Unconditional Transfers: An Important Instrument of Local Public Finance

Prof.Asoc.Dr. Fran BRAHIMI
Department of Finance, Faculty of Economics, University of Tirana
Address: "Arben Broci" Street, Tirana, Albania
Email: franbrahimi@yahoo.com

MSc. Mariel FRROKU
Department of Finance, Faculty of Economics, University of Tirana
Address: "Arben Broci" Street, Tirana, Albania
Email: Mariel.Frroku@unitir.edu.al

Abstract:
This study analyzes the role of unconditional transfers as an important instrument for financial management at the local level, using empirical data and findings from previous studies identified through a literature review. Unconditional transfers, as a significant form of financial intergovernmental transfers, are critical for assessing the central government's impact on local development. An in-depth analysis of the unconditional transfer formula, which includes the decentralization of functions and the distribution of grants, represents an essential tool for evaluating their effect on public services. The unconditional transfer is about 1% of the Gross Domestic Product in Albania and the study of the mechanisms of distribution of this fund is very important to scientifically argue its impact on the well-being of citizens.

This study includes all 61 municipalities established under the new administrative-territorial reform of 2015 and aims to assess both the effectiveness and equity of the unconditional transfer distribution formula. It examines how a fair allocation of unconditional transfers influences the quality of public services and contributes to improving investments at the local government level. The study is grounded in existing literature on this mechanism and draws upon the experiences of countries with characteristics similar to Albania, offering a scientific analysis of the unconditional transfer formula and the factors it should incorporate.

The results of this study clearly identify the key factors in the unconditional transfer formula and its impact on the progress of decentralization reforms, offering scientifically grounded recommendations for improving public policies and enhancing the effectiveness of unconditional transfer distribution.
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1. Introduction

In recent years of reform, Albania has undertaken significant steps toward establishing mechanisms for financing decentralization reforms, with the central aim of strengthening local autonomy and improving the efficiency of local governance in delivering public services (Brahimi, F; Frroku, M; 2025). In this context, the unconditional transfer serves as a crucial mechanism to ensure the efficient provision of public services at the local level. This chapter provides a detailed analysis of the foundations of the current unconditional transfer mechanism used to allocate funds to local government units.

The decentralization reform in Albania has been grounded in the principles of the European Charter of Local Self-Government and the National Decentralization Strategy, which include a commitment to financing local governments through autonomous and independent mechanisms. The approval of a dedicated legal framework in the year 2000 for the organization and functioning of local governance officially recognized, for the first time, the rights of local self-government units in accordance with the Constitution, followed by other laws regulating local governance activities and reinforcing local autonomy.

Reforms introduced in 2001 and 2002 marked significant progress in decentralization and the establishment of autonomous financing mechanisms for local governments. The concept of unconditional transfers for local

governments was formally adopted in the 2001 state budget law, increasing the fiscal autonomy of municipalities to collect revenues from local taxes and fees, as well as to secure a minimum level of funding for essential public services. Despite this progress, the most significant step came with the administrative-territorial reform of 2015, which brought renewed attention to the role of local government in developing public services. This reorganization was driven by several critical factors (Fran Brahimi, Elton Stafa, Mariel Frroku, 2016). First, there was a need to improve the efficiency and accountability of local governance. Existing structures were often ineffective, with limited resources and unclear accountability. The reforms aimed to create a simpler, more manageable structure that would better respond to citizens' needs. Second, the reorganization was necessary to meet the increasing demand for improved public services and to strengthen the financial mechanisms of local government. In both urban and rural areas, populations had rising expectations for faster and better-quality services, putting additional pressure on public service delivery. By decentralizing authority and providing more effective mechanisms for distributing unconditional transfers, the central government aimed to enhance service quality and ensure a more equitable allocation of resources (OECD, 2019).

Under Albania's legal framework for local government organization, mayors and municipal council members are directly elected, while county councils are composed of representatives from municipal councils within the region. Local government functions are divided into two categories: own functions and delegated functions. For their own functions, local governments have full decision-making authority. These functions include basic services such as waste management, public infrastructure maintenance, and local economic development. Delegated functions remain under the primary responsibility of the central government but are implemented by local units, involving the management of special funds and specific programs that require close coordination between the two levels of government (World Bank, 2021). The establishment of this functional model of local governance necessitated an efficient mechanism for distributing transfers from the central budget, with unconditional transfers playing the most significant role.

Following the 2015 administrative-territorial reform, substantial changes were made to the functional and organizational structure of local self-government units, affecting political, executive, administrative, and community structures. The revision of the unconditional transfer distribution formula redefined its role in local government financing.

A key objective of the territorial reform was to promote fiscal and functional decentralization by creating larger and financially stronger local units capable of providing higher-quality and more efficient services. The reform also aimed to reduce excessive administrative fragmentation and improve inter-municipal cooperation, leading to a more coordinated and integrated local governance structure.

