge more than compensated for loss of discontinued 3% surcharge on salary note decline in personal income tax. Local taxes, including personal income tax surcharge, real estate tax, and corporate title tax, grew more than ten fold. Subsidy growth reflects the implementation of the equalization transfer fund.

Table 3. 2003-2004 Municipal revenue growth for responding municipalities

Real Estate Taxes (16 municipalities)			
	2003 (€)	2004 (€)	Growth Rate
Total billing	11,233,280	12,591,176	12%
Total collection	4,056,025	6,988,547	72%
Collection rate	36%	56%	54%

Fee for Use of City Construction Land (12 municipalities)			
	2003 (€)	2004 (€)	Growth Rate
Total Billing	3,308,239	3,735,747	13%
Total Collections	1,510,605	2,432,916	61%
Collection Rate	46%	65%	43%

Notes: Sixteen municipalities reported both billing and collections of real estate tax. Twelve municipalities reported both billing and collections of fee for use of city construction land. Tables based on unverified data voluntarily supplied by municipalities to GLG project, Jan-Feb 2005. Overall collection rates are for both legal owners (business) and private persons.

Table 4. Publication dates for 2004 and 2005 municipal budgets

No.	Municipality	2004 Budget Publication by Assembly	Municipality	2005 Budget Publication by Assembly
1	Bijelo-Polje	December 2003	Kolašin	20 December 2004
2	Podgorica	December 2003	Andrijevica	25 December 2004
3	Kolašin	December 2003	Podgorica	27 December 2004
4	Bar	December 2003	Bijelo Polje	28 December 2004
5	Andrijevica	December 2003	Berane	30 December 2004
6	Herceg-Novi	March 2004	Plav	30 December 2004
7	Plužine	March 2004	Pljevlja	30 December 2004
8	Plav	March 2004	Rožaje	30 December 2004
9	Mojkovac	March 2004	Herceg Novi	16 February 2005
10	Pljevlja	March 2004	Cetinje	11 March 2005
11	Kotor	March 2004	Mojkovac	21 March 2005
12	Danilovgrad	March 2004	Danilovgrad	25 March 2005
13	Šavnik	March 2004	Bar	28 March 2005
14	Berane	March 2004	Ulcinj	30 March 2005
15	Nikšić	March 2004	Tivat	19 April 2005
16	Cetinje	March 2004	Plužine	28 April 2005
17	Ulcinj	March 2004	Šavnik	19 May 2005
18	Budva	July 2004	Nikšić	19 July 2005
19	Zabljak	July 2004	Kotor	27 July 2005
20	Rožaje	August 2004	Budva	No 2005 budget
21	Tivat	October 2004	Žabljak	No 2005 budget

Notes: Only five municipalities adopted their 2004 budgets before the beginning of 2004 and another 11 by the end of March 2004. In 2005, eight municipalities adopted their budgets before the beginning of 2005 and another six before the end of March 2005.

Table 5. Publication dates of annual municipal financial statements for 2003 and 2004

No.	Municipality	Publication of 2003 Annual Statements	Municipality	Publication of 2004 annual statement
1	Andrijevica	July 2004	Andrijevica	8 July 2005
2	Bar	July 2004	Bar	25 July 2005
3	Bijelo Polje	July 2004	Berane	
4	Berane	July 2004	Bijelo Polje	
5	Budva		Budva	
6	Danilovgrad	Sep 2004	Danilovgrad	8 July 2005
7	Žabljak	July 2004	Žabljak	
8	Kolašin	June 2004	Kolašin	19 July 2005
9	Kotor		Kotor	
10	Mojkovac	Sep 2004	Mojkovac	
11	Nikšić	Dec 2004	Nikšić	
12	Plav	Sep 2004	Plav	27 April 2005
13	Plužine		Plužine	12 May 2005
14	Pljevlja		Pljevlja	1 Aug 2005
15	Podgorica	May 2004	Podgorica	1 June 2005
16	Rožaje	Oct 2004	Rožaje	
17	Tivat	Dec 2004	Tivat	19 July 2005
18	Ulcinj	Feb 2005	Ulcinj	
19	Herceg Novi	Nov 2004	Herceg Novi	24 Aug 2005
20	Cetinje	Jan 2005	Cetinje	
21	Šavnik	Apr 2004	Šavnik	24 Aug 2005

Notes: By law, municipal annual accounts must be published by 31 May of the year following the reporting year. As of 27 September 2005, only 17 of 21 municipalities have published the 2003 annual financial report required by May 31, 2004. Only two reports were timely issued and two were delivered in 2005; only 11 of 21 municipalities have published their 2004 annual financial reports, required by 31 May 2005; only three reports were timely.

