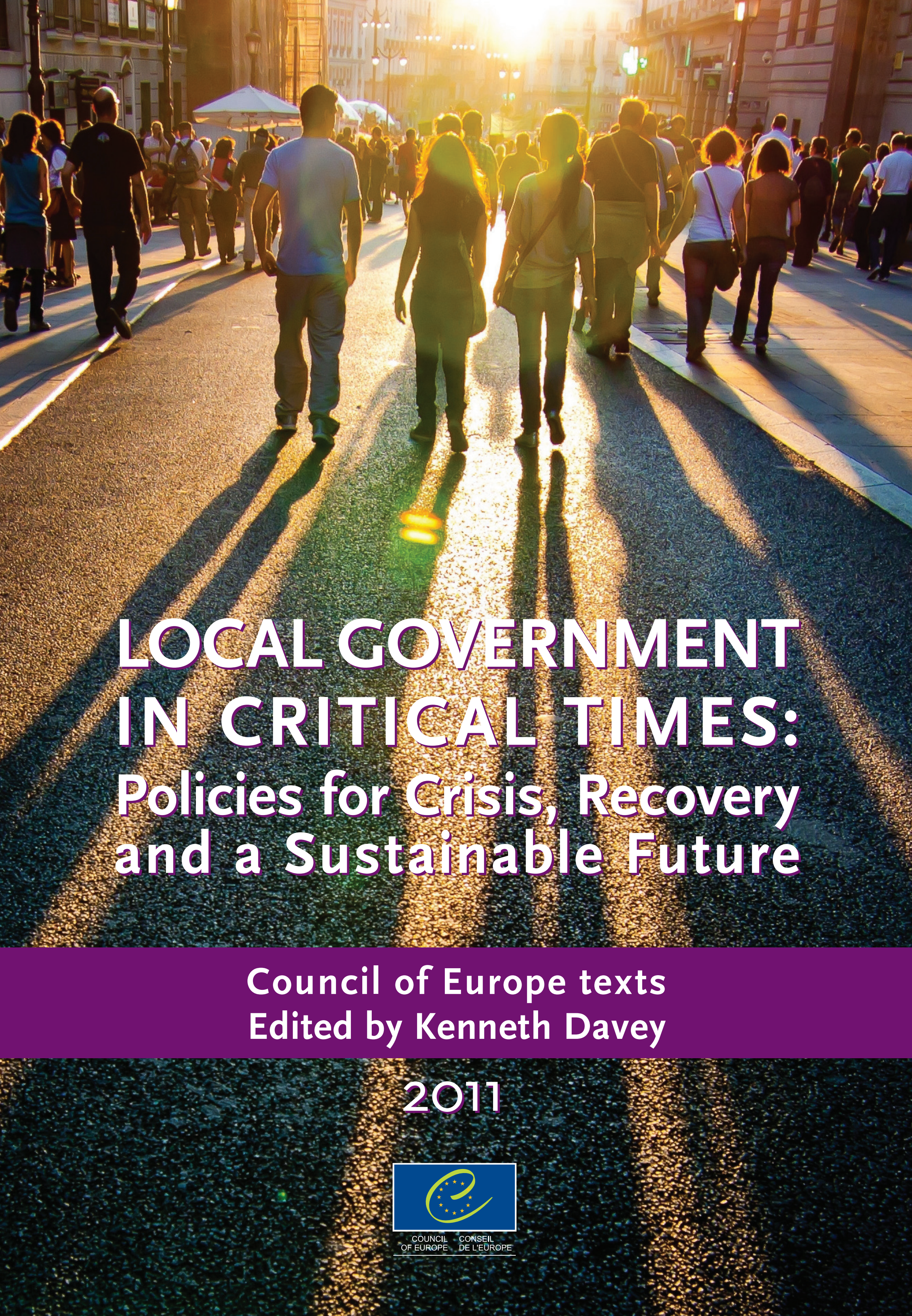


LOCAL GOVERNMENT IN CRITICAL TIMES:

Policies for Crisis, Recovery and a Sustainable Future

Council of Europe texts

Edited by Kenneth Davey

2011

COUNCIL OF EUROPE CONSEIL DE L'EUROPE

LOCAL GOVERNMENT IN CRITICAL TIMES:
Policies for Crisis, Recovery and a Sustainable Future

Council of Europe texts

Edited by Kenneth Davey

2011

Council of Europe
Centre of Expertise
for Local Government Reform

Address
F–67075 Strasbourg, France

Fax:
+33 (0)3 88 41 27 84

E-mail
webmaster.local@coe.int

Web Site
http://www.coe.int/t/dgap/localdemocracy/

The research for this publication has been funded in part by the Open Society Institute–Budapest.

Cover photo: © Pedro Rufo | Shutterstock.com | 2012
Printed in Strasbourg, France, 2012
Design & Layout: Judit Kovács | Createch Ltd.

Contents

List of Boxes, Figures and Tables

Boxes

Figures

Tables

Local Government in Critical Times: Policies for Crisis, Recovery and a Sustainable Future

Council of Europe texts
Edited by Kenneth Davey

This collection of texts contains documents presented and adopted at the 17th Session of the Council of Europe Conference of Ministers Responsible for Local and Regional Government, held in Kyiv, 3–4 November 2011. It also includes Committee of Ministers Recommendation Rec(2004)1 and Recommendation Rec(2005)1 and the European Charter of Local Self-Government.

The report is based on final data for 2010 in Council of Europe member countries. It was prepared by the European Committee on Local and Regional Democracy (CDLR) with input from the Council of European Municipalities and Regions (CEMR) and a team of country observers, in the framework of the joint project of the Council of Europe with the Open Society Foundations (OSF).

Foreword

Council of Europe

Robert Palmer
Director of Democratic Governance, Culture and Diversity
Directorate General of Democracy

This document contains the texts on the impact of the economic downturn on local government across Europe presented and adopted at the 17th session of the Council of Europe Conference of Ministers Responsible for Local and Regional Government, held in Kyiv (Ukraine) on 3–4 November 2011, under the theme *Local Government in Critical Times: Polices for Crisis, Recovery and Sustainable Future.*

Ministers agreed that governments must take responsibility to mitigate, counter, and overcome the impact of the economic crisis, all the more so because it has potentially wide destructive effects on social cohesion and risks exacerbating societal tensions. Any and all action in response to the crisis must remain fully compatible with member states' obligations under the European Charter of Local Self-Government. There is a widespread recognition of the need for improvements in governance and in the management of public expenditure, for increasing efficiency across the whole public sector, and for greater collaboration between all stakeholders, central government, and local and regional authorities as well as their associations.

Two messages resonate with these challenges. The first is the demonstrated role of transparency and increased public scrutiny in making the most of reduced resources. The second is the risk to human rights involved in making disproportionate cuts in the funding of voluntary bodies who directly serve the most vulnerable families.

This collection contains the Kyiv Declaration and Kyiv Guidelines adopted at the 17th session of the Council of Europe Conference of Ministers Responsible for Local and Regional Government, the report *Local Government in Critical Times: Policies for Crisis, Recovery and a Sustainable Future* prepared by the European Committee on Local and Regional Democracy (CDLR) to serve as background to the ministerial debates. It also includes the Recommendations Rec(2004)1 on financial and budgetary management at local and regional levels and Rec(2005)1 on the financial resources of local and regional authorities adopted by Committee of Ministers of the Council of Europe, and the European Charter of Local Self-Government.

This publication is meant to be an important tool for central governments, ministries of local government and ministries of finance, local governments and their associations as well as for NGOs. In Kyiv ministers committed themselves to actively disseminate and draw the attention of relevant stakeholders to draw inspiration from the Kyiv Guidelines, use them and contribute actively to the work to be undertaken by engaging senior officials competent in these matters. The Center of Expertise for Local Government Reform will continue to assist member States and their local and regional authorities to weather the economic downturn and address long-term challenges.

I encourage you to read it and make best use of these provisions when developing policy responses in your country.

Introductions

Organisation for Economic Co-operation and Development

Council of European Municipalities and Regions

Parliamentary Assembly of the Council of Europe

Congress of Local and Regional Authorities of the Council of Europe

Organisation for Economic Co-operation and Development

Mario Marcel
Deputy Director
Public Governance and Territorial Development Directorate

The recent crisis and its aftermath have increased the demand for more effective public governance and highlighted the importance of the institutional and financial frameworks in the design of public governance schemes. Improving public governance is important to limit the growth of government debt at all levels, to ensure fair and sustainable public service delivery and to foster growth in all regions. Yet despite this renewed awareness of the need for improved governance, sub-central actors are often forgotten in the discussion. Sub-central governments are responsible for the delivery of essential public services, and they represent two-thirds of public investment on average across the OECD area, as well 16 per cent of public deficits and 17 per cent of public debt. They are therefore sources of both challenges and potential solutions.

Given the great diversity of situations and frameworks both across countries and within them, there is no one-size-fits-all solution, and policy responses must be tailor-made to reflect the fact that, even within countries, different regions face very different challenges and have different assets. Policies designed to address the crisis and its consequences have had to mobilise sub-central actors, first in support of stimulus and by now in the consolidation phase. Engaging sub-central authorities will remain a priority. In a context of increasingly volatile and uncertain economic conditions, effective responses by local governments, in harmony with the policies of central governments, are crucial to sustainable growth and sound fiscal outcomes. Policy co-ordination between the central and sub-central governments is of profound importance to the effectiveness of both. Without co-ordinated fiscal policies, expansionary fiscal policies initiated by central governments can be neutralised by pro-cyclical nature of sub-central governments' budget constraints. Likewise, vertically unco-ordinated fiscal consolidation may put sub-central governments under excessive tight restrictions, jeopardizing their ability to perform basic functions. Data and analyses developed by the OECD under the aegis of its Territorial Development Policy Committee (TDPC) and its Network on Fiscal

Relations across Levels of Government seek to cast light on these problems and point to possible solutions. They thus complement and reinforce the work of the Council of Europe in the field of local and regional democracy. The OECD's and Council of Europe's work in this field are therefore quite complementary and we value the cooperation established so far in the data collection and policy evaluation. The next months will continue to require close scrutiny of trends and policies, thus providing potential for continued co-operation.

Council of European Municipalities and Regions

Frédéric Vallier
Secretary General

Jean-Jacques Rousseau, whose birth three hundred years ago we are celebrating this year, said: ***"The great shortcoming of Europeans is always to philosophise on the origins of things exclusively in terms of what happens within their own milieu."*** Undoubtedly, the context of the 18th century is quite different from the one we know today, but this maxim nevertheless still seems remarkably pertinent. Consequently, rather than seeking lasting solutions through the development of a new European project in response to the financial, economic and social crisis, not to mention the crisis of confidence that Europe, or at least its great majority, is undergoing, European leaders seem to be philosophising on its origin. At a time when none of them were able to bring the runaway debt under control over the years and did not stay bound to any of the rules imposed by the treaties in force, such a project cannot be limited to the mere adoption of a treaty establishing a golden rule.

This new edition of the report on the crisis and its consequences paints a picture of the situation in 2011, which clearly shows that the state of affairs has worsened even further since the previous year. Its main significance, however, is that it also allows for the emergence of new prospects with the Kyiv Declaration and its guidelines, adopted by all of the participants at the ministerial conference in November 2011 which was organised by the Council of Europe at the invitation of the Ukrainian government.

We are particularly pleased to welcome the result of a unique collaborative effort between the services of the Council of Europe, the Parliamentary Assembly and the Congress of Local and Regional Authorities, the OECD and the financial experts of the Council of European Municipalities and Regions and its members from all across Europe. It was not the contributors' aim to place blame on any particular actor or sphere of governance, the institutions, the states or local and regional authorities. Their aim was rather to analyse a situation that everyone must face and that carries within it the seeds of a crisis that's negative impact on investment and on the level of confidence of Europeans in their future is still being assessed daily.

The publication also lists a number of suggested policy responses aimed to cope with the pressure on public finances. In the case of policies implemented at the national level, their advantages and impacts should be assessed in view of the principles and provisions of the European Charter of Local Self-Government, in dialogue and due consultation with local authorities. In turn, local authorities are invited and encouraged to familiarise themselves with the policy options which may be implemented at the local level, including improvements in efficiency and effectiveness as well as increased transparency and accountability in the use of public funds, as recommended by the Kyiv Guidelines adopted by the Conference of Ministers Responsible for Local and Regional Government.