Local finances are at the heart of the decentralization process, and one of the main mechanisms is related to intergovernmental fiscal relations, ensuring that local units have access to the minimum necessary funding to fulfill their responsibilities to citizens. To ensure sustainable financing, mechanisms such as the legally adopted unconditional transfer formula have been established. This formula is based on local governments' fiscal capacity and aims to improve the efficiency of service delivery at the local level.

One of the core elements of these reforms is the unconditional transfer distributed through a legal formula, which serves as a key source for financing the gap between citizens' service needs and locally generated revenues. This transfer provides a stable revenue source not tied to specific projects or expenditures, granting local units the flexibility to manage their resources efficiently and responsibly. Nevertheless, despite the availability of such transfers, local own-source revenues remain the primary financing mechanism for fulfilling local government functions.

2. Literature Review

Unconditional transfers, decentralization, and funding sources are concepts central to an extensive discourse within the economic and political literature, addressed by numerous authors globally, though studies focusing specifically on this aspect are largely lacking in Albania. Decentralization processes—at the core of public sector reforms—entail the delegation of authority from central government to local self-government units, which are essentially established as instruments to enhance governance efficiency and increase democratic participation by aligning decision-making with citizens' needs. Unconditional transfers are funds allocated by the central government to local self-governing units without restrictions on their use. This literature review examines existing scholarship on intergovernmental fiscal relations, with a particular focus on unconditional transfers, analyzing their effectiveness, their role in fostering democratic participation, and their impact on local development.

Public financial management at the local level has been extensively studied within the frameworks of governance and public administration theory, as well as intergovernmental fiscal relations. Decentralization theories and performance-based public financial management advocate for the delegation of public service responsibilities to the level of government closest to the citizens—namely, local government. The main arguments for deepening decentralization and implementing intergovernmental transfer mechanisms include:

- **Improving the efficiency of public services:** Bringing decision-making closer to citizens and ensuring adequate financial resources through central government transfers allows local units to respond more effectively to local needs and preferences. This can lead to better-tailored service provision at the community level (Oates, 1999).
- **Enhancing citizen participation and accountability:** These instruments promote civic engagement in local decision-making processes, strengthening a sense of responsibility and government accountability (Faguet, 2004). The more stable the funding mechanism, the stronger the link with service delivery at the local level
- **Promoting local economic development:** With the authority and adequate resources from the central government, local units can prioritize economic growth and the qualitative development of public services (Smoke, 2015).

Local government units can allocate central government transfers in the most appropriate ways, an indicator that supports more effective resource management (Bahl & Linn, 1992). Unconditional transfers may enhance the financial autonomy of local units, enabling them to plan and implement long-term development projects (Bird & Smart, 2002). By having the discretion to decide how funds are used, local governments can optimize expenditures and improve public service delivery (Rodden, Eskeland, & Litvack, 2003).

Reforms at the local level in Albania have aimed primarily at enhancing governance efficiency and increasing the financial autonomy of local government units. These reforms have been supported by various legislative changes and public policies intended to strengthen the administrative and financial capacities of local authorities (Brahimi, Stafa, & Frroku, 2016). One of the primary financial sources for local government units in Albania has been the unconditional transfer, distributed through a legally defined formula, which constitutes a significant revenue stream. These transfers have played an important role in supporting local budgets and promoting fiscal autonomy (Ebel, R. D., & Yilmaz, S., 2002). Nevertheless, empirical studies indicate that the level of decentralization in Albania remains low despite efforts to strengthen local governance. A recent case study on Albania (Frroku & Brahimi, 2023) has scientifically confirmed that local self-government units continue to rely heavily on central government financing and require improvement in both administrative and managerial capacities. Econometric analyses have demonstrated that unconditional transfers have a significant impact on the well-being of local units in Albania. The same study (Frroku & Brahimi, 2023) found that these transfers support expenditures for public services and local investments, leading to improved service delivery and infrastructure development.

Closely tied to public financial management processes, decentralization is defined as the transfer of powers and resources from higher to lower levels in a political system. According to Bardhan, P., & Mookherjee, D. (2006), based on the relationship between central and local government, decentralization is categorized into:

- Deconcentration
- Delegation
- Devolution (Transfer of competences)

Deconcentration is viewed as a form of administrative decentralization, in which higher-level government agents shift responsibilities to lower levels. **Fiscal decentralization** occurs when higher levels of government transfer budgetary and fiscal decision-making authority to lower levels. **Devolution**, a more comprehensive form of decentralization, involves the transfer of resources, powers, and often responsibilities to lower-level authorities that are largely independent from higher levels and are democratically empowered. For democratic decentralization to succeed, it requires a robust framework in which local governments possess the authority, resources, and accountability mechanisms necessary to function effectively. In theory, decentralization fosters a sense of ownership over governance and enhances stakeholder engagement (Weingast, 2021).