Table 6. GLG project survey of municipal communal service fee publication in eight municipalities

Municipality	Are Municipal Service Fee Decision's Published?
Andrijevica	No. Board of Directors adopts level of tariffs, Secretariat for Finance approves it.
Bar	No. Board of Directors adopts level of tariffs, Secretariat for Economy approves it.
Berane	No. Board of Directors adopts level of tariffs, Secretariat for Economy approves it.
Budva	Not yet. Mayor issues approval for tariffs. In 2005 Constitutional Court requested Decision on Tariffs to be published in the Official Gazette
Kotor	No.
Mojkovac	Yes. Decision published in the Official Gazette - Municipal Regulations: Local Public Companies-Tariff Structure
Podgorica	No.
Tivat	No.

Notes: Only one (Mojkovac) of eight municipalities surveyed by the GLG project in October 2005, publishes its municipal fees in its official gazette. One other (Budva) is in the process of publishing its fees following a Constitutional Court order.

Table 7. Municipal contracting practices with municipal communal service companies

Municipality	Does municipality have a contract with communal service company for its services?	Does municipality control execution of obligations from contract?	Who monitors execution of obligations from contract within municipality?
Andrijevica	N/A	N/A	N/A
Bar	No. They pay according to municipal plan, not per invoices.	Yes.	Secretariat for housing and communal affairs monitors execution of works.
Berane	Yes	Yes. The Company submits requests for payment for the services provided and the Municipality transfers the money.	Secretariat for Finance
Budva	No for 2005. Yes for 2004. Work is planned according to Municipal Program and contracts are signed in accordance with the Program.	Yes. Every bill PCC presents to Municipality for payment must be first signed by authorized municipal officer confirming that work has actually been done.	Secretariat for Communal Affairs within Municipality.
Kotor	No. They have Municipal Decision approved by the Assembly and published in the Gazette.	No. Agency for Development and Construction of Kotor is in charge.	Agency for Development and Construction.
Mojkovac	Yes. The Annual Contract is signed between the Fund for City Construction Land and the Company.	Municipality transfers the money to the Fund for this purpose.	The Fund performs monitoring and control.
Podgorica	No.	Yes. The Company submits the requests for transfer of money for services provided.	Secretariat for Finance.
Tivat	N/A	N/A	N/A
Plav	Yes. Contract has been signed on 2001 and is renewed.	Yes.	Directorate for development and construction monitors execution of obligations from the contract

Notes: Data collected in October 2005 survey of municipalities. The three largest municipalities do not have contracts in place for municipal services

Table 8. Reported municipal arrearages as percentage of actual 2004 revenues

Municipality	Reported municipal arrearages (€), January 2005	Reported municipal revenues (€), 2004	Reported municipal arrearages as percentage of 2004 revenues
Andrijevića	31,000	574,597	5.4%
Bar	301,000	6,474,727	4.6%
Berane	904,713	2,634,432	34.3%
Bijelo Polje	401,000	6,470,091	6.2%
Budva	11,000,000	10,012,896	109.9%
Danilovgrad	396,632	1,266,168	31.3%
Herceg Novi	454,700	5,068,310	9.0%
Kolašin	186,378	1,353,126	13.8%
Kotor	856,700	2,221,733	38.6%
Mojkovac	244,287	769,964	31.7%
Nikšić	1,039,826	8,035,012	12.9%
Plav	282,115	1,311,978	21.5%
Plužine	44,379	722,606	6.1%
Pljevlja	1,542,673	3,912,376	39.4%
Podgorica	5,086,896	19,118,983	26.6%
Rožaje	111,729	1,776,976	6.3%
Tivat	50,000	2,074,773	2.4%
Ulcinj	595,000	1,770,065	33.6%
Ćetinje	428,631	1,601,675	26.8%
Šavnik	20,000	354,679	5.6%
Žabljak	-	538,139	0.0%
Median municipal arrearage as % of total 2004 revenues			13.8%

