

THE MODEL OF THE ASYMMETRIC FISCAL DECENTRALISATION IN THE THEORY AND THE CASE OF REPUBLIC OF MACEDONIA

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Introduction

In the last few decades the phenomenon of the fiscal decentralisation becomes highly important and challenging. The countries implementing decentralisation reforms are transferring fiscal revenues and competences due to assigned local tasks from central to local level. The reforms are aimed by some **economic reasons** (achievement of efficiency in the local governance, higher quality services), **administrative reasons** (moving the governance towards closer level to individuals, facilitating the work of the central government) and **legal reasons** (respect of constitutional provisions and making use of ratified international agreements).

With an analyses in various countries, such as those that already have implemented the fiscal decentralisation and at this point are modifying the relations between central and local authorities, and those where this process is starting, a common conclusion arrives: in the last ten years new reasons for decentralisation have appeared on a world level². These are **purely political reasons** that could be explained with the need for resolving different ethnical tensions in fragmented societies. In this respect, it could be seen that in a global context the tendencies of the separatists in the particular parts of one territory might be prevented through improvement of the intensity of decentralisation and with expansion of competences and responsibilities concerning local fiscal matters. The fiscal devolution as the highest stage of decentralisation is generally used for resolving these and similar problems or conflicts and at the same time presents a part of the global public sector reform.

In this respect, fiscal decentralisation contains new qualitative elements, determining it differently in comparison with a fiscal decentralisation taking place 30-40 years ago. This refers both to post socialistic regimes and to countries with powerful economies and highly developed local democracies. As always, the choice of the model of fiscal decentralisation is followed by many dilemmas: Which competences should be decentralised; which degree of local fiscal autonomy should be obtained; is the principle of symmetry and equality between different local units obligatory; what kind of local fiscal accountability should be obtained.

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² The analysis on the process of the fiscal decentralisation includes the following countries: Canada, Belgium, Italy, France, Bosnia and Herzegovina, Chile, the Russian federation etc.

1. The model of asymmetric fiscal decentralisation in the theory

In the public finance theory, there are numerous newly conducted analyses regarding different models of fiscal decentralisation. Classical views respect the principle of **symmetry** in the transfer of financial competences to the local authorities, as an essential one. But as a result of various circumstances and conditions specific for the different countries, it would be difficult to define a general rule for the question *what* and to *which degree* should be fiscally decentralised.

In the last few years, faced with the same constraint, Richard M. Bird³ presents a theory for the positive effects through the implementation of the model of asymmetric fiscal decentralisation. From the theoretical point of view, the asymmetric decentralisation relates to a transfer of different “dosages” of fiscal powers, authority and responsibility in different municipalities taking into consideration the conditions and requirements for each particular country and local development⁴.

The model contains proposals as an answer to the question of the “specific needs” in countries in process of decentralization, where in particular municipality there is a group of people that is (or they are considered to be) different (in ethnical, lingual or even in a historical aspect) from the majority of the population on the territory. According to some theoreticians these societies are multiethnic and others are identifying them as fragmented⁵.

The point is that the takers of the political decisions are willing to complete serious reforms (such as the fiscal decentralisation) that are going to be “glue” for sticking the different municipalities in order to obtain political stability and territorial integrity⁶.

In the theory of the public finances there are other theoreticians defining the asymmetric decentralisation in regard to the fiscal competences and responsibilities as: “a system in which the municipalities that are able and have competences to provide public services have to be provided with enhanced fiscal rights and powers than the rest of the unites of that country” (Jorge Martinez–Vasquez)⁷.

Joachim Wehner⁸ thinks in the same direction. He argues that the asymmetric “arrangemens” might be product of political reasons, for

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⁴ Richard M. Bird, „Rationale and forms of fiscal decentralization”, in Bird and Stauffer book of Public Finances, Oxford University Press, 2001, pg.5.

⁵ Richard M. Bird, Asymmetric Fiscal decentralization: Glue or solvent?, Published as a part of International Studies Program Papers, Andrew Young School of Policy Studies, Georgia State University, U.S., April 2003, pg.1-3.