In conclusion, existing literature provides clear evidence that decentralization and unconditional transfers can yield positive outcomes in terms of governance efficiency, democratic participation, and local development. However, to realize these benefits, it is essential to ensure a strong institutional and political framework that supports the financial and administrative autonomy of local government units.

3. Methodology

This study employs a mixed-methods approach, combining both qualitative and quantitative techniques to assess the impact of unconditional transfers at the local level in the case of Albania. Evaluating the model of unconditional transfers enables a comprehensive and in-depth analysis by leveraging the strengths of each methodological approach in understanding their influence on the financial sustainability of local governance. In the qualitative component, key policy documents, international reports, and relevant academic literature are reviewed to better understand the institutional and contextual framework of decentralization and local government financing.

Quantitative data were collected from official sources such as the Institute of Statistics (INSTAT), the Ministry of Finance, and other public finance and decentralization-related reports. The quantitative analysis applies statistical techniques, primarily regression analysis, to evaluate the relationship between decentralization, unconditional transfers, and various economic and social performance indicators at the local level. This includes both time-series and cross-sectional data analysis to identify significant patterns and trends.

Data and analytical insights were gathered from institutions such as the Ministry of Finance, the former Ministry of Local Government and Decentralization, the Ministry of Internal Affairs, INSTAT, and academic publications by both Albanian and international authors. Tables and graphs are utilized to better illustrate the results.

The economic model used in this study is a panel data econometric model, based on a balanced panel where each local government unit is represented with the same set of variables across the observed years. The statistical software "Eviews" is used for data processing, focusing on the relationships between local government revenues and key welfare indicators, such as investments and public service expenditures.

Table 1: List of variables

Variable Name	Variable Description	Variable Type
M	**Welfare = Investments + Public service expenditures**	**Dependent**
TRK	**Conditional transfers**	**Independent**
TRP	**Unconditional transfers**	**Independent**
TRV	**Own revenues**	**Independent**
P	**Population**	**Independent**
S	**Surface Area**	**Independent**
BN	**Municipality in need**	**Independent**
BM	**Mountain municipality**	**Independent**

Source: Author's work (2025)

The model is built on a reliable dataset that informs the formulation of a new unconditional transfer mechanism and the allocation of central government revenues to local governments. Data are based on the 2015 administrative-territorial reorganization, covering 61 municipalities over the period 2012–2023, resulting in a

total of 671 observations per variable. Each former commune has been integrated into its corresponding municipality, preserving its characteristics and forming new administrative units.

This model aims to test the following hypotheses:

> *H_0: Welfare indicators are influenced by the funding sources of local governments.*

> *H_1: Welfare indicators are not influenced by the funding sources of local governments.*

By combining qualitative and quantitative methods, this methodology provides a comprehensive analysis of the impact of decentralization and unconditional transfers at the local level. Integrating document analysis with statistical techniques, the study contributes to the existing literature and offers evidence-based recommendations for improving public policy in Albania.

4. Budget Allocation Efficiency in Albania

One of the key aspects in assessing the performance of local government is measuring the efficiency of budget fund utilization. This indicator is crucial as it directly relates to the intergovernmental fiscal relations established over time between central and local authorities. The sources of financing are fundamental, as they significantly influence the spending behavior of local governments over time. Changes in the structure of financing, as illustrated in the graph below, provide a clear visualization of how these dynamics have evolved.

