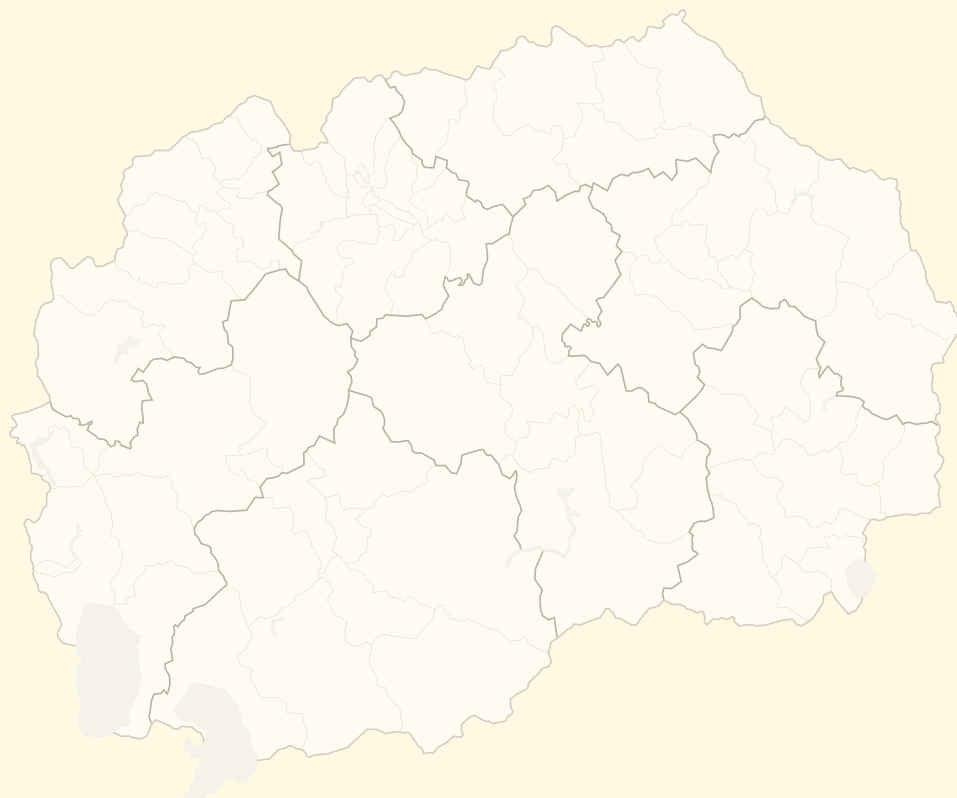


IMPACT ASSESSMENT OF THE UKRAINE CRISIS ON MUNICIPALITIES IN NORTH MACEDONIA





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INTRODUCTORY NOTE:

In May 2022 the UNDP country office in North Macedonia began a process that commissioned the making of two impact assessment studies aimed at providing a comprehensive valuation of the 'impact of the Ukraine crisis on the socio-economic situation' in the country.

We pursued two studies, one focusing on the impact of the crisis on local governments, and the other focusing on the availability and price of commodities in the energy and agricultural sector, and how in return this impacts the socio-economic milieu in the country.

With this publication, we would like to share the 'executive summary' from the report that investigated the impact assessment of the Ukraine crisis on municipalities in North Macedonia.

Report commissioned
by the UNDP country office
in North Macedonia

Authors: Aleksandar Stojkov
Agron Rustemi

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EXECUTIVE SUMMARY OF THE REPORT

The multidimensional crisis (multiple crises) worsened the environment for local governments. The Ukraine crisis is one aspect of the multidimensional crisis in 2022, a complex combination of ongoing Covid-19 pandemic, energy crisis, higher inflation, and security crisis in Europe. The crisis not only put pressure on revenue, expenditure, and financing side of local budgets, but also revealed the long-term systemic weaknesses in the design of intergovernmental fiscal relations.

