

# The Impact of Municipalities Own Source Revenues in Municipalities Capital Investments

## A case study: Prishtina

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**Abstract-** This paper aims to show the impact of municipal own source revenues execution in municipal capital investments execution. Municipalities of Republic of Kosovo especially Municipality of Prishtina faces a low capital investments execution which is supposed to be consequence of low own source revenues execution. This paper intends to show the relationship between own source revenues execution and capital investments execution in Municipality of Prishtina. By trend analysis is shown that in period 2006-2012 municipal own source revenues have been increasing and after 2013 they have been decreasing. Also the trend line estimates a decrease of municipal own source revenues in forecasting period 2016-2018. The significance of own source revenues execution in capital investment execution in Municipality of Prishtina is analysed by regression analysis which showed that own source revenues execution has impact in capital investment execution but the increase of own source revenues, if circumstances would remain unchanged, would have a negative effect-would increase the surplus. This paper proves that Municipality of Prishtina faces with not well budgetary planning and mismanaging of funds.

**Index Terms-**capital investments, budget execution, Municipality of Prishtina, own source revenues.

### I. INTRODUCTION

In order to achieve higher economic development, states worldwide seek to make many reforms, especially in the way they are organized. Most evident are reforms to decentralize or transfer government functions to municipalities in order to improve public sector (Carristine, Lonti & Joumard, 2007; Hammond & Tosun, 2009; Schaeffer & Yilmaz, 2008). Municipalities are assets, solutions and drivers of economic development which possess a great economic potential that can create wealth and economic opportunities for all (UnHabitat, 2015). Luger (2007), pointed out that municipalities' role in economic development include activities such as planning, financing, delivering, regulating and managing. However, the success of these activities depends on the existence of sound public financial systems both at the central and local levels (Ahmad, Albino-War & Singh 2006). The process of decentralization has powered municipalities but at the same time has challenged them a lot. This paper aims to analyse one of the biggest challenges of Municipalities of Republic of Kosovo, especially Municipality of Prishtina – gathering own source revenues. "Adequacy of own revenues is the key to an improved

ability to deliver needed goods and services and to a better accountability of local officials to their constituents" (Martinez Vazquez, 2015 p.30). Municipalities of Republic of Kosovo especially Municipality of Prishtina faces a low capital investments execution which is supposed to be consequence of low own source revenues execution. Municipality of Prishtina in period 2009-2015 has shown low level of budget execution, mainly caused by low execution of capital investments. Low execution of capital investments comes as a result of low execution of own source revenues, which means when planning capital investments the municipality had counted on funds it failed to collect (National Audit Office, 2009, 2010, 2011, 2012, 2013, 2014 & 2015).

Referring to the above paragraph, the topic of this paper is relationship between own source revenues execution and capital investments execution. How is the level of municipal own source revenues collection in Republic of Kosovo? What kind of relationship exist between own source revenues and capital investments in Municipality of Prishtina? If own source revenues would increase, would capital investments increase too? Does low execution of capital investments come just as consequence of low execution of own source revenues or does it also come as consequence of mismanaging? The aim of this paper is to give answers to the questions above, furthermore to confirm the significance of municipal own source revenues in municipal capital investments in Republic of Kosovo.

First chapter is an introduction of contents of the paper. Second chapter will content data analyses which will consist two parts. In first part, by dint of trend analysis will be shown the collection of municipal own source revenues in Republic of Kosovo in period 2006-2015, while in second part by engaging regression analysis-least square method will be explained the relationship between capital investments execution as depend variable and own source revenues execution as independent variable. Third chapter will content the conclusions.

The data that are used to accomplish this paper have been taken from reports and financial statements published by Ministry of Finance - Republic of Kosovo ([mf.rks-gov.net /Departments/ Treasury/ Reports and Financial Statements](http://mf.rks-gov.net/Departments/Treasury/Reports%20and%20Financial%20Statements)) and audit reports published by National Audit Office ([www.zka-rks.org / Publications/ Municipalities/ Prishtina Municipality](http://www.zka-rks.org/Publications/Municipalities/PrishtinaMunicipality)).

## II. DATA ANALYSIS

### 2.1. Municipal own source revenues collection in Republic of Kosovo, 2006-2015

Municipal own source revenues are financial means which are collected by taxes, fees, fines, payments for public services provided by the municipalities, rents from real estates owned by the municipalities, revenues from municipal assets sales, revenues from municipal enterprises and revenues from healthcare and education co-payments and services (Hopland, 2016; Vera & Kim, 2003; Law on Local Government Finance-Republic of Kosovo, 2008; Law on Local Self Government-Republic of Kosovo, 2008; Ministry of Local Government Administration & USAID, 2015).

According to the laws that regulate this area, all revenues collected in a municipality, belong to it and become part of its municipal budget (Law on Local Government Finance-Republic of Kosovo, 2008; Law on Local Self Government-Republic of Kosovo, 2008; Law on Public Financial Management and Accountability-Republic of Kosovo, 2008). Exactly herein lies the importance of own-source revenues and of their growth. Since the municipalities fulfil the biggest part of their needs via Government grants, there are indicators that this fact is having a negative impact on increasing the level of collection of own-source revenues (Ministry of Local Government Administration & USAID, 2015).