Table 9. Proposed Fiscal Decentralization Reform Objectives and Activities

No.	Decentralization Element	Objective	Indicators and Activities
0	Preconditions	Municipal property rights established.	1. Adoption of Municipal Property Law; 2. Development and provide full GoM property register to municipalities. 3. Convey properties (including city construction land) to municipalities and record at Cadaster.
1	Locally accountable municipal councils	A. Municipal assembly members directly elected	Modify Law on Elections to allow direct election of assemblies.
		B. Enhance assembly effectiveness	Number of assembly members pass certification tests on: 1. Introduction to policy making and budgeting. 2. Budget review, monitoring and evaluation. 3. Statutory obligations of assemblies 4. Fiscal obligations of assemblies. 5. Introduction to assembly operating procedures.
2	Locally appointed chief officers	Professionalize senior recruitment and promote retention	A. Development of template senior job descriptions and qualifications (varied according to region/municipal size, etc.)
			B. Training program on professional recruitment and use of screening committees.
			C. Training program on staff evaluation procedures.
3	Significant local discretion to raise revenues	A. Incentive grants reward municipal collection rates	Modify incentive grants to be based upon actual collection rates that are set according to municipal location and size
		B. Local revenue system based on simplified and appealable taxes, charges or fees.	Review, consolidate and base revenues upon taxes or charges and fees that are based upon cost of service. 1. Expand real estate tax to include movable and utility property. 2. Consolidate duplicate administrative fees and adjust them to include related communal fees. 3. Eliminate most or all remaining communal fees.
		C. Increased central government cooperation to support local revenues.	1. GoM halts practice of swapping unpaid taxes for unpaid GoM bills. 2. Review and simplify annual provision of cadastral data to municipalities. 3. Routinely supply GoM PIT payments to enable municipal receipts of PITS.

3	Significant local discretion to raise revenues	D. Increased revenue transparency	1. All local revenues, with possible exception of water/sewer charges should be collected and reported through a central municipal revenue account. 2. All local fees, charges and taxes should be approved during adoption of the municipal budget.
4	Significant local expenditure responsibilities	A. Document mandated municipal expenditures	1. Review all legislation and document mandated municipal expenditures 2. Document municipal performance levels. 3. Cost municipal expenditures and test for adequate expense and funding levels. 4. Develop revised municipal expenditure requirements. 5. Revise expenditure and revenue assignments as needed
		B. Increase expenditure transparency	1. Enforce that all municipal expenditures be processed and reported through treasury.
5	Budget Autonomy	A. Timely and effective assembly budget supervision.	Enhance assembly performance through training programs on: 1. Policy and budget setting 2. Budget review, monitoring and evaluation 3. Assembly statutory obligations 4. Assembly fiscal obligations 5. Assembly procedures
		B. Enhance GoM municipal training and oversight	1. Establish municipal support unit 2. Establish and enforce municipal financial and budgetary reporting 3. Consolidate and post comparative municipal financial performance data on web.
6	Hard budget constraint	A. Timely and effective assembly budget supervision.	1. Municipal training program on making mid-year budget revisions 2. Modify LLGF to require assembly approval for reserve fund transfers.
7	Transparency	A. Enhance citizen awareness of municipal financial performance	1. Adopt single entity budgeting and reporting standards. 2. Draft templates for municipal service performance contracts. 3. Provide media special workshops similar to assembly member training to enhance media financial and regulatory literacy.
8	Freedom from excessive central expenditure mandates.	Full compensation awarded to municipalities for unfunded or under-funded mandates.	Annual report by GoM that compares the actual financial impact of legislation on municipalities against the estimated impacts at the time of legislation and recommends funding adjustments, as required.

9	Unconditional transfers from higher level government	A. Full and accurate municipal financial data	1. Single entity responsible for collecting and reviewing municipal data -- with power to enforce withholding grants.
		B. Non-distortive grant criteria	1. Grant allocation determined by non-distortive formula based on population, area, and local revenue capacity.
10	Municipal borrowing powers	A. Municipal indebtedness fully reported and monitored	1. Municipal debt redefined to include unpaid bills and arrearages. 2. Debt reported on quarterly basis with budget reports.