Ever since the beginning of the crisis, CEMR has repeatedly shown that this situation can in fact prove to be an opportunity for Europe, a chance to define a new model of growth based on an endogenous development of territories, so long as the states do not engage in a policy to recentralise means and that they preserve intact local and regional authorities' financial independence and their capacity to act. We are convinced, as numerous examples have demonstrated, that it is the municipalities, cities and regions that are best suited to envision their development as they can best utilise the resources at their disposal, whether they be financial, human or material in nature, thus ensuring the future of our continent.

That is why we must implicate all levels of governance to work together in partnership and to strengthen cohesion policy, possibly by enlarging it to countries outside of the European Union if they have the will to participate in the new mobilisation effort that Europe needs. Europe, which remains the richest continent on the planet, will only find solutions to the crisis by facing its own destiny. Our continent must respond to global competition, a reality which must be dealt with by everyone, with a new ambition, that of creating an exemplary continent of governance: whether it pertain to good use of the planet's resources, social measures, human rights, the vital solidarity between Europeans or opening up to the world. It is by envisioning this new project that Europeans will be able to continue offering to the world future prospects of peace and shared progress.

Parliamentary Assembly of the Council of Europe

Sir Alan Meale
Member of the UK Parliament

The publication *Local Government in Critical Times: Policies for Crisis, Recovery and a Sustainable Future* provides both an insight into the different types of effects that can emerge in nations during periods of economic downturn, together with recommendations which those responsible for management/budgetary control and/or legislation can adopt to help them deal with changed fiscal circumstances.

The publication proposes a number of important guidelines that can be readily adapted in context to meet the differing systems operating in individual nations.

As such it's an important tool for repairing damage to broken systems and thereafter building required recovery mechanisms towards sustainable futures.

The Congress of Local and Regional Authorities of the Council of Europe

Keith Whitmore
President

The theme of this book is of paramount importance to the Congress of Local and Regional Authorities. I welcome the initiative in preparing it taken by our governmental partner, the European Committee on Local and Regional Democracy with the support of the Open Society Foundations. This is a timely publication, an excellent opportunity to address issues which are of utmost concern to all of us.

The financial crisis, since its outbreak in 2008, has had a major impact on all levels of government and its consequences are being particularly felt by local self-government bodies in every state of Europe. The crisis has seen a widespread and substantial fall in local and regional tax revenues, additional costs in social assistance expenditure, a significant increase in budget deficits and a consequent decrease in public spending affecting investment in infrastructure and leading to cuts in staff and services. If this trend continues, it will severely jeopardise social cohesion and social harmony. Decisive sustainable action by local government is needed to reverse it.

In March 2009, the Congress debate on the consequences of the economic and financial crisis for European local and regional authorities was a first attempt to gauge the degree of its impact on local communities and to compare the experiences of various municipalities and regions in coping with the crisis. We followed this up with a second debate in March 2010.

These debates highlighted that the crisis has not just been a source of difficulties but has also provided an opportunity for new initiatives and innovation. More cooperation among municipalities was advocated to achieve economies of scale while maintaining the political discretion and the identity of the community. A rethinking of procedures and processes, excessive quality standards and bureaucratic reporting systems was also called for. Further examples can be found in this book.

The current crisis gives rise to doubt and pessimism at all levels of governance. At a time when people are worried about the future, local and regional authorities have to re-establish their citizens' confidence and hope, and perspectives on how we can find ways and means to create a coherent framework for action.

There are no obvious and quick solutions to this crisis, but there are different ways in which its impact can be softened. The Congress is committed to addressing the challenges which the global financial crisis poses for local authorities across Europe. I encourage local and regional authorities to read and use this book and to apply the guidelines that are tried and tested approaches for facing this situation.

Kyiv Declaration

Adopted by the European Ministers Responsible for Local and Regional Government at the 17th Session of their Council of Europe Conference

3–4 November 2011

We, the European Ministers responsible for Local and Regional Government,

Having come together at the 17th session of our Conference on 3 and 4 November 2011 in Kyiv in order to take forward our longstanding cooperation,

Having reviewed progress with taking forward the Utrecht Declaration and the Utrecht Agenda,

Have decided

As concerns the outlook for the future of pan-European work on local and regional democracy

1. to commit ourselves to taking continued and new initiatives in the future in our member states to strengthen good governance, capacity building and citizens democratic participation at local and regional level, following up the progress review reports on the Outlook to the future presented in Kyiv, and to report to the Committee of Ministers on the result;
2. to affirm our support for the report prepared by our colleague Manuel Chaves, noting with satisfaction the support it has received from the Congress and the recognition it gives to each of the institutional actors within the Council of Europe;
3. to invite the Committee of Ministers to put in place arrangements for implementing the proposals of the report and suggest, with the concurrence of the President and other representatives of Congress present with us at Kyiv, that:
   - these arrangements might include a "political high level follow up group", convened by the Chairman for the time being of the Committee of Ministers, to assist in the development of such proposals as the "agenda in common", and
   - such a "political high level follow up group" might involve Ministers or State Secretaries having responsibilities for local and regional government and members of the Parliamentary Assembly and the Congress;

As concerns the further impact of the economic crisis on local government and the policy responses to it

4. to agree, including drawing also on our discussions in Kyiv highlighting the common problems and challenges we face, on a more developed set of guidelines for our actions at domestic level that will henceforth be known as the "Kyiv Guidelines";

5. to commit ourselves to draw inspiration from the “Kyiv Guidelines”, to use them and to contribute actively to the work to be undertaken under 7 below by engaging our senior officials competent in these matters;
6. to actively disseminate and draw the attention of all relevant stakeholders in our respective countries to the report “Local Government in Critical Times: Policies for Crisis, Recovery and a Sustainable Future” and the “Kyiv Guidelines”;
7. to invite the Committee of Ministers that it, in order to assist member States and their local and regional authorities to weather the economic downturn and address long-term challenges, include in the Council of Europe programme on local and regional democracy and governance the work of:
   - analysing the impact of changing economic fortunes on local budgets, and of
   - monitoring and developing policy responses on the basis of the “Kyiv Guidelines”

   and in full compliance with the European Charter of Local Self-Government, the Committee of Ministers’ acquis and, as applicable, the Reference Framework for Regional Democracy;

As concerns human rights at local level

8. to invite the Committee of Ministers that it, as part of the Council of Europe programme on local and regional democracy and governance, in dialogue with the Parliamentary Assembly, the Congress and the Conference of INGOs, elaborate proposals for strengthening awareness raising of the human rights dimension of local and regional governance;
9. to invite the Committee of Ministers to examine how the Principles of good democratic governance at local and regional level can best be promoted and embedded in the practices of local and regional authorities and be supported by the adoption of the draft Recommendation on the principles of good democratic governance at local level;

As concerns the role of government in overcoming obstacles to transfrontier cooperation

10. to encourage member States, as far as they have not yet done so, to sign and ratify the Madrid Outline Convention on Transfrontier Co-operation and its three additional Protocols;
11. to continue, despite current budgetary constraints, our support for crossborder co-operation with the aim of putting into practice public policies across wider areas or which encompass larger populations, enriching and rationalising the supply of

public services, facilitating territorial integration and promoting more effectively economic and social development;

12. to step up efforts to remove or reduce, as far as possible, obstacles to transfrontier co-operation for those territories which have often been handicapped by their position at their country's borders;

13. to envisage, according to need, a central or regional government "special task mediator/mediation office" for crossborder co-operation, tasked with making the action of the different ministries and players concerned more dynamic, or a border zone "contact person or body" whom territorial authorities and communities could contact when promoting and setting up cross-border co-operation;

14. to invite the Committee of Ministers to include in the Council of Europe programme on local and regional democracy and governance the work of sharing the results of the experience of certain member states which have designated a crossborder "special task mediator/mediation office";

As concerns the Declaration as a whole

15. to commit ourselves to ensure the continuity of our work and to liaise with our colleagues of Foreign Affairs to ensure optimal exchange of information and synergies with the Committee of Ministers;

16. to invite the successive Chairs of the Committee of Ministers, namely Ukraine, the United Kingdom and Albania, to bring this Declaration to the attention of the Committee of Ministers at their earliest convenience.

Kyiv Guidelines

Agreed by the Council of Europe Conference of Ministers Responsible for Local and Regional Government at its 17th Session

3–4 November 2011

1. The survey of members carried out in preparation of the 16th Session of the Council of Europe Conference of Ministers responsible for local and regional government in Utrecht (The Netherlands) in November 2009 identified main possible policy responses for which more detailed guidelines were adopted in the so-called Utrecht guidelines. In the light of experience gained since 2009, the guidelines have been further developed into those set out below. It is to be stressed that the feasibility and desirability of individual guidelines may vary from country to country and thus are to be seen as range of policy options and not a prescriptive set of measures.
2. The economic crisis has generated a widespread recognition of the need for radical improvements in governance and in the management of public expenditure. Even when the worst of the crisis is over and whilst the means to be deployed will differ over time and vary from place to place, there will be a constant need for increasing efficiency across the whole of the public sector, and hence for greater collaboration between all the stakeholders, central government, local and regional authorities as well as their associations. The aim should be to remove duplication and to drive down costs arising from a lack of co-ordination, integration and flexibility in the delivery of public services, not only to meet the demands of the current fiscal situation, but also to be better placed to address longer-term social, economic, demographic and environmental changes the challenges of which will no doubt outlast the crisis. These challenges also place emphasis on the value of partnership with private and social enterprise and the voluntary sector.
3. Above all, the Council of Europe is concerned to protect and enforce the values of local democracy enshrined in the Charter of Local Self-Government and also of social responsibility, embodied in the European Social Charter. Exchanging and sharing information and experience at local, regional, national and international level, as well as the identification of good practices this enables, will be key to achieving success at the earliest possible time.

I. Council of Europe Standards

4. Any policy response by central government to the impact of economic downturn on local government must be fully compatible with its obligations under the European Charter of Local Self-Government (CETS 122), which recognises that questions as to the financial resources for local authorities are to be determined within a Party's national economic policy.
5. The two recommendations of the Committee of Ministers in the field of local finance: Rec(2004)1 on financial and budgetary management at local and regional levels

and Rec(2005)1 on the financial resources of local and regional authorities, offer a powerful and coherent set of guidelines aimed at ensuring a sound local finance system, many of which are ever the more useful in the context of the economic downturn.

II. Possible Policy Responses Identified So Far

The main options identified so far are:

1. Stabilising local revenue bases;
2. Improving accountability and efficiency;
3. Combating social deprivation;
4. Partnership in delivering public services;
5. Enhancing local flexibility and discretion;
6. Promoting economic recovery.

1. Stabilising Local Revenue Bases[1]

Tax assignments

7. Local budgets are heavily encumbered by regular operating costs. This is particularly the case where they include teachers' salaries, social assistance or medical services, but most pay for basic essential services like road maintenance, waste management, care for the elderly and water supply. They need relatively stable revenues to sustain these responsibilities.
8. Governments and local authority associations might wish to consider changes in those local revenue bases which depend excessively on shares of highly volatile taxes such as those on corporate profits and property transactions. Overall, the ratio of own revenue to transfers does not seem to make much difference to the stability of the local budgets in crisis. What is important is to ensure a broad and diverse basis of own revenues, avoiding over-reliance on a single volatile tax.

---

1. France and Malta reserve the right not to take account of the guidelines in paragraphs 7–20.

9. Alternatively, consideration should be given to transfer mechanisms with automatic stabilizers incorporated, such as those used in Northern Europe to finance the social services. Where volatile taxes are already assigned to local governments and legal changes are difficult to make, local governments might consider to introduce “buffer” mechanisms, which would neutralise revenue fluctuations.

10. Personal income is the only tax base which is both technically susceptible to variation by local decision and capable of funding a large proportion of the costs of major services, such as education and social and health care. Revenue from local budget shares of personal income taxation has inevitably suffered from reductions in employment, hours, salaries, etc., but less dramatically than that of corporate income. It remains the most effective alternative to over-dependence on transfers and should be protected or may be introduced where it does not exist.

11. Taxation of property ownership or occupation has proved remarkably resilient. This is because in most European states liabilities do not vary according to annual changes in property values; municipalities also have used freedom to increase rates or intensify administration to compensate for decline of other sources. Conferring such opportunity on local governments who do not have it would contribute to financial resilience.

12. The property tax based on effective market values has no tradition in Europe (with exceptions, such as Denmark and Sweden), and where it is applied, e.g. in the United States, its drawbacks have come to the fore during the recent crisis. Stability is enhanced where property taxes are based on statutory values and are revised from time to time, but not annually. In the interest of stability, such revisions should reflect long-term market developments, rather than short-term fluctuations.