Relevant period and comparison basis. The cutoff date of the analysis is the second half of August 2022, so the relevant period under investigation is January-July 2022. We use most recent data for revenue, expenditure, financing, and arrears of 81 municipalities in North Macedonia. The analysis uses budget items (three-digit level) and budget sub-items (six-digit level), where necessary. The comparison is not only with respect to 2021 – which was a pre-election period for the local polls organized in October 2021, but also with regard to the pre-pandemic levels (2019 as a “normal” base year) and the pandemic 2020 year (as another crisis year).

Local government revenue in the first seven months of 2022 was

1.3 billion denars

lower or

5.4% less compared
to Jan-Jul 2021

The impact of municipal financing on the provision of local public services is felt through two groups of factors: (1) long-term (structural, persistent) factors, such as the design of the inter-governmental relations, and (2) short-term factors felt during the Ukraine crisis.

72.2%

of the surveyed municipalities stated that the Ukraine crisis negatively impacted the normal functioning of the municipality

Short-term problems felt during the Ukraine crisis in 2022 encompass problems in tax and non-tax revenue collection, substantially increased costs for communal utilities (especially, electricity and other energy bills) and transport costs, slowdown of local investments, postponed projects and initiatives, etc. Significantly increased current expenditure, rising prices of construction materials, and tighter financing conditions for municipalities are undermining local investment and local public service delivery.

Strong impact of the Ukraine crisis. 72.2% of the surveyed municipalities stated that the Ukraine crisis negatively impacted the normal functioning of the municipality. Municipalities in North Macedonia are facing enormous challenges in functioning and maintaining the service delivery as a result of the Ukraine crisis.

The increase of cost of goods and services mainly due to higher prices of electricity, fuel prices, other heating materials, etc. had a direct impact on their financial position and ability for public service delivery.

Declining local revenue in Jan-Jul 2022.

Local government revenue in the first seven months of 2022 was 1.3 billion denars lower or 5.4% less compared to Jan-Jul 2021. We observe moderate changes in the revenue composition. Tax revenues in Jan-Jul 2022 were lower by 464.6 million denars or 7.5% less compared to the same period last year. The inflow of inter-governmental transfers was also lower: 816.5 million denars less or 5.4% less compared to Jan-Jul 2021. The decline in inter-governmental transfers is to a large extent due to lower surplus (unused funds) carried forward from 2021. Grants are lower by 22.8% or 134.2 million denars, but more or less in line with the pre-pandemic 2019 level. During the observed period, non-tax revenue and capital revenue registered increase of 2.6 and 2.7%, respectively.

Tax revenues in Jan-Jul 2022 were lower by

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LG expenditure of the entire local self-government are almost at the same level (only 0.03% lower) in Jan-Jul 2022 compared to Jan-Jul last year. However, there are important structural changes within LG expenditure. We

1.3 billion denars

more are spent in Jan-Jul 2022 compared to the same period in 2021

observe an expansion of current expenditure, so that 1.3 billion denars more are spent in Jan-Jul 2022 compared to the same period in 2021. In the same period, a slowdown of local investments (capital expenditure by the local governments) occurred, so that 1.3 billion denars less are spent in Jan-Jul 2022 compared to the first seven months of 2021.

Deteriorated financial position of the central budget, the associated lack of fiscal space and/or political will to help financially distressed municipalities implies that solutions have to be found by the local self-government itself. Local governments could consider additional borrowing, but the interest rates have also increased several times by end-August 2022. More than 30% of the municipalities in North Macedonia revised their budget so far, due to the negative impact of the Ukraine crisis.