Attachment 1. Municipal responsibilities described in laws

1. Law on Local Governance (Official Gazette 42/03)

Article 32

The Municipality, in accordance with the law, shall regulate and provide:

- 1) Conditions for perform and development of community affairs;
- 2) Conditions for entrepreneurial development;
- 3) Performing affairs of settling, using and protecting construction land;
- 4) Use of business premises;
- 5) Conditions for preserving and protecting natural resources;
- 6) Social welfare in relation to home care and help at home for the aged and persons with disabilities, resolving housing issues for persons with social needs status, and additional methods of social welfare;
- 7) Child welfare in relation to school holidays and other recreational periods during the school term, accommodation, nutrition, and other additional methods of child welfare;
- 8) Conditions for preservation, use, management, and improvement of areas with natural medicinal qualities;
- 9) Public transport of passengers in local traffic areas;
- 10) Affairs of establishing, controlling, and collecting local public revenues;
- 11) Relations in the field of housing, creation of conditions for the maintenance and protection of blocks of flats, and protection of condominium ownership rights;
- 12) Conditions for constructing and using facilities;
- 13) Conditions for providing information to the local population;
- 14) Conditions for protection from natural disasters, fires, explosions, damages, and other accidental and extraordinary events and creates conditions for their prevention;
- 15) Conditions for improvement of sport and physical education, recreation for children, youth, and adults, construction and maintenance of physical education facilities and development of inter-municipal sports co-operation;
- 16) Relations concerning the construction and installation of temporary and other facilities;
- 17) Conditions for protecting monuments of local importance;
- 18) Noise supervision and protection;
- 19) Conditions for development of librarianship and archive activities of local interest;
- 20) Conditions for the development of publishing affairs;
- 21) Conditions for deep-sea navigation on its own territory;
- 22) Working time and conditions in premises providing services to the citizens;
- 23) Conditions for performing auto-taxi transportation;
- 24) Conditions for organizing public affairs of local significance.

Article 33

Within its primary jurisdiction, the Municipality shall also perform the following affairs:

- 1) Take care of protecting eroding areas;
- 2) Determine whether there is within the public interest to expropriate heritable property to meet local needs;
- 3) Manage, dispose, and protect local property;
- 4) Exercise inspection supervision;
- 5) Define offences for violating its regulations and initiate misdemeanor procedure;
- 6) Organize the provision of legal aid to citizens;
- 7) Maintain population data, election rolls and other records, in accordance with the law; issue water management conditions, water management accords, and water management permits;
- 8) Maintain data with respect to communal and sewage effluents, users and polluters of water management facilities and installations and other affairs;
- 9) Determine public acknowledgements and awards;
- 10) Decide on rights and duties of citizens in affairs within its own jurisdiction;
- 11) Meet certain needs of citizens in other fields of direct interest to them;
- 12) In addition, perform other affairs in accordance with the needs of the local population and its interests.

2. Law on Roads (Official Gazette 42/04)

Article 5

With regard to their importance for transportation and function of connecting different areas, public roads shall be categorized into:

- State roads (superhighways, major roads, and regional roads), and
- Municipal (local roads, as well as streets in communities).

The functions related to development, construction, reconstruction, maintenance, protection, use, and management of state roads shall be performed by the administrative body in charge of the state roads.

The functions related to development, construction, reconstruction, maintenance, protection, use, and management of municipal roads shall be performed by relevant local government bodies.

The functions related to development, construction, reconstruction, maintenance, protection, use, and management of municipal roads in parts of special purpose areas (national parks, coastal zone, etc) shall be performed by relevant local government bodies, with previous consent from the relevant public administration body from paragraph 2 of this Article.

The categorization criteria and method of marking state roads shall be defined by the Government of Montenegro (hereinafter referred to as: the Government), and for municipal roads by relevant local government bodies.

Article 27

When a state road is being built through a community, local governments shall fund the following:

- Facilities and devices on, along, or over a state road surface, intended for traffic regulation, i.e. for conducting safe transportation activities through the community;
- Communal infrastructure in the road base;
- Stopping lines, parking lots, and similar traffic ridden surfaces intended for transportation;
- Passages over and under the road for pedestrians and cyclists;
- Lighting, traffic lights, and other sign works intended for traffic safety;
- Sidewalks and cycling paths.

Local governments shall also fund a proportional part of expenses for construction of roads passing through their communities, if the section of the road built through a community is wider for transportation purposes than the road running outside that same community.

Attachment 2. References

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7. Proposals for 2005 Equalization Grant rules and Calculations, Juliana Pigey et al. The Urban Institute, USAID Good Local Governance Project, 8 May 2005
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9. Real Estate Tax Simplification Study, Alan Ferguson (when where is it??)
10. Municipal budget preparation
11. Municipal Financial Reporting.....
12. Any other of importance even if not referenced in the body of the report.

[***you might add a phrase indicating where the archives of the Good Local Governance project are held in case someone is seeking to obtain access to these or other reports.]