Graph 1: Local Government Budget by Source of Revenue
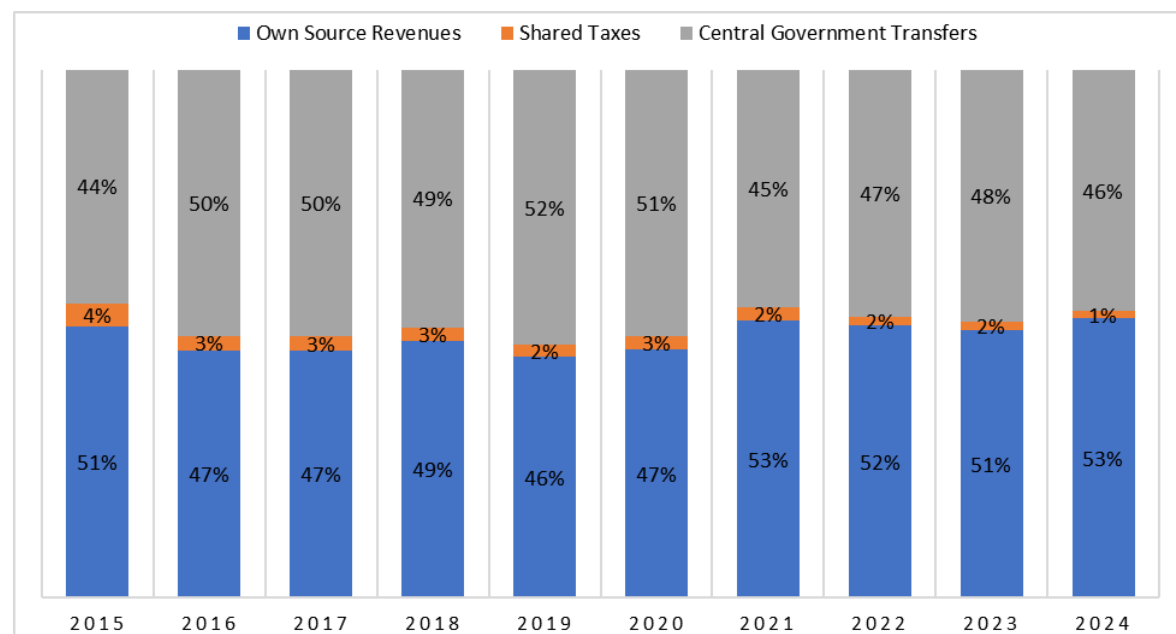
Source: Ministry of Finance (2025)

The main factors significantly affecting the financial capacity of local governments include:

- Potential areas for stimulating local development

In response to the failures of centralized governance, decentralization has become a global trend. Cities and local governments, particularly in rural areas, are increasingly empowered across all continents. A major rationale behind the decentralization of responsibilities is to grant more authority to lower levels of governance, driven by objectives such as: improving local government efficiency and accountability; enhancing the influence of local authority in development; strengthening democracy and protecting civil liberties; and increasing the capacity to

safeguard minority rights and values. One of the most important advantages that decentralization offers to local governments over centralized systems is enhanced legitimacy. When citizens trust their officials and actively engage in community improvement, their overall relationship with the state also improves. Hence, while decentralization may reduce central government authority, it simultaneously enhances the legitimacy of the state as a whole. Decentralization should thus not be perceived as a dichotomy of "local versus central government," but rather as a mutually beneficial framework for all levels of government and citizens.

However, experience has shown that local governments are often capable of effectively implementing development policies and programs, especially when provided with the necessary authority and resources. It is important to note that good governance is not an automatic outcome of decentralization—it must emerge as a result of a comprehensive and inclusive reform process. Still, if local governments are adequately empowered, the likelihood of achieving better outcomes than centralized governance increases significantly.

The territorial-administrative reform has strongly influenced the functional and organizational restructuring of local governance units, affecting both political and administrative structures, as well as service delivery mechanisms. This reform has also reshaped intra-municipal relationships and the dynamics between local governments and the deconcentrated structures of the central government.

**Graph 2:** Unconditional Transfers Over Time
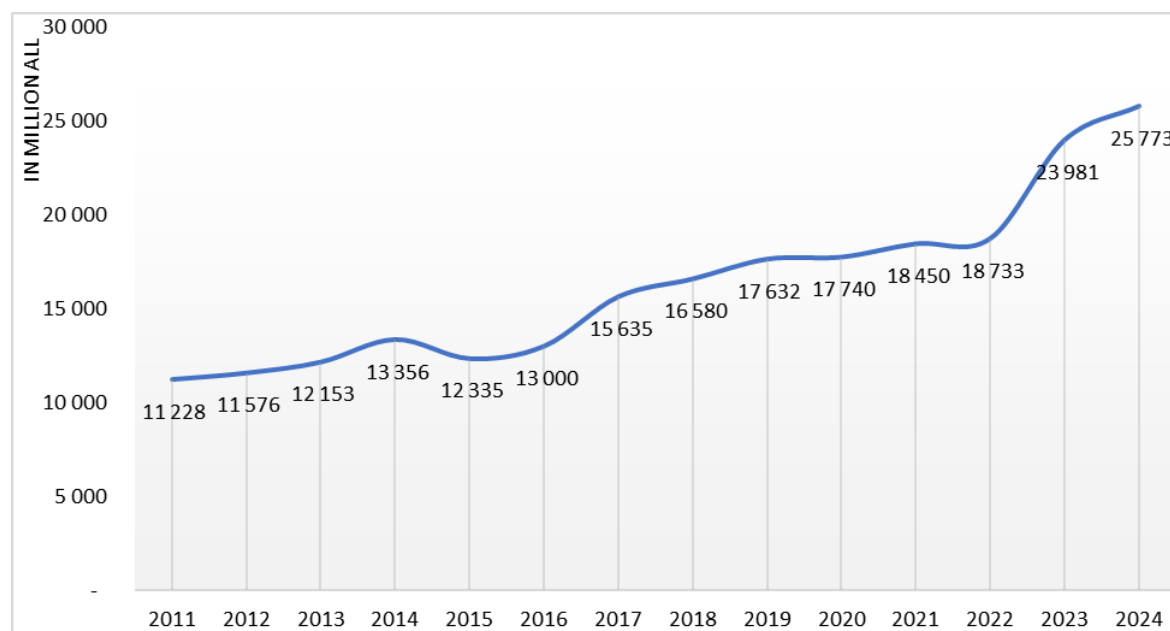
Source: Ministry of Finance (2025)