13. Regular changes to property tax liabilities will be needed between periodic revaluations to reflect increases in the municipal costs that they fund, but they should not be subject to the severe fluctuations that sometimes influence property market values because of the potential damage to either municipal budgets when these are depressed or to taxpayers’ pockets when they surge. Indexing the base to an appropriate price index is one possible solution. Regular increases in tax rates set by local councils is another; as practised by British and Polish local councils, for example, annual increases just above the rate of inflation have secured substantial revenue increases over time without serious political opposition.

Discretion to set local tax rates and charges

14. On balance policy responses to the crisis have reduced the freedom of local governments to determine their local tax levels though there are exceptions. This appears to weaken compliance with the European Charter of Local Self-Government.

15. It must be recognised, however, that local councils' sense of accountability to their business taxpayers may be weaker than to their residents. Restrictions on rate-setting powers to prevent discrimination against non-voters may well be justified. Curbs on excessive local PIT rates may also be justified where they have a proven impact on labour supply and fiscal sustainability.

16. Some countries employ caps on local tax rates or surcharges such as on the personal income tax. This is counterproductive, especially if all, or almost all, municipalities have reached the rate ceiling. In this case the local taxpayer knows that he/she is protected against higher taxes and loses interest in controlling a possibly spendthrift local budget policy. Caps on local tax rates simply endanger accountability and leave scope for pressure on national governments to come to the rescue of unbalanced local budgets.

Intergovernmental transfers

17. Local budgets cannot be indefinitely shielded from national revenue losses and budget deficit. However, immediate and arbitrary cuts are damaging to local public services if conducted during the fiscal year. Such harm can be minimised where local governments are given notice in advance of finalising their budgets. Cuts, where unavoidable, should be distributed by objective formulae to ensure their equity and political neutrality.

Debt

18. Reviving capital investment will be important to recovery, which means restoring operational surplus sufficient to fund it directly or redeem debt. But growing indebtedness calls for improvements in the regulatory regime for both borrowing and insolvency. This also applies to the often murky financial relationships between municipal budgets and those of their utility companies.

19. In some member countries, unsustainable local government debt has emerged as a problem. In these instances actions must be taken to correct any fundamental imbalance between responsibilities and resources. Municipal budget autonomy needs to be exercised within clear policies over prudential and macro-economic limits to borrowing and processes of public scrutiny. Clear rules and procedures are also needed to govern cases of municipal insolvency.

20. The Maastricht criteria induced a number of countries to introduce an intergovernmental mechanism for restricting public sector borrowing under headings such as "internal stability pact" or "debt brake". The Council of Europe Committee of

Ministers issued Recommendations in 2004 and 2005, whilst the Network of Associations of Local Authorities of South-East Europe (NALAS) has just published a very comprehensive analysis on borrowing procedures in South East Europe. These deserve constant bearing in mind.

2. Improving Accountability and Efficiency

21. Making the most of more limited resources will remain a priority for the foreseeable future. Much of the reduction in revenue has been absorbed simply by deferring capital investment. Reports, however, reveal many attempts to improve the efficiency and effectiveness of local budgets. These deserve dissemination and replication.

    Of particular significance are:

    - increasing co-operation between municipalities, particularly in operating major infrastructure or shared administrative processes like development control, tax collection, procurement and IT, and between municipalities and other public agencies;
    - reductions in payroll costs which have minimised staff layoffs through pay cuts or freezes, reductions in hours and overtime, freezing vacancies, etc.;
    - engaging staff in identifying efficiency savings;
    - transparency over procurement and budget expenditure, including use of electronic auctions and online publication of expenditure;
    - enhanced use of benchmarking, comparing systems and their attendant costs (a process actively promoted by the Council of Europe – Centre of Expertise for Local Government Reform);
    - use of computerisation to enhance the speed, neutrality and transparency of administrative procedures.

22. In a number of countries wholesale territorial reorganisations have been carried out or are in progress to achieve scale economies or more uniform service quality. These may well be beneficial but have initial political and financial costs which limit their immediate gains. Increasing intermunicipal co-operation offers quicker returns. Territorial re-organisation will nonetheless be something that many States will wish to consider as a medium- to long-term reform.

23. Obstacles to efficiency remain, which governments, associations and individual local authorities are urged to address. These include:

- the reduction in some countries of the contribution of the private sector and market mechanisms to efficient delivery of public utility services in a few countries, with potential danger to the results of successful partnerships over the past three decades;
- the continuing weakness of performance audit, particularly in countries with large numbers of small municipalities without qualified personnel;
- continuation of administrative and financial arrangements in some countries which encourage services like health and social care to be provided in an unnecessarily expensive way.

3. Combating Social Deprivation

24. The recession has inevitably increased social distress reflected in rising unemployment, lower household incomes, increased costs such as heating, utility charges, food and evictions. Budget cuts, national and local, threaten benefits and some programmes such as early childhood development, important to the human rights of poor and minority households. In some cases support to programmes most significant for such vulnerable groups is being cut disproportionately because the services concerned are not mandatory and are provided by non-governmental organisations whose employee severance costs do not fall on local budgets.
25. Local governments' social expenditures have risen substantially and are destined for sustained growth because of long-term increases in the population of elderly people requiring medical and social care.
26. Measures are recommended to mitigate these burdens. These include:
    - means-testing subsidies for services like heating, housing or public transport;
    - shifting the bias of care for the elderly to community rather than institutional provision and increasing support for family and voluntary carers;
    - giving priority to expenditure on support to vulnerable groups whether provided by public or private agencies.
27. National and local governments should also review their benefit procedures to ensure that the poor are not hindered from access by legal and bureaucratic obstacles.

4. Partnership in Delivering Public Services

28. Local government faces long-term challenges that will outlast the crisis. The autonomy promoted by the European Charter should give the freedom to innovate in meeting these and some security over resources. But these challenges require a style and habit of partnership with other key actors such as other levels of government, the private sector, universities and other members of the research and training communities, social enterprises and other non-governmental organisations

29. The crisis has slowed down the spread of partnerships involving the private sector in carrying out the initial investment in a public service facility. These remain widespread in cases such as waste disposal where construction and operation can be combined in a single management and where costs can be recouped directly from beneficiaries. Efficiency can suffer, by contrast, where responsibility for operation becomes fragmented between commercial investors and public service professionals; costs can also escalate substantially when loaded with the higher interest rates attached to private sector borrowing.

30. By contrast, the crisis has increased interest in partnership with the voluntary sector and social enterprise in running community level services. Care of the elderly is an increasingly important field for such partnership. Giving social enterprises freedom to provide both residential and domiciliary care services and providing beneficiaries with cash benefits rather than services in-kind, provides an arena for choice and competition which can enhance quality of life. Family and voluntary carers, in practice mostly women, can also be supported and encouraged by measures like compensation for pension losses, arrangements for career breaks, re-entry on the labour market, respite care and even petrol allowances. Involvement of the private or voluntary sector in provision of public services must be in line with public policy and have regard to the requirements of efficiency and value for money and, above all, the needs of those to whom services are intended to address.

31. Partnership will also be vital in keeping local economies ahead of the game. Partnership with other local actors will be crucial in identifying contemporary opportunities, promoting technological research and innovation, providing education to improve the local skill base and providing the planning and infrastructural framework (including information and communication technology).

5. Enhancing Local Flexibility and Discretion[2]

32. The impact of the crisis on compliance with the Charter of Local Self-Government has been mixed. The report "Local Government in Critical Times: Policies for Crisis, Recovery and a Sustainable Future" gives examples of both increases and losses of local tax autonomy. Examples have been given of national governments intervening in detailed local budget decisions, while there are fears that EU attempts to impose common economic government within the Eurozone will curtail the ability of local government to determine their spending levels. On the other hand, some conditionality and control have been relaxed by national governments to avoid responsibility for detailed cuts in services.

33. The need to preserve and possibly enhance local discretion over local taxes and charges has already been highlighted. It will also be important to

    - avoid an intuitive recentralisation of authority;
    - abolish unsustainable expenditure norms that prevent efficient management of local public services; these tend to regulate inputs rather than outcomes;
    - reform funding mechanisms that encourage costlier types of service provision.

6. Promoting Economic Recovery

34. With GDP almost static and unemployment still rising in much of Europe, helping to engineer recovery must be a priority for local government.

35. Its first contribution should be to revive its former levels of infrastructural investment that have been the biggest casualty of the budget squeeze. This primarily means restoring the operational surplus that funded investment directly, serviced loans, repaid bonds and provided pre-finance and counterpart support for EU structural funds.

36. Its second major role is to work with banks, private enterprise and the local research and training community to identify and exploit opportunities for economic growth in the 21st century. Vocational training and broadband networks are key components. So are planning framework and development control procedures that create a favourable business environment and increase the competitiveness of local economies.

---

2. France reserves the right not to take account of the guidelines in paragraphs 32 and 33.

37. Finally, local governments are key actors in responding to climate change and rising energy prices. Making municipal assets more energy efficient, increasing the use of renewable energy, reforming transportation, increasing the capacity of stormwater drainage are all key tasks for local government, requiring partnerships with utility and transport companies, "green" technology companies and any other suitable actors with capabilities and commitment.

Local Government in Critical Times: Policies for Crisis, Recovery and a Sustainable Future

REPORT

Prepared by the European Committee on Local and Regional Democracy with input from the Council of European Municipalities and Regions and a team of country observers, in the framework of the joint project of the Council of Europe with the Open Society Foundations.

CHAPTER I

Overview: Living with Uncertainty

An Age of Heightened Uncertainty

How has the financial crisis in Europe affected local governments? How have they and their national governments responded? These were the questions set by the ministers meeting in Utrecht in 2009 for review over the two years leading to the next meeting at Kyiv.

Answers are the purpose of this stocktaking, conducted with the help of country surveys by members of CDLR and CEMR and a pool of independent observers, together with presentations at two Strasbourg conferences.

Some conclusions are clear. From the surveys and from data published by Eurostat and Dexia *we know that:*

- Local budget revenue contracted in real terms in most Council of Europe member states surveyed over the period 2008 to 2010.
- The fall was due chiefly to declines in tax revenues (including shared taxes), particularly in 2009.
- In 2009 revenue falls were cushioned in many states by compensating increases in intergovernmental transfers, either for general budget support or for "fiscal stimulus" capital programmes, but this intervention lessened in 2010. In 2011 transfer reductions have intensified in states affected by sovereign debt crises (Greece, Ireland, Italy, Portugal and Spain) and were introduced in Romania and the UK in medium-term programmes to reduce national budget deficits.
- Local public services have suffered from reduced funding but not commensurately. There have been efficiency gains while capital expenditure has been widely deferred.
- Local budget expenditures on social welfare and support have increased as a result of economic pressures on households and will continue to do so as the proportion of the population over 65 maintains its rise.

But future developments are far from clear. *We do not know:*

- When economic growth will resume. A weak recovery in 2010 has been halted in much of Europe during 2011 by the expansion of the sovereign debt crisis and threats to the Euro; even German growth halted in the second quarter.
- Future trends in commodity prices and their impacts on local budget revenues and expenditures.
- Impacts of the crisis and its aftermath on governance, including the ability of individual governments to sustain austerity measures and possible extension of EU influence on national and local fiscal management.
- Effects on society and their incidence on different groups.

We also do not know what else will happen to destabilise the environment within which local budgets operate. The unexpected is sure to happen. At Utrecht, for example, we could anticipate neither the Arab Spring nor the Japanese tsunami.

Living with Uncertainty

We do not know whether the crisis is over or not. In the Czech Republic or Turkey it never seems to have arrived. In Spain it is perhaps more acute than ever. Most countries are still holding their breath.

This continued uncertainty is all the more unsettling because of the contrast with the pre-crisis mood of growth and optimism. “Yesterday, all our troubles seemed so far away.” Services could be expanded, payrolls increased, money borrowed with apparent confidence. All that is past but local governments have not collapsed; the streets are still cleaned and children taught. As Chesterton put it, “God fulfils Himself in many ways, even by local government”. The Kyiv Conference can:

- *Acclaim* the resilience of local government since Utrecht, and
- *Proclaim* the need for adherence to robust strategies that can withstand fluctuating economic fortunes.

Three such strategies emerge from the substantive part of this report:

- Stabilising revenue bases;
- Making the most of limited resources; and
- Developing partnerships to meet long-term challenges.

Stabilising Revenue Bases

Local budgets are heavily encumbered by regular operating costs. This is particularly the case where they include teachers' salaries, social assistance or medical services, but most pay for basic essential services like road maintenance, waste management, care for the elderly and water supply. They need relatively stable revenues to sustain these responsibilities.