⁶ Bird gives the following examples: Kosovo, Kashmir, Sri Lanka, Sudan, Macedonia where after the war crises there is a process of fiscal decentralisation Оп.цит., pg.7-10.

⁷ Jorge Martinez–Vasquez, „Asymmetric fiscal decentralization: Cure or Poison?”, Research project, published at Georgia State University Press, U.S., 2002.

⁸ Joachim H-G, Wehner, „Asymmetrical Devolution” Development Southern Africa 17, June, 2000, p.249-62.

preventing the ethnic and religious tensions and even for achievement of particular economic goals: efficiency, better macroeconomic management and administrative cohesion.

Taking into consideration various proposals in this field, several types of asymmetry could be identified while defining the relations between the central and the local authorities: **political asymmetry**, which is applied mainly for non economic and political reasons in countries where there are local units with different capacities or where there are local units with different responsibility assignments; **administrative asymmetry** achieved with an agreement between the central and local authorities where the competences are agreed considering the administrative capacities of the local authorities; and **fiscal asymmetry** in the light of the two previous models followed by their financial dimension. In other words, the asymmetry might be *de jure* or *de facto* or it might be implemented on the entire territory or only on a specific part, where there is a need, as for instance in Spain and Canada. In practise, fiscal asymmetry could be implemented as different fiscal transfers from the central authorities to the municipalities; as different share of central tax revenues to various municipalities; as different responsibility assignment between local units in the area of local expenditure; as different competences and authorisations for non tax revenues (loans, grants, issuing local bonds etc, property revenues etc); as different competences in terms of fiscal autonomy (for example, determining the level of local taxes).

Experiences from practice lead to two general conclusions:

a) The fiscal decentralisation may not necessarily obtain economic development, better quality of the public services, efficiency and responsibility, but

b) The fiscal decentralisation is the most adequate "weapon" for providing: national unity (the case of South Africa and Uganda); potential political solution for preventing the civil war (the case of Sri Lanka and Sudan); preventing the secessionists tendencies (the case of Bosnia and Herzegovina and to some degree Ethiopia); enough power and competences for preventing the aspirations for succession of different republics (the case in the Russian federation); the effect of the „grass-root“ democracy as a support to the politics of the central government (the case of Columbia and other states).

Therefore the model of asymmetric decentralisation is considered as a possibility for resolving the conflicts of political and ethnical nature in fragmented societies. However, we might not be sure that the fragmented societies will become more coherent if the central authorities merely apply an asymmetric political, administrative, and fiscal decentralisation. Other reforms are also required.

The recent events in the history in the Balkan countries, demonstrates that the passions might not be overcome without difficulties but they remain even in the minds of people that are looking for a different approach from the central government towards their everyday problems (Macedonia, Serbia, Kosovo). The fiscal rationality in this context might seem irrelevant when faced with some everyday problems of the people living in those local units. In other words, if in one country there is a multiethnic population, placed in a particular part of the territory, **a specific decentralisation model is required**. The

asymmetric approach does not lead to federalism or separation, but on the contrary keeps the territory as unitary. The rule is that only real needs, conditions and capacities on each local area should be ***criteria divisions*** for asymmetric transfer of the competences and responsibilities. The aim is to improve the quality of the public services and to produce more satisfied local citizens in differently organized local units in one country.

Either observed from legal, political, economic or from practical aspect, the asymmetric decentralisation in general might be understood merely in the framework of one specific country with its particular requirements. Therefore, only in a concrete situation one might reach a conclusion whether the asymmetric fiscal decentralisation improved the situation and provide a solution for some problem or it foster the tendencies for division and separatism.

The different approach in implementation will have considerable implication on one hand in the relations between the central and the local authorities and between the different local units on the other.

2. The model of the asymmetric fiscal decentralisation in the Republic of Macedonia

2.1. Short historical background

Republic of Macedonia is a country with a rich experience in local government financing. From 1945 to 1990, it was a member of the Socialist Federative Republic of Yugoslavia (SFRJ), in which **extreme fiscal federalism** existed, by different fiscal systems co-existing between the federation, the republics and local governments within each republic. There was a system of financing the federation from bottom to top (i.e., from municipality to the federal level). All LSGU were thus empowered with important fiscal revenue responsibilities and a system of horizontal and vertical transfer equalisation was established to correct major imbalances. When the SFRJ broke up, all the LSGU's' fiscal and financial revenues and responsibilities were taken back by the central government.