Decentralization also fosters a stronger sense of community, respect for public spaces, and the conceptualization of environmentally responsible action. It supports comprehensive, inclusive planning with long-term potential. In many countries, enhanced local self-governance has been designed to ensure self-determination and protect minority rights against majority domination. These aspects contribute to better territorial control and development orientation.

However, recent developments in Albania have highlighted inefficiencies among local governments in managing and responding to unregulated urban development, especially in the western regions. This raises the question: How can this uncontrolled development be curbed, and what role should the newly consolidated municipalities play?

Graph 3: Indicators of Local Government Autonomy
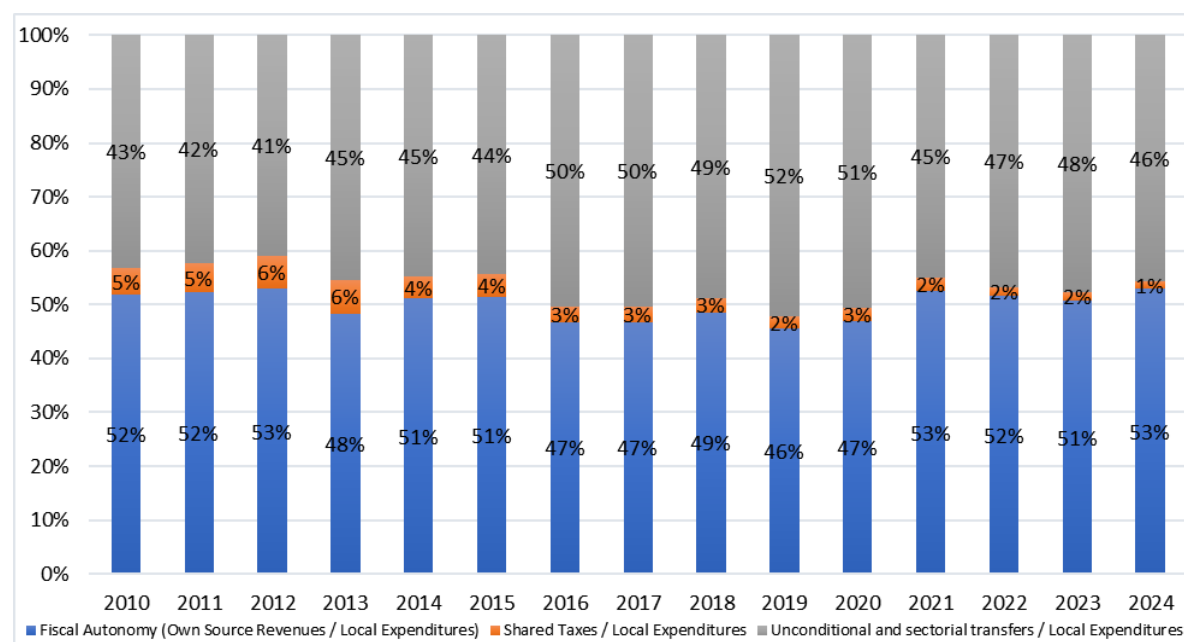
Source: Ministry of Finance (2025)

Despite skepticism that larger territorial units might complicate governance and territorial coverage, both literature and international experiences offer several arguments to refute such concerns:

a) Larger municipalities have sufficient financial and human resources to exercise more effective territorial control, preventing unregulated, visionless development.

b) Territorial expansion enhances the municipality's capacity to develop and implement comprehensive urban planning strategies, guiding future development based on clearly defined objectives.

c) Decentralization and territorial enlargement reinforce local decision-making power, increasing the influence of local governance over the areas they administer.

d) Uncontrolled development can be curtailed because larger municipalities are more likely to pursue integrated planning efforts and implement strategies aimed at systematically organizing residential areas.

The ongoing territorial reform in Albania is built upon the principle that expanded powers and responsibilities should enable local governments to play a decisive role in guiding sustainable and controlled development. A more competent local unit—closer to both the population and the territory represents the most effective solution to managing development and ensuring long-term territorial integrity.