It is clear from recent experience that some resources are far more stable than others. Funding strategies should draw on the following lessons:

- Local budgets should not rely too heavily on volatile revenues that overreact to economic fluctuations. Taxes based on corporate profits or property transactions are the prime examples. There is good argument for municipal access to these bases, but not for major dependence on them. The German *Gewerbesteuer,* assessed on corporate profits, for example, constitutes 30 per cent of municipal tax revenue. Before the crisis taxes on property sales contributed 56 per cent of municipal tax revenue in Bulgaria, which shrank in 2009–10 by 55 per cent.
- By contrast, taxation of property ownership or occupation has proved remarkably resilient. This is because in most European states liabilities do not vary according to annual changes in property values; municipalities also have used freedom to increase rates or intensify administration to compensate for decline of other sources. Conferring such opportunity on local governments that do not have it is important.
- Revenue from local budget shares of personal income taxation has inevitably suffered from reductions in employment, hours, salaries, etc., but less dramatically than that of corporate income. It remains the most effective alternative to overdependence on transfers and should be protected (or introduced where it does not exist).

Local budgets cannot be indefinitely shielded from national revenue losses and budget deficits. However, immediate and arbitrary cuts are damaging to local public services. Cuts should not be disproportionate to national budget economies, and harm can be minimised where local governments are given a year's or more notice of reductions and are able to plan how they can best be absorbed. Cuts, if necessary at all, should be distributed by objective formulae to ensure their equity and political neutrality.

Reviving capital investment will be important to recovery, which means restoring operational surplus sufficient to fund it directly or redeem debt. But growing indebtedness calls for improvements in the regulatory regime for both borrowing and insolvency. This applies also to non-transparent financial relationships between municipal budgets and those of their utility companies.

Making the Most of Limited Resources

Chapter III catalogues ways in which local governments have cut costs in the face of revenue loss. They are diverse and in most cases locally generated. Particular worthy of emulation are:

- Increasing co-operation between municipalities, particularly in operating major infrastructure or shared administrative processes like development control, tax collection, procurement and IT;
- Reductions in payroll costs avoiding staff layoffs;
- Engaging staff in identifying efficiency savings;
- Transparency over procurement and budget expenditure;
- Enhanced use of benchmarking, comparing systems and their attendant costs.

On the other hand, the contribution of the private sector and market mechanisms to efficient delivery of public utility services have been reversed in a few countries, with potential danger to the results of successful partnerships over the past three decades.

Developing Partnerships to Meet Long-term Challenges

Local government faces long-term challenges that will outlast the crisis. The autonomy promoted by the European Charter should give the freedom to innovate in meeting these and some security over resources. But they all require a style and habit of partnership with other key actors such as other levels of government, the private sector, universities and other members of the research and training communities, social enterprises and other non-governmental organisations. Of special importance are the challenges to:

- *Keep local economies ahead of the game*. We can no longer assume that recovery from the current recession can be based on strategies like attracting inward investment and urban regeneration that were so successful in the 1980s and 1990s.

Global competition is greater and the property market weaker. Partnership with other local actors will be crucial in identifying contemporary opportunities, promoting technological research and innovation, education to improve the local skill base and providing the planning and infrastructural framework (including information and communication technology).

- *Cope with climate change.* Making municipal assets more energy efficient, increasing the use of renewable energy, reforming transportation, increasing the capacity of storm water drainage are all key tasks for local government, requiring partnerships with utility and transport companies, "green" technology companies and any other suitable actors with capabilities and commitment. Planning frameworks, for example, are often based on producing, assembling and distributing goods in multiple locations, scattered round the world despite transportation and environmental costs. The sustainability of these is likely to come under increasing pressure.
- *Support the vulnerable, with special attention to children and the elderly*. Supporting increasing numbers of elderly people will depend on strategies to encourage community care and assist family members and others providing informal care. Services such as early childhood development that contribute greatly to the human rights of vulnerable groups should be safeguarded in times of austerity. Benefits may have to be targeted to the most needy households more restrictively.

Conclusion

The impact of the crisis on compliance with the Charter of Local Self Government has been mixed. Chapter II reports examples of both increases and losses of local tax autonomy. From Ireland to Hungary examples have been given of national governments intervening in detailed local budget decisions, while there are fears that EU attempts to impose common economic government within the Eurozone will curtail the ability of local government to determine their spending levels. On the other hand, some conditionality and control have been relaxed by national governments to avoid responsibility for detailed cuts in services.

Over three years and with bewildering speed the crisis has changed its focus – housing finance, banking collapse, economic recession, sovereign debt, currency survival – and its geographical heartland from the Baltic states to the Mediterranean. It is not surprising that commentators have been reluctant to pass judgment on the impact on local public services. Quantitative evidence supports a slowdown in infrastructural investment despite increased EU spending, and there is worrying evidence of cutbacks in discretionary expenditure in aid of vulnerable groups.

The good news is that the crisis has promoted a culture of greater accountability by local government for the careful use of resources, and of mutual co-operation with neighbours and other local partners. This leaves it in better shape to tackle the challenges, social, economic, demographic and environmental, which will endure well beyond recession.

CHAPTER II

Revenue: Performance and Policies

Revenue Performance of Local Budgets in Crisis

In mid-2011 we have for the first time the opportunity to look back at all three years of the economic crisis (2008–2010) and assess its effects on subnational budgets across Europe. Although this is not an easy exercise, for reasons briefly outlined below, it is very important to be able to differentiate not only between countries, or groups of countries, but also between what we would call, somewhat arbitrarily, the first and the second phases of the crisis: 2009/2008 versus 2010/2009 budget trends. We will notice that the onset of the crisis and especially its impact on the public budgets have occurred at different moments in various countries with substantial time gaps between them.

Snapshot views or continental average indicators tend to obscure what is otherwise a very mixed picture. The common, unifying theme for the whole continent is the radical change these two years have made in the entrenched assumptions and expectations of both local decision-makers and the markets. Before the crisis, for a good number of years, the local and regional budgets had been on the rise in virtually every country, and across all the major sources of revenues, with rates of growth above that of the respective national GDP. Projections incorporated in the multi-year budgets were that the trend would continue.

The booming economies made municipalities and regions increasingly confident and tempted to share in the good times by relying on sources of revenue directly related to the (positive) business cycle: either business taxes in various forms or property transaction taxes, calibrated so as to follow closely the upward trends of the market. This was often leveraged driving municipalities into potentially unsustainable debt.

What the two years of crisis in the public budgets have brought about is, above all, increased heterogeneity at the continental scale. The economic trends, the policy responses to the economic shock and the effects of these measures were much more divergent than the calm situation before the crisis. It could hardly have been otherwise, due to the following reasons:

- The moment and severity of the economic downturn was different: more than one year separates the peak of the crisis in the Baltic states from that in Greece;
- The capacity of the state administrative machine to implement policies in adverse circumstances, as well as the fiscal space for manoeuvre, was variable too, especially in Southern and Eastern Europe;

- The size, functions and scope for decision-making in subnational governments vary widely, from substantial in the Scandinavian countries (40–60 per cent of the public spending) to modest in Greece, Cyprus, Ireland, Turkey or Portugal (around 10 per cent or less).

All these factors led to divergent policy responses to the crisis as far as subnational authorities are concerned, from being protected by the central governments against the worst effects of shrinking budgets, to having to shoulder a disproportionate burden in crisis. This is understandable, as the political attention given to local spending is not the same in countries where subnational authorities do not provide essential social services. The following sections are an attempt to identify some patterns in this otherwise complex and shifting landscape over the past three budget cycles.

Comparative Trends in Local and National Revenues

Figure 1 groups together both stages of the crisis on the same charts: first the changes in nominal terms with inflation represented separately (Figure 1A) and then the changes in real terms (Figure 1B).

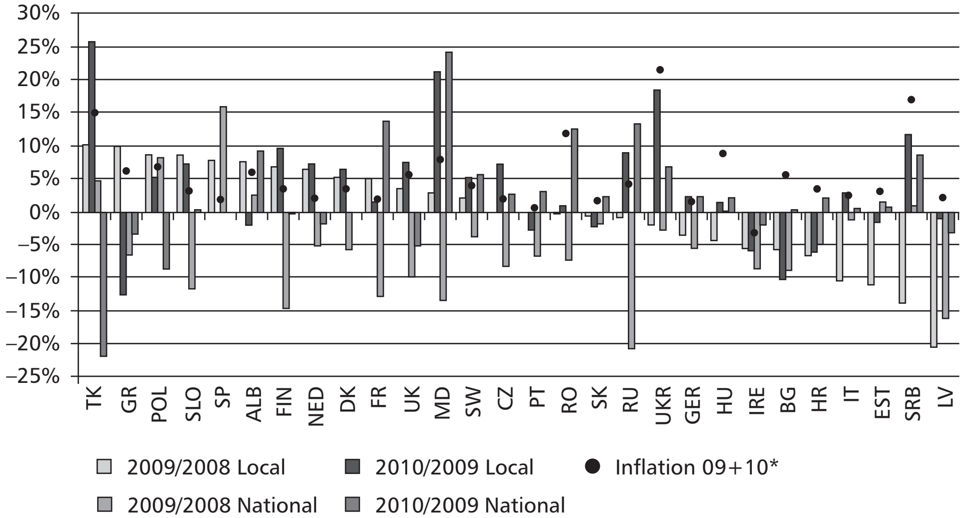
A careful reading of the trends shows that the hypothesis formulated in the preliminary analysis in 2010 is verified:

- in the majority of European countries the local budgets have suffered a contraction in real terms in the interval 2008–2010 (i.e. taking the inflation rate into account);
- and in more than half of the countries for which we have data, local budgets dropped more on the aggregate than the corresponding central ones, at least in one of the two years of the crisis.

This second trend is obvious in many Central and Eastern European countries (Hungary, Romania, Slovakia, Bulgaria, Estonia, Croatia, Serbia) but also in some old member states (France, Italy, Ireland). It is only the timing of various micro-trends that differs, but the net effect is the same. Other countries for which data is only partial (Spain, Greece) belong most likely in this category too. In a number of these countries there is evidence that the central governments have deliberately applied pressure on local budgets in order to create fiscal space at the centre in order to deal with the effects of the crisis, either by cutting transfers and local borrowing or forcing local governments to run surpluses (Romania, Serbia, Bulgaria).

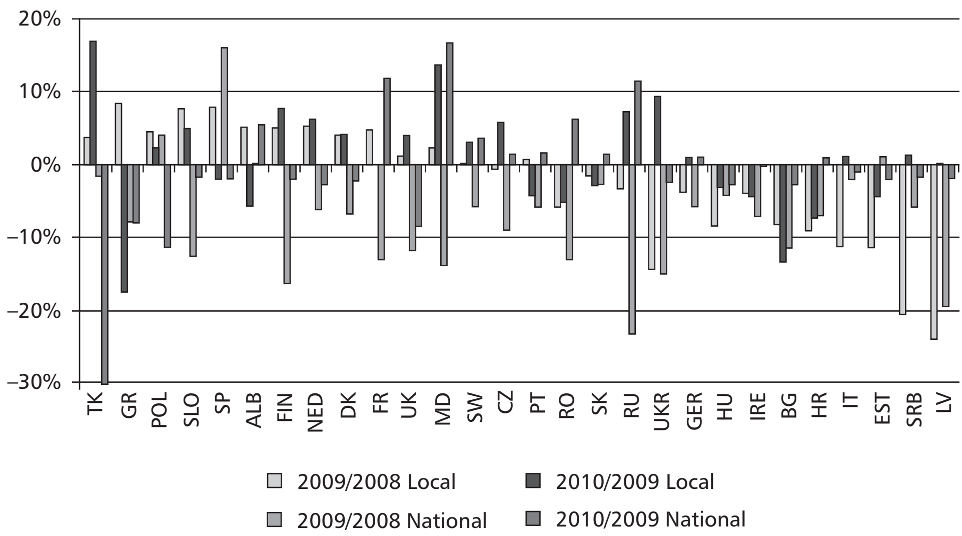
Some large countries, that in the first phase of the crisis seemed to shelter the hard times well, registered drops in real terms in the local budget revenues in the following year, which confirms the general trend, just with a time lag (Poland, Spain, France).

Figure 1A
Comparative trends in local and national revenues – nominal terms and inflation



Note: * HCPI according to Eurostat.