What are the major changes on the expenditure side in Jan-Jul 2022? There has been a massive increase of LG expenditure for communal services, heating, communications, and transport of nearly 747 million denars. And this number cannot capture the full-blown impact of the energy crisis, as some energy bills (electricity, gas supplies, wood for heating, etc.) are not yet paid. The payment of the bills is either reprogrammed

The costs are higher by nearly

747 million denars

compared to Jan-Jul 2021

in more installments or simply put aside in the shelves as municipal arrears. Travel and daily expenses were temporarily low in Jan-Jul 2021. Erasmus-sponsored school trips and fiscal prudence before elections were the main reasons behind the exceptionally strong rise in Jan-Jul 2022. Contractual services, wages and subsidies for local public enterprises are also on the rise.

Communal services, heating, communications, and transport is one of the expenditure categories that experienced very strong growth during Jan-Jul 2022. The costs are higher by nearly 747 million denars compared to Jan-Jul 2021. This is a massive and unprecedented increase in a short period. Two thirds of these costs refer to electricity bills (67.9%), followed by liquid fuels (9.0%) and water supply and sewage (4.1%). Costs for electricity bills more than doubled in the analyzed period, registering a rise of more than 110%. The increase of other costs was also very strong: other heating materials (+96.7%), central heating (+51.7%), transport of people (mainly pupils) (+55.6%), other communal costs (+35.1%), fuels and oils for motor vehicles (+33%).

62

municipalities recorded lower investment spending

One of the strongest impacts of the multiple crises in 2022 on local self-government is the significant slowdown of local investments. 62 municipalities recorded lower investment spending. A strong reduction is observed

among expenditure for other construction activities (primarily, construction and reconstruction of local streets and roads) by 1.3 billion denars and repairment and current maintenance by almost 267 million denars. Capital expenditure of local governments is indeed impacted by the (multidimensional) crisis.

Provision of even basic local public services is endangered. Not only local investment, but also even basic local public services are at risk of disruption. For example, treatment plants for waste water are heavily dependent on electricity. Their managers warn that the ordinary operations are at high risk of disruption due to the high electricity bills.

54

municipalities are strongly affected by the crisis

54 municipalities are strongly affected by the crisis. From a cash-based accounting perspective, the financial position of 54 municipalities was strongly and negatively affected by the Ukraine (multidimensional) crisis.

Traditional cash-based fiscal indicators have not proved fully fit for purpose. The stock of municipal arrears is steadily increasing. A special Law on Financial Support of Local Self-Government Units and Unit Users established by Local Self-Government Units for Financing Arrears, was enacted in mid-November 2018 to pay 51% of all municipal arrears (even less than 60 days). However, in a year, arrears

of local self-government units started to rise again. This is also valid for local public enterprises. Compared to their short historical minimum at end-March 2020, arrears of local self-government units increased by 28.2% at end-June 2022. Arrears of local public enterprises also strongly increased by 46.5% in these two years. Arrears of second-line unit users at local level are lower by 20% compared to the historical minimum, but they are still high.

The way forward. Easier said than done, solutions involve greater cooperation and coordination between the central government and ZELS. A major redesign of the system of inter-government relations is desperately needed, allowing for higher fiscal discipline at the local level, more revenue and expenditure autonomy, more responsive design of inter-governmental transfers (e.g., more frequent reassessment of cost of services instead of reliance on historical costs), systematic long-term mechanisms and solutions for reduction of municipal arrears and prevention of new arrears. We also highlight that the improvement of the financial position does not necessarily lead to improvement of local public service delivery. For example, we do not recommend additional municipal revenue generation at any price, especially not at the expense of sacrificing urban living standards, green spaces, air quality, acceptable noise levels, traffic safety, etc.

While crisis management is a top short-term priority, addressing structural weaknesses must not be forgotten. The improvement of local public services requires energy-

efficient solutions, environment-friendly municipal waste selection and management, much better human resource management in the local public sector, including capacity building. Although highly important, gender-based budgeting at the local level is still in its infancy.

Fixing local finance and building buffers for combatting future crises are important prerequisites for making decentralization work. The full report includes policy recommendations for local governments, central government, and international development partners into immediate and medium-term priorities.

For more information about this research process, please do contact the UNDP team in Skopje.