5. Funding Scheme and Empirical Assessment

Starting from the year 2003 and especially after the administrative-territorial reform, the scheme of fund distribution from the state budget, primarily regarding unconditional transfers, has changed. From the empirical practice of fund distribution, the process has moved towards formula-based allocation, based on several indicators, with the objective of establishing the highest possible level of fairness in this regard. The application of the formula has made it possible that the distribution of grants from the state budget operates towards achieving proportionality and equalization — both vertical (top-down, from the state budget to the budgets of local government units) and horizontal (among local government units). Another important argument that further

highlights the need for a decentralization process is the almost total inability of all local units in Albania today to support and stimulate local economic development, as well as the high level of inequalities created not only as a result of the administrative-territorial division but also as a result of the fiscal decentralization policies pursued over the years.

The reform aimed at decentralization and division into polycentric functional zones of local government units will bring innovations and, along with them, characteristics will change. For this reason, it is necessary to study at least a little the effect and forecast of these changes. All these changes start with the factors (variables) which the budgets of local government units will face, with the importance and specifics of funding being altered.

Table 2: Measurement and source of information for variables

Variable Name	Variable Description	Measurement	Source
M	Well-being = Investments + Expenditures for public services	In thousand ALL	Ministry of Finance
TRK	Conditional Transfer	In thousand ALL	Ministry of Finance
TRP	Unconditional Transfer	In thousand ALL	Ministry of Finance
TRV	Own Revenues	In thousand ALL	Budget Directorate
P	Population	Number	Civil Registry
S	Surface Area	Square Kilometer	INSTAT
BN	Municipality in need	Income per Capita	INSTAT
BM	Mountain Municipality	Geographical Terrain	Institute of Geography

Source: Author's work (2025)

To assess the impact that several economic indicators and very decisive factors have on the evaluation of governance in local government units, a statistical (econometric) analysis was developed. This entire analysis is based on two perspectives: first, understanding the weight and behavior of the three main types of revenues of local government units according to the new territorial division relative to investments and expenditures for public services these units perform annually. The dependent variable is a direct influencer on the well-being of specific areas and therefore is considered as such in the analysis. Secondly, we will analyze the importance that the elements of the formula for distributing the unconditional transfer will take on the amount of transfer allocated according to the new administrative division. Through this, we will argue the necessary changes to the formula and what should be improved, by adding or removing components. Through this whole analysis, the goal is to reach certain valuable conclusions for the study.

In the first econometric model, we examined the impact of the following factors: i) conditional transfer, ii) unconditional transfer, and iii) own revenues. To test the effects that these variables have on the dependent variable considered as well-being. The first estimated model is:

$$Y = C + X1 + \beta2X2 + \beta3X3 + \mu$$

$$M = -103105.3 + 1.29TRK + 0.93TRV + 1.8TRP \quad (1)$$

Table 3: Model Evaluation

Dependent Variable: M
Method: Panel Least Squares
Date: 05/22/24 Time: 23:08
Sample: 2012 2023
Periods included: 11
Cross-sections included: 61
Total panel (balanced) observations: 671

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-103105.3	14740.42	-6.994731	0.0000
TRK	1.295340	0.153804	8.422002	0.0000
TRV	0.931399	0.024411	38.15534	0.0000
TRP	1.803847	0.129943	13.88180	0.0000

R-squared	0.923025	Mean dependent var		497261.6
Adjusted R-squared	0.922678	S.D. dependent var		946182.0
S.E. of regression	263102.7	Akaike info criterion		27.80442
Sum squared resid	4.62E+13	Schwarz criterion		27.83130
Log likelihood	-9324.383	Hannan-Quinn criter.		27.81483
F-statistic	2666.033	Durbin-Watson stat		0.812660
Prob(F-statistic)	0.000000			

Source: Author's work (2025)

From data processing, the results emerge according to the above formula, where the table describes every statistical detail. As can be clearly understood, the statistical model is fully significant because the observed Fisher value (Fv = 2666) is 2666, much greater than the Critical Fisher value (Fc = 5) which is equal to 5. In this way, we can affirm that well-being (Investments and Expenditures for Public Services) is highly influenced by these three forms of revenues that the local government secures. Also, the explanatory power of the model is high, ensuring that investments and expenditures for public services of municipalities depend about 92.3% on these forms of revenues of the local government units.

Own revenues are a variable that turns out to be statistically very important and with a considerable impact compared to the other revenues taken in the study. This variable includes all the revenues secured by the local government unit from taxes and fees that the central government has transferred for them to administer and collect. Compared to the amount of revenues from taxes and fees that local government units potentially have the capacity to collect, what is actually collected is at the lowest levels, thus expressing the weakness and inefficiency in their collection by the current local administration. Based on the student's t-distribution, the variable is important for well-being, statistically explained by the fact that the observed student's t-value is 38.15, much larger than the critical t-value of 2. Certainly, the analysis shows that, if all other conditions remain unchanged, an increase in revenues collected by a local government unit would reflect a smaller increase in well-being by 0.93 units. From this, we understand that their importance in well-being decreases because, besides the inefficiency in collection, a considerable part of these revenues is used to cover the operational (administrative) expenses of the unit's activity, which is not accompanied by a significant increase in the added value of the well-being of these local government units. Thus, the growth rate of revenues from local taxes and fees is smaller than the growth rate of local well-being. This indicates that local administrations are still not at the required level of efficiency in the use of public funds.