Figure 1B
Comparative trends in local and national revenues – real terms



It is only in a handful of states that the central governments have managed to protect local budgets from the impact of the downturn, through increasing the volume of transfers in the first year of the crisis (France, Czech Republic, Slovenia, Russia) or in the second (Poland); but also by revising upwards the local tax rates which are set through national legislation (Czech Republic). In the UK, too, it looks like the local budgets were relatively protected in crisis, in contrast to the central ones (although faced now with substantial cuts starting in 2011).

The Scandinavian group (Sweden, Denmark, Finland) have also fared well in crisis all along: they managed to shelter their large local budgets from any cuts, though their central budgets dropped in the first year in all three cases. This was mainly the effect of the automatic stabilizers inbuilt into the intergovernmental transfer mechanisms, which helped to neutralize the impact of budget shocks on sensitive social services.

Finally, in Turkey and Ukraine the trends are affected by important changes in the financial allocation rules, which make comparisons over the interval 2008–2010 difficult: without the major reallocation of revenues to municipalities, a downturn in local budgets would have been noted in Turkey, too.

The indebtedness of local governments has gone up across the board, with just a few exceptions: the Scandinavian group and a few other countries such as Croatia or the Czech Republic. However, there is a large disparity between old EU member states or Turkey, where municipal debt is over 100 per cent of the total local revenues, and the Scandinavian countries and the new EU member states where it is still much lower (Table 1A).

Other countries with recent public debt problems for which we have only inconsistent direct information from our country operators can be analyzed using the Eurostat data (Table 1B). The two sets of data – ours and Eurostat – show by and large similar patterns, with the observation that the latter figures must be interpreted having in mind the very different size of the local government sector in terms of per cent GDP in each country. On average, the core Euro area displays a small rise of the subnational debt, mostly in the first year of the crisis (9 per cent); and the larger EU a somewhat higher but still moderate rise.

Table 1A
Local government debt

	Local government debt as per cent of total local revenues (all tiers combined)			
	2008	2009	2010	
Spain	169.7	182.5	Over 220	↑↑
Germany	153.0	171.7	187.4	↑
Turkey	120.8	126.0	127.0	↑
Ireland	100.0	114.0		↑
Sweden	46.3	50.5	45.8	
Latvia	39.7	57.0	62.0	↑↑
Estonia	37.7	45.9	44.8	↑
Hungary	32.2	36.6	43.3	↑
Croatia	29.1	32.2	30.2	
Denmark	29.3	29.3		
Slovakia	26.7	31.8	38.4	↑↑
Czech Republic	24.5	26.2	24.7	
Finland	22.4	23.8	23.2	
Romania	21.8	26.0	27.1	↑↑
Poland	20.3	26.0	33.8	↑↑
Slovenia	15.9	22.4	25.4	↑↑
Moldova	6.4	5.0	4.0	
Russia	6.1	7.6	8.0	↑
Bulgaria	2.7	6.2	6.5	↑↑
Serbia	0.0	0.0	30.6	↑↑

Source: Country observers.

Table 1B.
Local government debt as per cent of GDP

	2007	2008	2009	2010	increase in crisis 2010/08 (per cent)
Norway	9.6	9.8	11.7	12.6	*29*
Netherlands	7.1	7.3	8.0	8.4	*15*
France	7.2	7.5	8.2	8.3	*11*
Italy	8.0	8.1	8.6	8.3	*2*
Denmark	6.3	6.6	7.3	7.2	*9*
Finland	5.3	5.4	6.6	6.6	*22*
Latvia	3.3	4.1	5.8	6.4	*56*
Euro area (16 countries)	5.5	5.6	6.1	6.1	*9*
EU (27 countries)	5.1	5.1	5.7	5.8	*14*
Sweden	5.6	5.5	5.5	5.6	*2*
Portugal	4.2	4.5	5.1	5.2	*16*
Germany	4.9	4.8	5.2	5.2	*8*
Belgium	5.0	4.8	4.8	5.1	*6*
United Kingdom	4.6	4.7	4.8	4.9	*4*
Hungary	3.1	3.9	4.1	4.6	*18*
Poland	2.2	2.3	3.0	3.9	*70*
Estonia	2.7	3.2	4.0	3.7	*16*
Ireland	2.5	3.0	3.6	3.6	*20*
Spain	2.8	2.9	3.3	3.3	*14*
Austria	1.9	1.9	2.3	2.8	*47*
Slovakia	1.8	1.9	2.4	2.7	*42*
Czech Republic	2.5	2.5	2.7	2.6	*4*
Romania	1.7	1.9	2.3	2.4	*26*
Luxembourg	2.2	2.2	2.3	2.3	*5*
Cyprus	2.0	1.9	2.0	2.0	*5*
Slovenia	0.7	0.9	1.5	1.7	*89*
Lithuania	1.0	1.2	1.6	1.6	*33*
Bulgaria	0.6	0.6	1.0	1.2	*100*
Greece	0.8	0.8	0.9	0.9	*13*
Iceland	4.8	7.6	9.4		
Croatia	0.5	0.6	0.6		
Turkey	0.4	0.6	0.8		

Source: Eurostat.

There are some diverging trends in the countries currently in the spotlight: Italy and Greece witnessed almost no increase in local government debt between 2008 and 2010 (however, in Italy subnational governments are much more important than in Greece in terms of spending); and Portugal shows only a moderate increase. In other words, the public debt problems in these countries do not seem to be due to subnational authorities' indebtedness spiraling out of control. However, in Spain, Greece or Turkey, while the local debt may not represent much in terms relative to the GDP, it is quite high in terms of total local revenues.

Although still at moderate levels, the rapid increase of municipal indebtedness in new member states like Latvia, Romania, Slovenia, Hungary or Slovakia is a matter of concern, having gone as a group up by roughly 50 per cent or more in just three years. True, this is a time during the 2007–2014 European budget cycle when the absorption of structural funds is expected to accelerate, and many infrastructure projects are implemented by the local authorities. Nevertheless the trend – which is also true in Serbia, where an abnormal surge was registered in 2010 (mainly as short term and arrears of payment) – needs closer monitoring.

On the other hand, the authorities of Croatia and the Czech Republic have in one way or another managed to control better the municipal borrowing, which has remained flat during the crisis. This is even truer for Bulgaria, which applied a tight grip on municipal borrowing, opting probably to err on the safe side in such uncertain times. As a result the levels of credit look similar to that of Moldova, where market conditions, and not so much the regulation, make borrowing difficult.

Surplus in Executing Local Government Budgets

Another way to straightjacket local governments in some countries was to have them run operational surpluses at the end of the year, in order to create more space to balance the national books, as also hinted at in Section 1. There are strong signs[1] that this was a deliberate strategy of the national governments of Bulgaria and Romania, for example, which were under pressure to curtail spending.

Spain has begun to follow a similar trend over the last two fiscal years as the overall fiscal position of the country has turned for the worse. And measures to the same effect were announced in Greece as part of a larger package of local government reform, though no data are available yet to assess their real impact.

1 Consultations with mayors during the NAMRB conference in Borovets, Bulgaria, 27 June 2011.

Table 2.
Surplus in executing the local government budgets – all tiers combined (per cent)

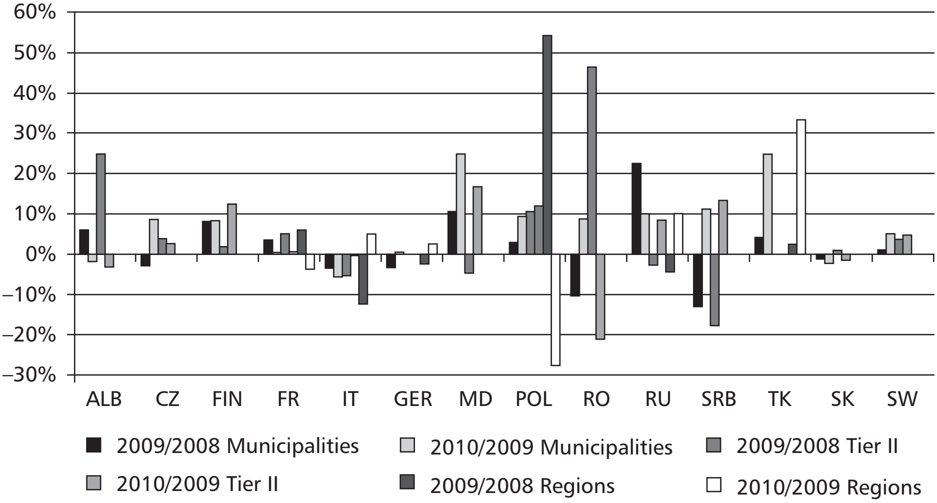
	2008	2009	2010
Bulgaria	9.4	8.0	7.2
Armenia	–7.6	6.1	2.7
Romania	3.3	3.3	6.2
Finland	–1.1	1.8	4.8
Denmark	1.0	1.0	0.3
Spain	–1.2	0.8	
Sweden	–0.5	–1.2	0.2
Ukraine	–1.2	–1.3	–0.2
Albania	–1.4	–1.7	–1.6
Russia	–0.5	–2.2	–0.4
Hungary	0.5	–2.6	–7.3
Moldova	–5.2	–3.8	0.1
Latvia	–6.2	–4.6	3.9
Estonia	–4.4	–5.2	1.7
Czech Republic	3.8	–6.6	–0.3
Slovakia	–1.3	–6.7	–8.9
Slovenia	–9.2	–7.7	–6.1
Croatia	–1.0	–8.3	–0.7
Poland	–1.8	–8.4	–9.2
Germany	2.2	–9.9	–9.2
Serbia	–0.9	–14.9	–9.7

Impact by Tiers of Subnational Government

The visible pattern in Figure 2 is that the revenues were much more volatile on the upper levels of subnational government (regions, counties) than at the lower (municipal levels). This is true both in countries where such intermediary tiers play an important role (Italy, France, Poland, Germany) or a relatively minor one (Serbia, Turkey).

It would be too much to read in this a deliberate attempt to protect the most vulnerable subnational authorities (i.e. small municipalities) from adverse effects of downturns. The explanation more probably has to do with the fact that the sources of revenues assigned to this government tier are by nature more fluctuating (business taxes) or that investments represent a higher fraction of their spending: investments were cut (such as in Romania in the second year of crisis) or bolstered (as in Germany) or followed an erratic trend over the whole interval (Italy, Poland).

Figure 2.
Comparative trends in revenues by tier of subnational government



Trends by Types of Revenues

On the main types of revenues, the data we have at hand is insufficient for drawing robust conclusions. Most of this fiscal information comes from the Central and Eastern European countries, with Italy as the only the large old EU member state included in the analysis. Anecdotal evidence indicate that Spain may follow the same trends as Italy in local tax collection.

Figures 3 and 4 show that indeed the property tax was much more robust in crisis, at least when compared with Personal Income Tax (PIT): except in Albania and Romania in the first crisis year, and Italy in the second, the yield from taxing property grew in all ten countries for which data is available. By contrast, the PIT has witnessed a drop in collection in the majority of countries – even in Poland, where technically there was no recession.

The explanation relies on a combination of factors. In many countries there was a broad scope for improving the functioning of the local fiscal mechanisms and increasing the collection rate, and local governments, faced with a shortage of revenues, did just that with the sources of revenue they can control directly. This is what happened in Serbia, Romania, Bulgaria and Albania. On the other hand, the central government has raised the tax rate by law in the Czech Republic; a similar change will follow in Ukraine at the beginning of 2012, when a true property tax will be introduced alongside the current "land tax".

On PIT, it may be that not all the decline in revenues shown in Figure 4 was "natural": at least in Romania the governments have cut the PIT share allocated to local governments in order to bolster the central budget.