Since independence in 1991, Republic of Macedonia has experienced several systems of fiscal relations between the central government and the local authorities:

- 1991 to 1995 was a period of **extreme centralisation** as the main concern was to build the nation and national institutions. All fiscal functions and responsibilities were centralized at the State government level.
- 1996 to 2002 saw the **establishment of local self governments units**, following the promulgation of the Law for Local Self Governments in 1996. However, local financial situation was weak and unstable as all the revenues were transferred as grants from the central authorities. There was not any fiscal decentralization.
- 2002 to 2004 could be labelled as a **preparation period for fiscal decentralization, because the war conflict pressured the process of decentralization**. Since 2005, decentralization has picked up steam. The momentum came from several fronts. First, the pressure of the Ohrid

Framework Agreement⁹ which called for constitutional and legal changes in the relations between the central government and local authorities, mostly in the adoption of amendments to the Constitution where the right to local self government is stated as a basic democratic value and to the Law on Local Self Government which in its Art. 22 recognizes increased competences of local units in the areas of education, health care, environment, urban planning etc. Second, the ratification of the European Charter on local self government. Finally, there was the process of EU membership. Although decentralization of competences to the municipalities was not in itself a condition for membership to the EU, it was part of the Macedonia's undertakings made in the Stabilization and Association Agreement (2001) and the European Partnership (2004).

- After the local reform in 2004, the Macedonian local fiscal system is based on new fiscal relations between central and local authorities. The whole system is **one-tier**, meaning that all municipalities (84) are equal, and there is a special rule for the **capital city-Skopje, which has two-tier** administrative organization covering 10 sub municipalities.

2.2. Why the asymmetric approach?

When decentralization officially started in 2005, the municipal capacities (administrative, technical and most of financial) were not adequate to resume and carry on all newly assigned local functions (mainly from article 22, Law for local self-government). Therefore, the Law of financing local self-government contains conditional provisions *for mitigation* of the process. The process of fiscal decentralization is organized in two phases followed by asymmetric approach in allocation of fiscal powers. Consequently, in the first phase (2005-2007), all municipalities could independently perform only few of the local functions (mostly communal), and after fulfilling some conditions (prescribed by the Law) and approval from the State Commission, they may enter the second phase and run through the rest of the activities (set in the article 22). The mandatory local functions in the first phase for all municipalities are urban and rural planning, local economic development, healthcare, social care, communal activities and fire fighting. The main fields of decentralization functions like maintenance and financing all activities in primary and secondary education, culture and childcare (that were included and amplified in the Law of local self-government article 22, under pressure of Ohrid Agreement) are set up conditionally for the second phase. The transition into second phase is based on the capacity of each municipality to show good financial results in the first phase. That means that some municipalities go into second phase after 2 years and run all assigned local function by the Law, but some poorer or not developed municipalities could never do so, and stay in the first phase performing local functions together with the central institution (for example, Ministry of Education). As a result we have different fiscal assignments to various municipalities in one unitary

⁹ The war conflict in 2001 ended with Ohrid framework agreement.

country. The central government actually divides the municipalities in a group that receives fiscal grants from central level as earmarked grants for the first phase and municipalities in a second group that are assigned with block grants for the second phase. Earmarked grants are just sufficient to carry on the basic functions, and the transfer of block grants actually make possible to a municipality to provide all assigned functions in the second decentralization phase (financing primary and secondary education, culture, child care, named in the Article 22). In other words, The Law on fiscal decentralization postponed the execution of local functions from 2005 to 2007 and further, because of great disparities among the municipalities at the start of the process, aiming to put pressure on local development by setting different grants in different phases that support different scopes of local functions. Getting authorization for second phase in decentralization and receiving bigger fiscal transfers (block grants) operates as stimulant to municipalities to straighten their administrative and fiscal capacities. Until July 2008, 56 municipalities entered the second phase, and until January 2009 65 from total of 85 municipalities. Some of them are actually not willing to pass to higher stage, because they are not equipped with economic and administrative capacities. So, the asymmetric approach satisfied both types of municipalities.