The second test conducted is directly related to the formula for unconditional transfer, where the dependent variable is the aggregated amount by municipalities in the new administrative division, and the independent variables are the four elements of the formula. This form of testing was done to understand the role of each part of the formula in the total transfer to local government units. Also, this testing aims to highlight whether there will be a need for a change in the distribution formula of the unconditional transfer after the new administrative division. The analysis included qualitative, quantitative, and dummy variables to best realize the statistical model.

Of course, the model was statistically evaluated to test this, producing results as below:

$$Y = C + X1 + \beta2X2 + \beta3X3 + \beta4X4 + \mu$$

$$TRP = 24126 + 103.5S + 1.12P - 8910BN - 5452BM \quad (2)$$

Table 4: Model Evaluation

Dependent Variable: TRP
Method: Panel Least Squares
Date: 05/22/24 Time: 23:12
Sample: 2012 2023
Periods included: 11
Cross-sections included: 61
Total panel (balanced) observations: 671

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	24126.62	5741.951	4.201815	0.0000
S	103.5077	11.61288	8.913182	0.0000
P	1.122632	0.030294	37.05734	0.0000
BN	-8910.560	5704.786	-1.561945	0.1188
BM	-5452.864	6454.958	-0.844756	0.3986

R-squared	0.777890	Mean dependent var		141764.9
Adjusted R-squared	0.776556	S.D. dependent var		150002.3
S.E. of regression	70905.84	Akaike info criterion		25.18352
Sum squared resid	3.35E+12	Schwarz criterion		25.21711
Log likelihood	-8444.070	Hannan-Quinn criter.		25.19653
F-statistic	583.1297	Durbin-Watson stat		0.521721
Prob(F-statistic)	0.000000			

Source: Author's work (2025)

Looking at the statistical evaluation of the model in the above table, we understand the characteristics of the formula and the allocation according to the included features. It is clear that the model is statistically significant because the observed Fisher value (Fv = 583) is 583, a value much higher than the critical Fisher value which is 5. From this, we can say that the unconditional transfer statistically stands as a strong connection of the variables on which it is calculated, showing that despite the need for changes that will be analyzed below, the formula overall has been successful in budgetary orientation. The inclusion of logically necessary elements is also statistically confirmed by the Panel Data analysis according to the new administrative-territorial division. Also, from the statistical evaluation, another important element is clearly understood: the coefficient of determination, which stands at 77.7%, a considerable but also debatable value for the level it represents. This coefficient shows that the unconditional transfer according to this formula is explained up to 77.7% by the independent variables, which in our case are part of the components of the formula.

The Surface Area represents the extension in square kilometers, where according to the new administrative division a given municipality comprises the sum of all communes attached to it. It constitutes a statistically significant variable for the model and is characterized by its coverage area, so its extent has particular importance. Its importance was tested through the student's t-distribution; in this case, this variable has a student's t-value of 8.91, which is higher than the critical student's t-value of 2. In this sense, we can say that area is a variable that has increased the importance of the formula, making it more efficient and fairer in allocation. On the other hand, we can say that, holding other factors constant, a one-unit increase in area for the local government unit would increase the amount of funds it receives by 103.5 units. Consequently, we say that a municipality with a larger area should certainly have higher investments and public expenditures, and accordingly, the formula for unconditional transfers should favor this fact.

The Population is a variable included in the formula for unconditional transfer and is taken for the administrative division as the total population of each unit attached to the new unit. Population can logically be considered the most important variable because in the continuous effort to improve population welfare by increasing investments and expenditures for public services, the need for more funds significantly increases. In this way, the formula should favor population as a variable, meaning the more population a local government unit has, the more transfer it should receive. Statistical analysis of the variable's importance through the student's t-distribution shows that it is significant because it has a student's t-value of 37.05, much larger than the critical value around 2. Also, analyzing the formula, we understand that under unchanged other variables, an increase of one unit in population would correspond to an increase of 1.12 units in transfer for a given area. From this, we have statistically confirmed that population is a very important variable for the formula and its weight should be increased to follow the logic that for an area with more population, the need for investment funds and operating expenses from the local government unit increases.