Figure 3.
Relative change in property tax collection (2008 = 100%)

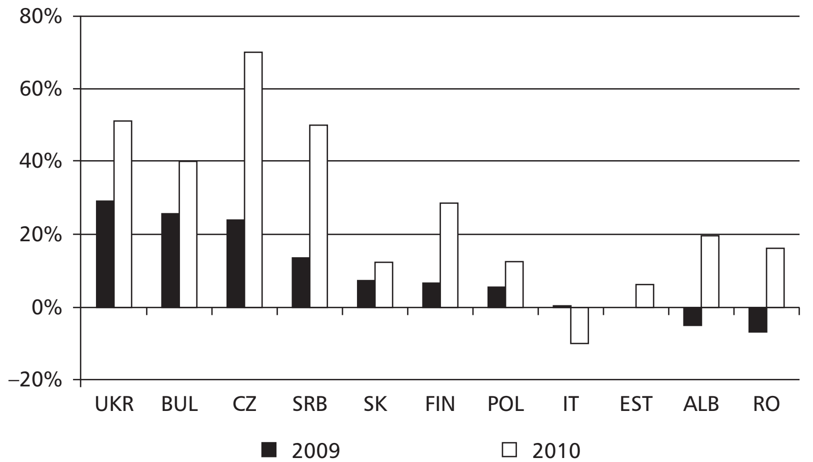


Figure 4.
Relative change in PIT collection (2008 = 100%)

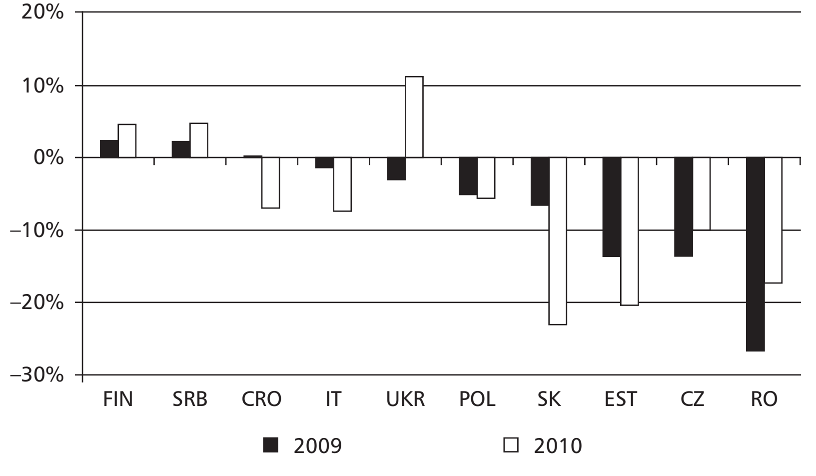
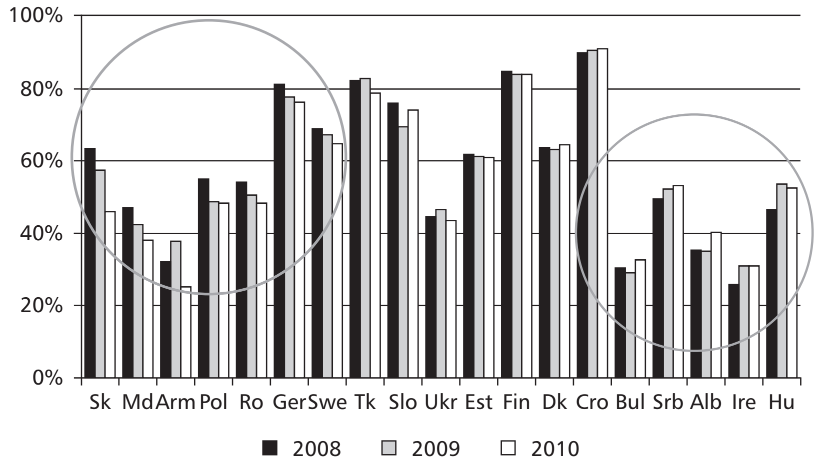


Figure 5.
Own revenues and tax shares, as per cent of budgets



The combined effect of the downturn trends and the policy responses of the governments can be seen on Figure 7, which shows the evolution of a very crude local financial autonomy indicator calculated as the fraction of own revenues plus shared taxes in the total local budgets (all tiers of subnational government included). At the left end of the scale, we find a group of countries where this indicator declined. The trend should be interpreted with care, in connection to that of the absolute size of the budgets (shown in Figure 1): in Slovakia, Romania or Germany there is a real decline, both in the total sum of money available to local governments and their financial independence. In Poland, on the other hand, it is only a reflection of the fact that transfers from the centre went up faster than own revenues.

The same caution in interpretation is necessary at the other end of the scale: financial autonomy appears to have increased in Hungary, Ireland, Serbia or Bulgaria, but this is only because the governments have cut transfers to local authorities, so local budgets have declined in real terms. Or, like in Estonia and Croatia, the central transfers were reduced roughly in the same proportion with the decrease in own revenues, but with the same final effect: a shrinking local budget.

Overall, it does not seem to matter much for the stability of the local budgets in crisis if the index on Figure 5 has a high or low value. What is important is to ensure a broad and diverse basis of own revenues, avoiding over-reliance on a single major tax, and put in place transfer mechanisms with automatic stabilizers incorporated, such as those used in Northern Europe to finance social services.

Revenue Policies

Assignment

The recession has heightened ongoing concerns about the impact of local taxes on business enterprises. This has a number of facets. From the side of local government such bases as business profits or turnover may be highly vulnerable to general economic downturn, entailing revenue volatility which does not fit well with the task of funding fixed recurrent commitments such as teachers' salaries or road maintenance. From the side of business they can be represented as an intolerable burden at times of recession, if based on criteria such as asset values that do not reflect changes in the income from which they have to be paid. They are also seen as a temptation to local politicians to impose disproportionate obligations on non-voters.

These arguments have long surrounded the French *Taxe Professionnelle*, local governments' largest local tax source. The recession renewed business pressure for a repeal of a tax based primarily on asset rental values, and legislation substituted the Cotisation Economique Territoriale (CET), which incorporates value added in the assessment base. The most significant change for local government is a loss of power to set the rates, which are now decreed nationally. Another significant change has been redistribution of part of the yield of property transfer taxes between *departements,* which had suffered considerably from the decline of the property market while also bearing the increased costs of social protection.

The recession has similarly added fresh vigour to the debate over reform of the German *Gewerbesteuer*, a local tax on business profits. Proposals to abolish or reduce it in return for enhanced shares of other taxes like income tax or VAT have been debated by a federal commission but without conclusion.

Some other local taxes on business have also been abolished or restricted in a general concern to ease fiscal burdens in poor trading conditions. Local taxes on sailes and boats in Estonia will disappear in 2012. Irish municipalities have largely observed national pleas for restraint in property rate rises, while Slovak municipal powers to set business property tax rates have been restricted. So have Albanian municipal powers to vary rates of small business taxation.

By contrast there have been some increases in local revenue sources. Finnish municipal shares of corporate income tax yields have temporarily increased to 32 per cent, until 2011. Moldova's motor vehicle tax rate has risen by 30 per cent. Fifty-four Croatian authorities have used enhanced powers to surcharge personal income tax. A municipal property tax will be levied in Ukraine from 2012. Irish municipalities have been given the right to tax second homes and a general residential property tax has now been reintroduced. The British government has announced its intention to restore the right of local governments to retain some portion of the property tax they collect from business tax payers; at present it is all redistributed on a national per capita basis.

Most radical are the proposals before the Italian Parliament to enhance fiscal decentralisation. These would, *inter alia*, transfer the taxation of rental income from the assessment of national income tax to that of a revised municipal property tax. National business taxes could also be surcharged by regions. If passed into legislation, these steps would mark a substantial departure from the current European trend to reduce local fiscal autonomy.

Box 1
Intergovernmental co-operation in Finland

Regular consultation between the Association of Finnish Local and Regional Authorities and the Ministry of Finance has led to adoption of a number of measures to relieve pressures on local budgets between 2009 and 2011. These have arisen particularly from the increase in welfare expenditures and the need to combat youth unemployment.

These measures included:

- A temporary increase in the municipal share of corporate tax from 22.03 per cent to 32.03 per cent.
- Reduction of the municipal share of National Pension Insurance Contribution in 2009 and total abolition from 2010.
- Legislation change to allow municipalities to raise their real estate taxes within redefined limits
- Municipalities were also given special assistance in certain sectors and received relevant rises to state grants.

Working groups have also reviewed the implications of the territorial reorganisation proposed by the incoming government in 2011.

Tax Autonomy

Some countries still employ caps on local tax rates or surcharges such as on the personal income tax. This is counterproductive especially if all, or almost all, municipalities have reached the rate ceiling. In this case the local taxpayer knows that he/she is protected against higher taxes and loses interest in controlling a possibly spendthrift local budget policy. Caps on tax rates simply bring accountability to an end. And they encourage moral hazard of local governments because, for lack of alternatives to hold citizens accountable, it commits the senior government to come to the rescue of unbalanced local budgets. Moreover the possibility to raise local tax rates should not be limited in view of possible debt bailouts with taxpayers' commitments.

On balance policy responses to the crisis have reduced the freedom of local governments to determine their local tax levels though there are exceptions. This appears to weaken compliance with the European Charter of Local Self-Government.

It must be recognised, however, that local councils' sense of accountability to their business taxpayers may be weaker than to their residents. Restrictions on rate-setting powers to prevent discrimination against non-voters may well be justified. Curbs on excessive local PIT rates may also be justified where they have a proven impact on labour supply.

Property Tax Assessment

As already noted, taxes on the ownership or occupation of property have proved relatively stable in Europe during the crisis. Increasing rates or improving collection have also offered local governments opportunities to recoup some losses from other sources.

While neither the Charter on Local Government nor the Recommendations of the Council of Europe state that property taxes are to be based on market values, this idea is recurrently floated by international advisors. However, the property tax based on effective market values has no tradition in Europe (with exceptions, such as Denmark and Sweden), and where it is applied, e.g. in the United States, its drawbacks have come to the fore during the recent crisis. Property taxes should be based on statutory values and should be revised from time to time. Such revisions should reflect long-term market developments rather than short-term fluctuations.

Regular changes to property tax liabilities will be needed between periodic revaluations to reflect increases in the municipal costs that they fund, but they should not be subject to the severe fluctuations that sometimes influence property market values because of the potential damage to either municipal budgets when these are depressed or to taxpayers' pockets when they surge. Indexing the base to the consumer price index is one possible solution. Regular increases in tax rates set by local councils is another; as practised by British and Polish councils, for example, annual increases just above the rate of inflation have secured substantial revenue increases over time without serious political opposition.

Volatility

Recommendation Rec(2005)1 of the Committee of Ministers[2] states "Local taxation should be reasonably stable so as to make for continuity and foresee ability in public services…"). The recession has particularly damaged the local budgets heavily dependent on such volatile tax bases as business profits or turnover and property transactions. Such revenue assignments need serious review.

The right solution is not immediately obvious. Companies, like individuals, should contribute to the cost of the services and infrastructure they enjoy; whatever the assessment base the tax has to be paid out of income that fluctuates. Profits and turnover, in that order, are the best indicators of ability to pay, but fairness to the taxpayer does not provide local budgets with the stability they need. It is all a matter of balance. Taxes on business should be part of local budget revenue, but the most volatile kinds, such as corporate taxes, should not be expected to bear an undue share of local costs.

Where volatile taxes are already assigned to local governments and legal changes are difficult to make, local governments should introduce "buffer" mechanisms, that would neutralize revenue attributable to a boom situation to be used against local government debt or as a reserve for "rainy days".

Intergovernmental Transfers

In almost all countries national government revenues were affected at first even more severely by recession than those of local government, although this trend reversed in 2010. The temptation, therefore, to reduce national deficits by cutting intergovernmental transfers – to make municipalities share the pain – has been strong.

It is a temptation that some governments have been unable to resist. In 2010 the Serbian Parliament amended the legislation indexing block grants to the national budget so that municipalities with above average per capita revenues obtained less than they would otherwise have received, at least for one year. Also last year the Bulgarian government withheld 15 per cent of the grant for delegated functions half way through the year. British government grants were cut in 2010/11 by GBP1.16 billion (2.1 per cent).

Most governments have been more sympathetic to local budgets. In 2009 several countries including Austria, Germany, Norway, Spain and the UK provided short-term funding for small-scale "shovel ready" investments designed to keep the construction

2. Recommendation Rec(2005)1 of the Committee of Ministers to member states on the financial resources of local and regional authorities. Available online: https://wcd.coe.int/wcd/ViewDoc.jsp?id=1378257&Site=DG1-CDLR&BackColorInternet=B9BDEE&BackColorIntranet=FFCD4F&BackColorLogged=FFC679#P1236_146909

industry in business. In the same year several countries including Albania, Denmark, Finland Norway, Poland, Slovakia and Sweden increased general purpose transfers temporarily to compensate local authorities for declines in tax revenue.

Most of these were *ad hoc* responses, with some repetition in 2010. From this year, however, serious doubts over the ability to service or roll over sovereign debt have led to grant restraint in countries such as Greece, Ireland, Italy, Portugal and Spain. Deliberate and longer-term reductions in transfers are being made in some other countries, such as Romania and the UK in serious efforts to reduce structural public finance deficits. In the UK these represent phased cuts in grants reaching 12 per cent per annum by 2015. This is bearing out the OECD's finding that the financial consequences of recession are felt most severely by local budgets once economic recovery has begun and national governments try to repair the damage to public finance overall.