It is obvious that in most municipalities of the Republic of Kosovo there is continued improvement compared to previous years regarding the level of OSR (Report of revenues, 2010 & 2014). But all this must be analysed in relation to the new opportunities and challenges as well as the increased need to improve public services for the citizens and to increase capital investments. New sources of revenue must be found and more effective ways must be utilized for both new and existing sources of revenues (Ministry of Local Government Administration, & USAID, 2015).

Municipal own source revenues in Kosovo include property tax, municipal charges, municipal fees and fines-penalties. Property taxes do not play any important role in Republic of Kosovo (World Bank, 2014). Property tax rate is 0.15-1%. This makes the property tax revenues non-significant and causes low partaking in own source revenues. Municipal charges include Regulatory Charges, Rental Income, Education and Co-Payments, Health Co-Payments and Other Municipal Charges. Municipal fees include Licenses and Permits, Certificates and Official Documents Fees, Motor Vehicle Fees, Building Related Permits and Other Municipal Fees. Fines-penalties are collected by central level-Ministry of Internal Affairs and then allocated to municipalities.

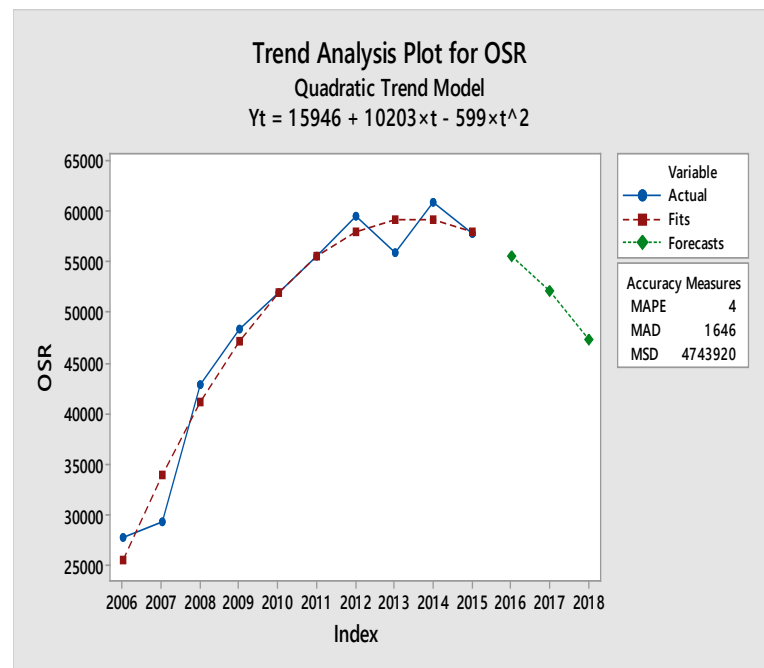
Trend analysis below will describe the own source revenues collection in Kosovo in period 2006-2015 (Fig.1).

It is noticed that trend line has concave parabola shape (a parabola that opens downward). In generally it is known about concave parabola that the left side of slope, up to turning point, shows a positive effect (by increasing of x value increases y value too) and the right side of slope, beyond the turning point, shows a negative effect (by increasing of x value decreases y value).

Based on the possessed data the trend line shows that in period 2006-2012, the municipalities have had growth in own source

revenues collection, from 27,755,000€ as they were in 2006 to 59,448,000€ in 2012. The growth has been: in 2007 about 5%, in 2008 about 46%, in 2009 about 13%, in 2010 about 8%, in 2011 and 2012 about 7%. In 2013 municipal own source revenues were 55,850,000€ or 6% less than in 2012. In 2014 there have been a growth for about 9% or there have been collected municipal own source revenues in amount of 60,955,000€ and again in 2015 the trend line shows a decrease of municipal source revenues to 57,880,000€ or 5% less than in 2014. Also the trend analysis is utilized as a forecasting method to estimate municipal own source revenues. Forecasting period includes 2016, 2017 and 2018. Trend analysis estimates a decrease of municipal own source revenues in forecasting period. If circumstances would remain unchanged, trend analysis estimates municipal own source revenues collection in amount of 55,648,000€ in 2016 or 4% less than in 2015, in 2017 52,064,000€ or 6% less than in 2016 and in 2018 47,281,000 € or 9% less than in 2017. Figure 1 presents the trend line of municipal own source revenues in Kosovo in period 2006-2015.