2.3. Novelties in the revenue system

The main features of the new system include the following:

- Important local financial resources, both in terms of number of taxes and scope of the taxes. Besides the traditional three types of local property taxes, the law assigns new tax revenues: (a) a share of personal income tax (PIT) and value added tax (VAT); and (b) five types of fiscal grants - called "*dotations*" - from the central government.
- Local financial management is enabled by new financial and administrative powers, including the right to determine local tax rates; complete budget autonomy; responsibilities for collection and use of non-tax revenues (fees, user charges, loans, local securities); and rights for introduction of self-contributions. Local self-contributions are a fiscal instrument that has been used traditionally in the ex Yugoslavia as a self-fee for capital investments. Today the Council of the LGSU could introduce the self-fee under the criteria set in the Law, after the citizens give an approval by different forms of agreement (for example, referendum).
- The right to enter the capital market, by taking loans from commercial banks or by issuing local bonds;
- Broad opportunities for achieving successful local financial management, including through the new system of accountability and responsibility, the system of central monitoring and support by State Commissions and Ministry of Finance and Local-self government.

2.3. Asymmetry in the assignment of financial resources

During **phase 1**, key local responsibilities were financed by:

- Property taxes (Property tax on real estate; Property tax on inheritance and gifts and property sales tax):
- Value added tax grant (3 percentages of central revenues, transferred upon criteria of population)
- Personal income tax grant (3 percentages of central revenues, transferred upon criteria of the place of settlement of the tax payer)
- Earmarked grants for education and culture (covering only costs for management of institutions)

The Law defines the fiscal relationship between central level and municipalities, including monetary transfers; it also defines the procedures and criteria by which municipalities will be measured to determine whether they are eligible to progress to phase 2 of the decentralization process.

Phase 2 started in September 2007, when 42 municipalities were allowed to enter, because they met the criteria defined in the law, which include (i) adequate financial management and tax administration systems and staff; (ii) satisfactory financial management and accounting during the previous two years; (iii) timely reporting to the Ministry of Finance, and (iv) no arrears to suppliers and creditors. Phase 2 involves decentralization of education instructional costs, salaries and funding allocation, health care and other fiscal responsibilities.

During phase 2, the municipalities were assigned with different revenues.

(1) Own source revenues, i.e., (i) local taxes, of which the property taxes are the most important; (ii) local fees and user charges; and (iii) other local taxes established by law. Since the start of the first phase of the fiscal decentralization in July 2005, municipalities have been given expanded powers under the Law to collect and administer these revenues instruments. The central government has no authority over them;

(2) Revenues from personal income tax (PIT). Municipalities get (a) 3% of the PIT levied on salaries of physical persons with domicile and residence in the municipality; and (b) 100% of the PIT of physical persons performing craft activities in the territory of the municipality in accordance with the Law on Craft Activity. In 2007, the PIT rate is 12%. It will be reduced to 10% in 2008;

(3) Revenues from donations from physical persons or corporations; and

(4) Grants from the central government. The most important grant is the value added tax grant. Municipalities get 3% of the total VAT based on the amounts collected the previous fiscal year¹⁰; Also, they get block grants, which were used as earmarked grants in the first

¹⁰Three percent of the VAT revenues going to municipalities are transferred to a special fund called the reserve fund for assistance to fiscally weak municipalities, i.e., those which have raised less than 25% of their potential tax revenues.

phase of decentralization to finance activities transferred to municipalities in education (primary and secondary schools, except for salaries), social protection (day care centres and retirement homes), fire fighting and culture (museums, cultural institutions, etc.). For municipalities that have passed to the second phase, these earmarked grants have been replaced by block grants which included funds for financing wages in the areas of education, social care and culture. Fire fighting will continue to be financed by earmarked grants specially set up for that activity.