How far such cuts in public expenditure are necessary is beyond the scope of this report, and in any case is country specific. It is important, however, that any reductions in transfers are made as smoothly, equitably and predictably as possible so that local governments have prior notice and opportunity to make their adjustments to service provision and employment. Basing tax base or share transfers on the basis of projections with *ex post* clearances according to actual data (as in Denmark, for instance) is another mechanism for easing in budget losses and stabilising revenue flows.

Indebtedness

Outstanding subnational debt grew in the EU by 9.9 per cent in 2009 and at a lower rate of 6 per cent in 2010 and represents 13 per cent of the total public sector deficit.

In some member countries, unsustainable local government debt has emerged as a problem. Especially in cases where resources assigned to municipalities are highly volatile and sensitive to the business cycle – in particular own revenues, but also funding through transfers – there is evidence of a "boom-and-bust" phenomenon, whereby municipalities were relatively careless during the boom, with incentives to spending excesses in particular on ostentatious capital projects, but also on payroll. What is worse, high creditworthiness during the "good years" combined with easy access to borrowing allowed the more affluent municipalities to leverage their budgets by incurring debt, the service of which is now unsustainable.

In these instances actions must be taken to correct financial imbalances in the local government sector, and there is need for a policy of municipal debt restructuring and the recovery of local authorities in financial difficulty. However, it raises the more fundamental problems of controlling debt without undue interference with municipal autonomy and enhancing public scrutiny of municipal borrowing. The regulatory structure has to cover both the freedom to incur debt and the management of insolvency.

The Maastricht criteria induced a number of countries to introduce an intergovernmental mechanism for restricting public sector borrowing under headings such as "internal stability pact" or "debt brake". The Council of Europe issued Recommendations in 2004, and Network of Associations of Local Authorities of South-East Europe (NALAS) has just published very comprehensive *Guidelines on Local Government Borrowing in South East Europe*. These deserve constant review.

CHAPTER III

Making the Most of More Limited Resources

Budget Squeeze

Whether to cut public expenditure, by how much and how fast are hot political issues at the national level from Washington and Whitehall to Athens and Madrid. Faced by a growing budget squeeze, local governments have less space for ideological and macro-economic debate. Making the most of more limited resources is likely to be an ongoing challenge.

As Chapter V discusses, much of the reduction in expenditure has been achieved simply by deferring capital investment. Reports, however, reveal many attempts to improve the efficiency and effectiveness of local budgets. Comprehensive approaches – one top-down, the other bottom-up – have been undertaken by two countries most severely affected by the recession: Ireland and Iceland.

The Irish government has orchestrated root and branch reforms including:

- reallocation and sharing of service provision and administrative processes between counties and municipalities to achieve scale economies,
- efficiency savings based on benchmarking worth EUR 500 million,
- 25 per cent wage cuts and recruitment freezes, and
- crackdowns on motor vehicle tax evasion.

The city of Reykjavik, faced with a 20 per cent revenue loss over two years, imposed:

- progressive wage cuts on senior staff,
- a recruitment freeze,
- 300 efficiency improvements based on internet suggestions by staff, and
- co-operation with commercial and voluntary bodies.

Other methods of tightening belts have been widespread but sporadic and rarely strategic. They are categorised below.

Territorial Re-organisation

The average size of local governments varies enormously between countries; average municipal populations range from 1,640 in the Czech Republic and 1,720 in France to 56,570 in Lithuania and 139,480 in the United Kingdom.

A number of trends in the 1980s and 1990s left a more elaborate structure in several countries. These included:

- Encouragement for the development of regional tiers of self government by European Union accession and structural funding;
- The post-1989 reversal of Communist era amalgamations;
- Regional autonomy as in Spain;
- Ethnic conflict in the Western Balkans;
- The functional requirements of environmental infrastructure funded by the European Union.

The financial crisis has further focused attention on the cost of this institutional proliferation, revealing costs in terms of increased administrative overheads, diluted professional resources, or lack of scale economies, and some national responses were already in progress. By 2008 Denmark had merged 271 municipalities into 98. Georgia had replaced 985 municipalities, mostly villages, with 64 large district authorities based on the former *rayons*, a policy already adopted in Lithuania. The number of Finnish municipalities has been reduced from 447 to 348.

The financial crisis has given fresh impetus to this process in three of the worst affected countries. Greece has reduced the number of municipal authorities from 1,034 to 325, Iceland from 7,200 (in 1990) to 76, and Latvia from 500 to 118. The new Finnish government is proposing a major consolidation of municipalities at what is currently a regional level (taking urban centres and directing pendel-traffic to them as a cornerstone for renewal).

Larger municipalities should spend a smaller proportion of their resources on administrative overheads and achieve greater economies of scale. But while amalgamation may enable local authorities to provide a larger range or quality of services, there is no evidence that it saves money overall. Quite apart from the one-off costs of re-organisation, there is a tendency for merged authorities to adopt the most expensive habits of their individual forerunners.

Increasing partnership between municipalities is a quicker route to economy with less political cost and this has been widely accelerated by the crisis. It is taking different forms.

The first, spurred more by EU Accession than the crisis, is the formation of intermunicipal companies to construct and operate environmental infrastructure such as landfill sites and water treatment plants with pronounced economies of scale. In Hungary the number of municipal landfills has shrunk by 90 per cent through the formation of joint utility companies able to maximise the use of modern technology and EU structural funds. A fifth of Croatian municipalities share joint utility companies.

The second, also ongoing, is the integration of planning and service delivery within conurbations, illustrated particularly by the large increase in French *communautés urbaines* (and the creation of a new intermunicipal tier, the *metropole*).

Most popular in current financial circumstances is the sharing of the professional resources and equipment needed for administrative operations like tax collection, development control, payroll management, internal audit and IT. Joint procurement attracts lower bids as well as saving administrative costs.

In Slovakia formation of joint offices enabled decentralisation of public services like education and social welfare to a highly fragmented municipal system. Even in the UK where local authorities have on average exceptionally large populations, the crisis has promoted much joint management of services. The city of Westminster has joined its neighbouring borough, Kensington and Chelsea, in running a single education service.

As the Netherlands report puts it, small municipalities resist amalgamation but sharing administrative processes is acceptable. This has been the most widespread outcome of the crisis. Irish authorities have formed "coalitions" to manage procurement, IT and development control, both north and south of the borders. Spain has recorded 780 new intermunicipal agreements in the last year.

Rationalising Service Provision

The crisis has encouraged a selective closure of underutilised service institutions. Bulgaria, Denmark, Hungary, Iceland, Moldova, Romania, Ukraine and the UK all report such measures, with small rural schools the most common target. In many cases the recession has provided the opportunity to introduce changes provoked by demographic change.

Such savings are not without cost. The Danish local government association report refers to reductions in the visitation of elderly residents resulting from mergers of daycare centres, while Ukraine reports a loss of access by ethnic minorities to native language education.

Local government, however, is often encouraged by administrative and financial procedures to provide services in an unnecessarily expensive way. For example, in a number of countries like Hungary and Ukraine responsibilities for residential care for the elderly and infirm and hospital care lie with the upper tiers of local government, while the municipalities provide domiciliary and primary healthcare. Funding of the upper tier service may well be based on formulae including the numbers housed or treated. These arrangements may well provide strong incentives to place social service clients in residential homes or patients in hospitals when it may be neither the most appropriate nor sympathetic response to their need. In most cases it is the more expensive solution.

Medical care costs can also be inflated by a system of paying providers per admission or individual treatment. These perverse incentives are widely recognised and systems like Diagnostic-Related-Groups (DRG) funding have been designed to reduce them. However, such reforms have not been universal and the crisis underlines their importance.

Other examples of excessive social sector costs abound. Schools with declining pupil populations, for example, frequently retain previous numbers of teaching staff while mandated contact hours with pupil are generously low.

Local governments that would like to cut cost, are frequently debarred by national regulation. Expensive services like education, social service and healthcare are often regulated by detailed standards of provision and local government management is subject to close supervision by sectoral ministries. Norms typically govern inputs, rather than outcomes.

This applies particularly in countries that distinguish between the "autonomous" and "delegated" tasks of local government and place the expensive personal services in the latter category. Under Ukrainian law, local governments cannot close grossly underutilised schools or social and cultural institutions without the permission of national ministries. This permission may well be withheld even though such institutions may well have lost their custom through changes in population or public preference.

The problem is typically exacerbated by the fact that the sectoral ministries concerned are not faced with the consequences of running uneconomic services, since the financing of delegated services is usually governed solely by the Ministry of Finance. Several national rapporteurs comment that failure to meet unsustainable service standards is widespread but tolerated. Others identify national insistence on observing the norms as a serious problem. Signatories of the European Charter should be ensuring that national ministries do not micromanage services entrusted to local government whether technically delegated or not.

Employment

Popular perception usually sees town halls as overstaffed. Bloated bureaucracies are a typical description of what may be myth or reality. Responses to recession quickly and widely homed in on cuts in staffing or pay (or both) as solutions.

Some outright retrenchment has been adopted. Irish local authorities have shed 6,600 jobs over the last three years. Municipal establishments in Denmark were cut by 2.6 per cent in 2009 and in Albania by three per cent in 2010. The Ukrainian government has set a target of cutting public sector employment by 20 per cent overall.

But many other states or individual authorities have tried to avoid redundancies, partly because of the cost of compensation and partly to avoid making the recession worse. The alternatives of pay freezes and cuts have been widely adopted. Pay in Spain is down by 5 per cent, in Estonia and Latvia by 15 per cent and in Romania by 25 per cent. The Greek government cut both pay and bonuses, while Hungary withheld 13th-month bonuses in both 2009 and 2010, except for the lowest paid staff. The same progressive approach has been adopted in Portugal where cuts have been imposed on all staff earning more than EUR 1,500, the size of the cut rising with salary up to a maximum of 10 per cent. Pay of all British public employees is frozen in 2011/12. Latvia did not cut numbers but reduced the working week to four days, while Icelandic municipalities have cut both hours and overtime. These cuts are generally represented as temporary, to maintain the long-term attractions of public service. Metropolitan Istanbul has avoided layoffs but restricted other costs such as the use of telephones and official cars.

Recruitment freezes since 2009 have been widespread. Romania allows one vacancy in seven to be filled. Serbia legislated to impose a ceiling of four municipal staff per 1,000 inhabitants. A number of municipalities evaded this by making staff redundant and then out-sourcing their former duties to them.

Elected officials have not entirely avoided such sacrifices. The Slovak Parliament legislated a cut in mayoral salaries; when Hungarian local council terms expired in 2010, memberships were reduced by 30–40 per cent.

As governments try to restore the longer-term viability of public finance, the related issue of pension rights has come to the fore. Faced with growing longevity, reforms are addressing three aspects, the level of contribution to pension funds, the age of pensionable retirement and the basis of assessment. Proposals normally cover national and local government alike. The French government forced modest changes through Parliament in 2010 against union resistance; more radical changes await legislation in the UK.

Public/Private Partnership

Another New Public Management favourite, outsourcing local service management to the private sector, might seem an obvious approach in times of fiscal stress. Both competition and scale economies appear to offer potential cost savings. Surprisingly few reports, however, mention increased adoption and one or two much heralded extensions by British county councils have failed to materialise. Both France and Hungary have experienced cases of utility franchises being rescinded.

The crisis has also slowed the spread of partnerships involving the private sector in carrying out the initial investment in a public service facility. These remain widespread in cases such as waste disposal where construction and operation can be combined in a single management and where costs can be recouped directly from beneficiaries. Efficiency can suffer, by contrast, where responsibility for operation becomes fragmented between commercial investors and public service professionals; costs can also escalate substantially when loaded with the higher interest rates attached to private sector borrowing. Both Iceland and the UK report serious impacts of changes in property market prices on sale-leaseback deals.

By contrast, the crisis has increased interest in partnership with the voluntary sector and social enterprise in running community level services. In Britain David Cameron has espoused a vision of the Big Society involving a sharing of responsibility between state and community; draft legislation would permit community groups to demand the right to manage local services and facilities. In Denmark DKK 100 million have been allocated in 2011 to promote voluntary participation in managing local public services.

The crisis is, however, posing a threat to existing third sector participation, particularly in the provision of social welfare to vulnerable groups. British charities claim that they have lost GBP 100 million in reduced local authority grants in 2011, although the government claims to have provided an additional GBP one billion for social care over the period to 2014.