Figure1. The trend line of municipal own source revenues in Republic of Kosovo, 2006-2015



Source: Ministry of Finance-Republic of Kosovo(mf.rks-gov.net), Author's calculations

### 2.2. The impact of municipal own source revenues in municipal capital investments

Capital investments in Republic of Kosovo include road construction, sewerage, water supply, maintenance work, education, healthcare and culture, youth and sport. Municipal spending accounts for close to one-fifth of total investment by general government. The municipalities' share of capital

expenditure is expected to increase to 26 percent in 2018 from 22 percent in 2009 (International Monetary Fund, 2016)

In this part will be elaborated the relationship between own source revenues and capital investments. Municipality of Prishtina is taken as a sample to achieve the results. The data include own source revenues execution and capital investments execution as percentage indicators in period 2009-2015. In this period Municipality of Prishtina is characterized by low capital investments execution that comes as a result of low own source revenues (National Audit Office, 2009, 2010, 2011, 2012, 2013, 2014 & 2015).

In 2015 Municipality of Prishtina has spent 79% of budget where has executed 62% of capital investments and 45% of own source revenues; in 2014 is spent 69% of budget where are executed 45% of capital investments and 44% of own source revenues; in 2013 is spent 81% of budget while the level of capital investments execution is 71% and level of own source revenues execution is 55%; in 2012 is spent 74% of budget where are executed 56% of capital investments and 43% of own source revenues; in 2011 is spent 77% of budget where are executed 62% of capital investments and 93% of own source revenues; in 2010 is spent 75% of budget where are executed 60% of capital investments and 49% of own source revenues; in 2009 is spent 85% of budget where are executed 78% of capital investments and 69% of own source revenues (National Audit Office, 2009, 2010, 2011, 2012, 2013, 2014 & 2015).

Referring to National Auditor Office's reports, by dint of quadratic form of regression analysis (Greene, 2012) will be explained the impact of own source revenues in capital investments moreover will be explained the behaviour of capital investments if own source revenues would increase. The estimation equation is:

$$CI = \beta_0 + \beta_1 OSR + \beta_2 OSR^2 + \varepsilon$$

where CI presents capital investments execution in percentage or the depend variable. The right side of equation presents the independent variables where  $\beta_0$  presents the level of capital investments execution if own source revenues would be equal to zero; OSR presents own source revenues execution in percentage;  $OSR^2$  presents increased own source revenues and  $\varepsilon$  presents the error term. Residuals are normally distributed and homoscedastic. There is no serial correlation between residuals. By least square method is reached the estimated equation:

$$CI = -90.6 + 4.77 * OSR - 0.03361 * OSR^2$$

where it is noticed that the linear term is positive whereas the quadratic term is negative. The negative sign of quadratic term shows that the parabola is opened downward. So this model shows that the relationship between own source revenues execution and capital investments execution in Municipality of Prishtina is a concave parabola. Regression analysis shows that own source revenues (OSR) have positive effect in capital investments (CI) which is proven by positive sign of linear term but the increase of own source revenues ( $OSR^2$ ) would have negative effect in capital investments, which is proven by negative sign of quadratic term. In unchanged circumstances, if own source revenues would increase ( $OSR^2$ ) would have almost the same significance on capital investments as own source revenues (OSR) do (referring to p-value). So Municipality of Prishtina would face surplus of funds or even worse would increase the surplus because this municipality has already faced

with this problem. Table 1 shows the regression analysis results for own source revenues execution and capital investments execution in Municipality of Prishtina.

Table1. Results of regression analysis about CI and OSR execution in Municipality of Prishtina, 2009-2015

Analysis of Variance						
Source	DF	Adj SS	Adj MS	F-Value	P-Value	
Regression	2	521.0	260.48	7.55	0.044	
OSR	1	448.8	448.84	13.01	0.023	
OSR^2	1	410.1	410.12	11.89	0.026	
Error	4	138.0	34.49			
Total	6	658.9				

Model Summary			
S	R-sq	R-sq(adj)	R-sq(pred)
5.87306	79.06%	68.59%	58.40%

Coefficients						
Term	Coef	SE Coef	T-Value	P-Value	VIF	
Constant	-90.6	41.2	-2.20	0.093		
OSR	4.77	1.32	3.61	0.023	104.11	
OSR^2	-0.03361	0.00975	-3.45	0.026	104.11	

Source: National Audit Office (www.zka-rks.org), Author's calculations

### III. CONCLUSIONS

Municipal own source revenues in Republic of Kosovo get collected by property tax, municipal taxes, municipal charges and fines-penalties. The analysed data in this paper show an unsatisfying level of municipal own source revenues collection in period 2012-2015 (Fig.1). If the municipalities do not start making more precise analyses, planning and calculations, and if they do not work in the direction of raising the internal control in order to achieve higher budget execution level, there will be decrease of municipal own source revenues.

Considering many impacts that own source revenues execution could have, in this paper was elaborated the impact of municipal own source revenues in municipal capital investments, by taking as a sample Municipality of Prishtina in period 2009-2015. It is noted that relationship between own source revenues and capital investments in Municipality of Prishtina in period 2009-2015 is a concave parabola, which means that the increase of own source revenues execution will not increase the capital investments execution. This proves that this municipality faces two problems: not well-planned budget (low execution of own source revenues and capital investments) and mismanaging of funds (surplus).

The conclusion of this paper is that municipal own source revenues has significance in capital investments execution, but if circumstances remain unchanged, the increase of own source revenues would lead to increase of surplus.

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