Municipalities that did not enter the second phase will continue to be financed with earmarked grants. The sector ministries propose to the Ministry of Finance distribution of earmarked grants and monitor their execution. Criteria for distributing these grants are set annually by the respective sector ministries through an ordinance adopted by the Government. However, the actual application of these criteria is not clear because the adopted decrees do not specify the evaluation procedures for weights applied to different criteria and sources of data;

The City of Skopje as a part of asymmetric model decentralization with special status has the same revenue structure but since it is a two-tier system (the City as a distinct municipality with special status and 10 municipalities with the same status -- and nearly same functions -- as the rest of the country), the distribution of revenues between the City and the 10 municipalities is somewhat different and is discussed below.

The City's tax administration collects local taxes and shares them with City municipalities at a rate of 50% for the City of Skopje and 50% for the ten City municipalities, with the exception of user charges where the ratio is 60% versus 40%.

While 3% of the PIT collected from taxpayers goes directly to the municipalities in the country, for the City of Skopje, they are deposited into a Joint Fund of the City of Skopje and distributed to the City of Skopje and the 10 City municipalities according to the sub law.

Finally, VAT revenues going to all municipalities in the country are shared between the city of Skopje and the rest of the country as follows: 12% for the City of Skopje and its 10 municipalities and 88% for all the other municipalities in the country. The City and its municipalities divide their share of the VAT revenues as 40% for the City and 60% for the 10 municipalities.

(5) Final type of grant is Capital grant from central government. Only municipalities in second phase could use it.

So, the asymmetric approach during first couple of years pushed the weak and unstable municipalities to straighten their financial capacities in order to meet the criteria and enter the higher second stage, where they could receive larger amounts and better grants. Besides improvement of financial state in many municipalities, what is important is that the process is seen by municipalities as transparent and fair.

Since the start of Phase 2, the Commission admitted another 15 municipalities during 2008, bringing the number of municipalities in the second phase to 57. On the other hand, according to revised data from the municipalities, at the end of 2007, 10 municipalities (11.8% of total municipalities) have not even met the criteria for Phase 1.

2.4. Results from implementation of asymmetric model

There are very significant **fiscal disparities** between urban and rural municipalities. Thus, while own revenues account on average for about 60% of total budget revenues, they only represent between 8% and 10% for rural municipalities.

When fiscal decentralization began in 2005, **grants** from the central level have become a very important feature in municipal budgets, due to their aim for financing new local responsibilities in the areas of education, culture, social protection and capital investment.

On the average, central government grants account for 37% of total municipal revenues. Central government transfers are also responsible for the steady decrease in the share of tax revenues in total municipal budgetary revenues, as well as for the steady increase in municipal revenues as a percentage of GDP as can be seen in Tables below. Local taxes as a percentage of GDP have only kept up with GDP growth, with the exception of 2008 when the municipalities' tax base was widened.

Table 1: Local Tax Revenues as % of LSGU Total Revenues

Year	2004	2005	2006	2007	2008
Share of Local Tax Revenues	65.1%	64.6%	59.1%	40.7%	38.1%

Table 2: Local Tax Revenues and LSGU Total Revenues as % of GDP

Year	2004	2005	2006	2007	2008
Local Tax Revenues	1.2%	1.2%	1.1%	1.1%	2.1%
Total LSGU Revenues	1.8%	1.9%	1.9%	2.7%	3.2%

**Table 3: LSGU Revenue Structure
(In thousands of MK Denars)**

Type of revenue	2006		2007		2007/2006 (%)
	Amount	% total	Amount	% total	
Tax revenues	3,098	40.7	4,059	38.1	31
Non-tax revenues	1,134	14.9	1,439	13.5	27
Capital grants	82	1.1	118	1.1	44
Grants & Donations	3,299	43.3	5,032	47.2	53
Total	7,615	100	10,649	100	40

As a result of pressure for showing better financial results in short time in order to satisfy the law criteria and enter the second decentralization stage, **total municipal revenues** jumped by about 40% from 2006 to 2007, mainly as a result of a 53% increase in intergovernmental transfers **due to the start of block grants** which include salaries and allowances for the employees in public institutions in the education, social care and culture sectors.