The population currently used is that of civil status, which due to the specific characteristics of our country raises many discussions. The discussions about this indicator relate to the fact that part of the population has migrated or emigrated. Migration is somewhat controlled since according to legislation every move from one area to

another as a change of residence should be accompanied by a change in civil status. Emigration is more problematic since a good part of the population appears with civil status in different places in Albania while they have emigrated for years to various countries. This indicator has been debated by specialists, experts, and local officials on whether it would be better to use census data. Census data are somewhat more realistic, but since they are data taken at a specific moment, they become outdated quickly regarding their accuracy. In this case, it would be suggested to consider both data sources according to a formula assigning weights to each.

Another problem related to the population indicator, which could be considered in the new formula, is the grouping or classification of the population by age groups. Since different age groups have differences and characteristics, costs and expenditures are also different. For this reason, it is necessary that the new formula considers this indicator to be used according to population age groups, giving each group the necessary weight within the coefficient of this criterion.

Municipality in need is a new characteristic included in the formula for unconditional transfer to increase the efficiency of budget allocation and to send funds where the need is most immediate. This variable was used in the old formula as a way to favor certain areas with a low GDP per capita ratio, thus preventing the creation of large disparities in the living standards between local government units. As can be seen also from the statistical study, the variable "municipality in need," taken as a dummy variable, becomes insignificant for the model because the observed student's t-value -1.56 is greater than the critical -2. In this sense, we argue the finding that with the new administrative division, the difference in living standards between the populations of the 61 municipalities' decreases, moving toward a higher level of unification of per capita revenues of local government units.

Mountainous municipality describes the geographical terrain in which a certain unit is located, thus differentiating municipalities based on this criterion for the amount of unconditional transfer. Geographical terrain is often considered an obstacle factor, due to poor infrastructure and unfavorable time conditions, and for this reason, efforts have been made to encourage these terrains with grants and continuous funding to maintain their living standards and welfare. This geographical indicator has also been used to reflect the differences and variability in the costs of public services. Various public services in mountainous units are provided at higher costs than those in local units in plain areas due to geographical conditions.

However, with changes and infrastructural investments, the priorities of mountainous municipalities may change, becoming an important catalyst between welfare and their owned resources such as tourism, climate, natural resources, etc. Also, comparatively, due to the above-mentioned resources, a certain unit, despite being mountainous, may have higher welfare than a non-mountainous municipality. In this sense, the larger geographical area has weakened the logic that a mountainous area needs more funds, because a municipality with a wider area should promote fairer reallocation favoring its zones.

6. Conclusions

From the theoretical analysis and statistical evaluation of the variables, this study draws important conclusions. The analysis of the period 2002–2024 shows that local government expenditures are significantly dependent on transfers from the central budget, a clear indicator of the importance of unconditional transfers for guaranteeing public services. The weight of the unconditional transfer should be closely linked to the functions, competencies, and fiscal autonomy related to local taxes and fees in order to ensure equality and development potential. To ensure a sustainable legal basis, the formula should be supported by effective criteria that encourage local self-government units to develop.

The econometric model of the study confirms the important relationship between local government financing from central transfers as an intergovernmental fiscal relationship and the improvement of welfare indicators such as investments or expenditures for public services. Any increase in funding sources from the central government will directly affect public services, regardless of whether it comes from own revenues or central budget transfers. Meanwhile, in the unconditional transfer, variables that have created an opposite impact in the distribution mechanism are being a mountainous municipality or a municipality in need for certain local self-government units. This is because these municipalities, for factors not linked to equal principles with other municipalities, have received greater financial support to ensure the minimum of public services. Furthermore, the study shows that the unconditional transfer has a strong statistical relationship with the variables on which it is calculated,

indicating that despite the need for changes, the formula has been successful in budget orientation and requires further improvements due to territorial division and population changes caused by migration and emigration policies.

In this regard, it is recommended that the transfer preparation process includes two main steps: first, the use of a mechanism to determine the amount of funds linked to an element that promotes performance, and second, a revision of the formula for distributing unconditional transfers to local government units according to a strong equalization-based mechanism that will ensure equality and reduce differences in the quality of public services.

Econometric and quantitative tests show that the level of decentralization in Albania remains low, despite changes, due to the high dependency of local budgets on central government financing. The analysis shows that welfare, measured through investments and expenditures for public services, is significantly influenced by different forms of local revenues. The policy of conditional transfers should be reviewed to reduce their weight or to increase local representation in decision-making. Also, government functions should be reviewed, and the decentralization process deepened, aiming for functions better performed at the local level to be transferred there. This would relieve the central government from some routine functions and improve its role as a policymaker. This study creates a strong theoretical base for detailed analysis of all potential variables that could be included in the unconditional transfer formula. The finding of this study can be a arguments for the future research on the optimal weight of this transfer in local budget that will ensure a significant role of local government in public services.

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