Tax revenues also surged by over 30%, mainly as a result of better collection of property taxes. Most municipalities made substantial efforts to improve tax administration and collection.

Municipalities' own revenues have kept up with GDP growth (i.e., growing by 20% from 2004 to 2007), but with property tax collection in Republic of Macedonia about ten times less than what is being collected in developing and transitional economies, there is room for growth. The property tax rate average is 0,1-0,3%.

Many municipalities cited lack of funds as the major problem slowing down the fulfilment of competencies assigned to them, but, no municipality has changed its property tax rate, which is very low by international standards. Many urban reported better tax collections during the first phase, as a result of straightening tax administration offices in order to meet the criteria for the second phase.

Budget preparation and execution have also improved and the municipalities appear to have a better control of their expenditures.

Today, it is safe to conclude that municipalities have improved their financial situation, but that much remains to be done.

By and large, fiscal decentralization has been progressing well. A recent OSCE study (Report on the Fiscal Decentralization Process in Macedonia, URC/OSCE, October 2007) and Study funded by the European Agency for Reconstruction (Report on the Fiscal Decentralization Process in Macedonia, URC/OSCE, October 2007), show that the 11 competencies assigned to municipalities by the 2002 law are at various stages of being fulfilled. However, none has been completely fulfilled by all municipalities. Urban development, communal services and education are among the most advanced; civil protection and environment, including utilities, among the least.

3. Conclusion:

In the respect of dilemma of choosing fiscal decentralization model there is always a question: how to maintain the central fiscal sovereignty with the process of decentralisation? In other words, how a sustainable local development might be achieved while different local areas have different economic, administrative, technical, personal capacities and requirements. The answer might be found in the model of **asymmetric decentralisation** - *de facto* recognised and accepted in numerous legal systems in the world. "The transfer of various doses of fiscal competences and responsibilities from central to local level, where the central authorities maintain equal and continuous financial control", represents one of the finest models in theory and often implemented in the process of fiscal decentralisation. The asymmetrical approach in the creation of essential rules in terms of the local financial management is a solution with broad positive effects in the comparative law and which might be implemented in other countries that have huge disparities among municipalities, like Republic of Macedonia. Moreover, the fiscal decentralisation as a complete form of decentralisation could be implemented for political reasons and in that respect, when in particular municipal areas there are unequal economic development and multiethnic population, this model is additionally attractive.

In Macedonia we implemented **conditional fiscal decentralization based on asymmetric transfer of grants**. Here each

municipality has equal rights in terms of competences and sources of finances but, taking into account the specific rules for entering into further step in the decentralisation process (phases) and followed with the fact that some unities might not fulfil the criteria, consequently, they will stay in the lower stage. The asymmetrical approach in fiscal decentralisation process in Republic of Macedonia is based on the following principles¹¹: gradual transfer of competences in accordance with the municipal capacities and revenue assignment for proper and efficient financial functioning. Therefore, the financial activity on local level was significantly improved in comparison with the previous period.

At the end, the conclusion is that as a country on its path towards the European Union and in a process of profound transformation of the public sector, the Republic of Macedonia went through a mixture of experiences in democratic reforms. However, it should remain in the reformation process and it should provide local democratic development. Somewhere between desires, actual circumstances and capacities, at the present, implementation of the new model for local finance is taking place. Even if the war conflict in 2001 and its result the Ohrid framework agreement and the Constitutional amendments have succeed in faster movement in the process of fiscal decentralization, there is a confidence that the reforms will be in favor of the citizens and that the local democracy as a crucial element in one civil society will be improved and further developed. Hence, proud on the long tradition in local governance but aware for the unpleasant experiences and inadequate model for local finance in the past and faced with the necessity for a better system in the future one should be optimist. In addition, various forms of civil initiatives will have an important role in creation of modern, democratic and financially autonomous local governance.

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¹¹ According to article 44, paragraph 3 from the "Law for financing local-self government units", Official Gazette of Republic of Macedonia, 64/2004.