Cost Control

Country observers' reports detail many efforts by individual local governments to reduce costs. These mainly apply to administrative overheads and include cuts in overtime, bonuses, official entertainment and telephone usage, while purchases of vehicles and furniture have been frozen. In the case of Romania some of these have been mandated by efficiency measures agreed with the European Union as conditions for national budget support. In Serbia GPS systems have been fitted in municipal vehicles so that both drivers and town halls know where they are.

Justified as they may be, these are temporary or one-off savings that do not greatly affect longer-term efficiency. This requires more fundamental examination of the practical ways in which services are run, the subject of "value for money" approaches and performance audit systems developed over the last three decades under the umbrella of New Public Management. Three such efforts deserve wider application:

- "Value for money" assessments of individual authorities and services are undertaken by the Danish Local Government Association, based like their British equivalents on disseminating the practice of those municipalities which perform well in a comparison of unit costs;

- Benchmarking individual service and administrative service costs carried out in Bulgaria by the Open Society Institute in collaboration with the Resource Centre for Decentralization and Municipal Development and Club Economika 2000;
- Performance standards measured by the Benchmarking Club of Hungarian water company managers, with the consultant help of the Regional Centre for Energy Policy Research at the Corvinus University of Budapest and based on comparing a range of technical and management issues.

Benchmarking is one of the tools designed to help the public scrutinise the care with which its money is being used. Another is the Citizens Charter, usually a promise to citizens to deliver services at certain standards and a set of procedures by which they can check its fulfilment.

The Council of Europe has been helping to develop performance management capacity in a number of countries such as Bulgaria, Russia and Serbia. It also supports French efforts in this field. The financial downturn emphasises the need.

The Romanian government has focused strongly on municipal budget management processes to avoid the accumulation of debts and arrears. Revenue estimates may not exceed 95 per cent of the previous year' actual receipts, and outstanding payments must be included as the first call on new budgets. The rise in indebtedness gives added importance to the municipal insolvency procedures developed in Hungarian legislation and the Greek *Kallikratis* programme.

Key to many service cost savings is computerisation. From 2012 public applications to Danish municipalities will have to be online. Irish citizens pay their local taxes and charges online. "Self service" is now practiced by British public library users who record books borrowed and returned on the library terminal. Spanish local authorities are accessible to citizens via the internet.

Performance Audit

In 2006 the Local Government and Public Service Reform Initiative (LGI) surveyed the audit of local government in 12 Eastern and South Eastern European states. It found that most states had an adequate legislative framework, much of it newly enacted with EU assistance, but implementation had been weak.

Qualified auditors were in short supply in the public sector and as a result actual external audits infrequent. Inevitably the situation was worse in countries with large numbers of small authorities (only 84 out of 7,455 Romanian local government final accounts had been audited).

Audit was still largely concerned with legality and conformity with required procedure; performance and efficiency, though within its terms of reference, were rarely examined. Audit training in these aspects was often inadequate. Public interest in audit findings was generally low, not aided by the customary opacity and circumspection of published reports.

The Council of Europe has been helping to develop performance audit capacity in a number of countries such as Bulgaria, Russia and Serbia. The financial downturn reinforces the need. In "the former Yugoslav Republic of Macedonia" and Romania, for example, small municipalities have been using intermunicipal associations to employ qualified internal auditors.

The current ambitious Strategy for Innovation and Good Governance at Local Level launched by the Council of Europe includes among its implementation measures the development of a European Label of Governance Excellence (ELOGE), which would be attributed in a decentralised manner to municipalities reaching a certain level of quality in their overall governance. Based in particular on a benchmark/measuring tool specifically tailored to the needs of local authorities, the label could be very effective in supporting the improvement of local governance.

Another form of performance audit is the use of consumer opinion survey, one of the approaches pioneered by the Citizens Charter.

Box 2
Surveys of user satisfaction with local public services in Denmark

Municipalities

In 2007 the Danish government published – as part of its programme for quality reform – a proposal for the introduction of surveys of user satisfaction for a wide variety of services supplied by local governments. (Municipalities deliver primary education, kindergartens, old-age care, and other social services; the regions supply health services and hospitals.) This proposal built, among other things, on a practice developed by a growing number of municipalities that had found this a useful way to identify and improve on quality failures in the municipal institutions, and on a desire to be able to compare results across municipalities.

A pilot project was initiated in cooperation between the government and the Association of Municipalities resulting in the development of a toolbox for the implementation in each of the major local services. There was much satisfaction with the new tool and both sides wished to roll it out for general use in the municipalities, but because of disagreements on the costs of such a compulsory programme it was not implemented and the surveys are now voluntary.

However, in an agreement from 2010 the government and the municipal association agreed to recommend surveys implemented every second year based on a set of definitions permitting benchmarking across municipalities. Several private suppliers now offer such programs, and work is in progress in the Ministry of Interior and Health to establish a central digital "warehouse" for the many different survey results.

There has been found no evidence that user satisfaction is correlated to the amount of resources made available, and this is perhaps the reason why such surveys have become popular among local authorities. It seems to suggest that improvements in consumer satisfaction can be obtained without necessarily spending more but just to do things the right way. And the evidence shows that the disclosure of failure for an institution to satisfy the expectations of the users normally leads to steps that improve satisfaction in survey next year, suggesting that the institutions take corrective actions when user satisfaction declines.

Regions

In the regions surveys of patient satisfaction with hospitals (including private hospitals and out-of-hospital clinics) are made annually and the results are published on the web for each hospital (together with information on waiting time and other measures of service quality). The surveys are made voluntarily by the regions which have chosen to survey quite a large population of 250,000 inpatients and outpatients (the number is equivalent to about 5 per cent of the national population). The surveys are so complete that that the results also reveal differences in satisfaction for departments of the hospitals. The regions now find the surveys indispensable instruments for controlling the quality of outputs from their different institutions.

Transparency

A less structured approach to curbing excessive costs has been adopted by a variety of local governments from Greece to the UK who publish details of all items of expenditure over a fixed limit (Windsor's EUR 600 is typical) on the internet for scrutiny by zealous media. Czech and Slovak municipalities are now compelled to publish purchases and contracts online.

Box 3
Electronic auctions in Slovakia

A software company, PROe.biz, has marketed an electronic auctioning system since 2002. Since the crisis began it has been frequently used by municipalities for procurement of construction and supply of goods and services, and the process has been mandatory since April 2011.

Tenders are published in the normal way, but bids are then published online. At a given time bidders may reduce their price or vary other conditions such as time of delivery. Prices and other factors are weighted by a published formula and the lowest, final weighted price wins. Research by Transparency International claims savings of 50 per cent in public sector procurement (compared to 18 per cent in the private sector).

Some delegates to the 2011 Strasbourg Conference expressed concerns about non-transparent off-budget operations of municipalities within their countries. Not only are such transactions concealed from control by elected local councils; they may also burden local budgets with hidden financial risks. The relationship between a local budget and public enterprises owned by the municipality could give rise to problems of non-transparency, lack of political control, and unseen financial hazard. An indicator of such risks was thought to be the existence, and possibly accumulation, of payment arrears from local budgets to local public enterprises. The interrelationship between municipalities and their public enterprises deserves further attention from the Council of Europe.

CHAPTER IV

Social Consequences of the Crisis

Shared Social Responsibilities

Developed industrial countries, affected by the crisis, are facing not only economic challenges, but heightening insecurity over employment, increasing poverty, widening social inequalities as well as harsher forms of social exclusion.

In the light of this challenge the Council of Europe is developing a European Charter of Shared Social Responsibilities. The Draft recommendation of the Committee of Ministers to member states (DGIII/DCS (2011) 09) acknowledges the ideal of universal social protection as the basis of the European social model and considers it an integral part of European heritage. In seeking to reconcile this with economic reality, it acknowledges that "several European countries are faced with public over-indebtedness and states, exposed to the risks of repeated crises and financial speculation, are less able to fulfil their role of ensuring access to social protection, health care, education, housing and common goods in general, even though such access constitutes a key source of confidence and social cohesion".

Sharing the burden of social responsibilities refers not only to the interdependence of the members of the society and the possible responsibility of the "most advantaged population groups" in sharing the negative effects of the crisis with the less powerful groups, but as a counterbalance to the weakening role of the state companies, social organisations, families and individuals are recommended "to acquire the skills and motivation necessary to exercise and share social responsibilities".

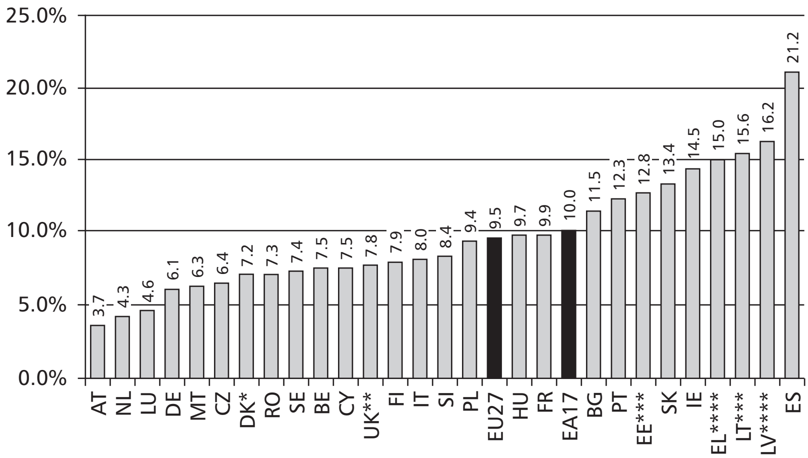
This chapter examines the social impacts of the crisis, the role of local government in responding to them and the potential for sharing this role with other possible partners.

Societal Impacts of the Economic Downturn

The consequences of the crisis hit the various social strata in different ways, with the poorest segment the most seriously affected. Statistical data illustrating these impacts demonstrate the following trends:

- Increases in unemployment (Figure 6);
- Material deprivation, particularly of children and the elderly, affecting at least 10 per cent of the population in 22 countries and above 20 per cent in 11 of them (Figure 7);
- Increasing household costs, aggravated by rising utility tariffs in 18 countries (Armenia, Austria, Bulgaria, Bosnia, Croatia, Estonia, Finland, Georgia, Greece, Hungary, Iceland, Latvia, Moldova, Romania, Serbia, Slovakia, Spain and Ukraine). These have an especially negative impact on the household budget in those countries, where there are no targeted housing benefits (Figure 8).

Figure 6.
Unemployment rates (per cent) in July 2011, seasonally adjusted[3]



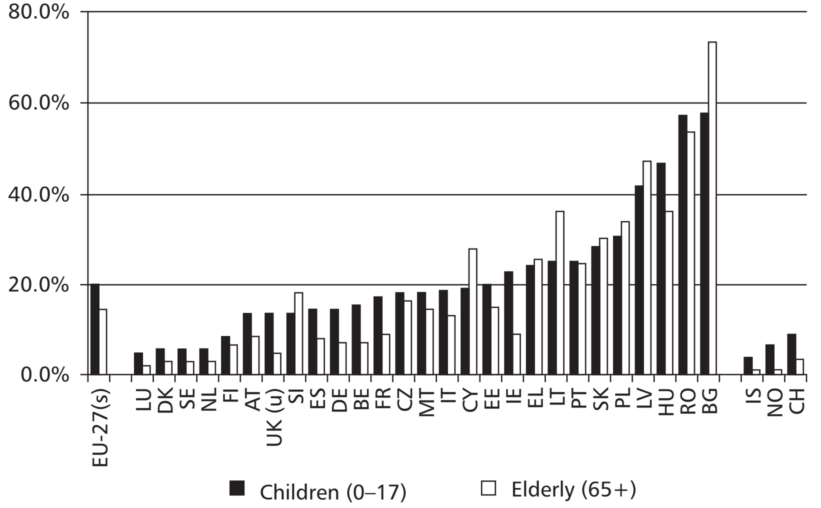
Notes: * June 2011, ** May 2011, *** Q2 2011, **** Q1 2011.
Source: Eurostat.

Some of these characteristics were evident already before the economic crisis and have only been aggravated by it. Even between 2005 and 2009 the average poverty rate increased in thirteen countries (Bulgaria, Cyprus, Denmark, Germany, Greece, Estonia, Finland, Lithuania, Latvia, Luxembourg, Malta, Netherlands and Sweden).

As far as the long-term prospects of the European countries are concerned, the situation of those countries is especially worrying, where children are more seriously hit by poverty and deprivation than other age cohorts.

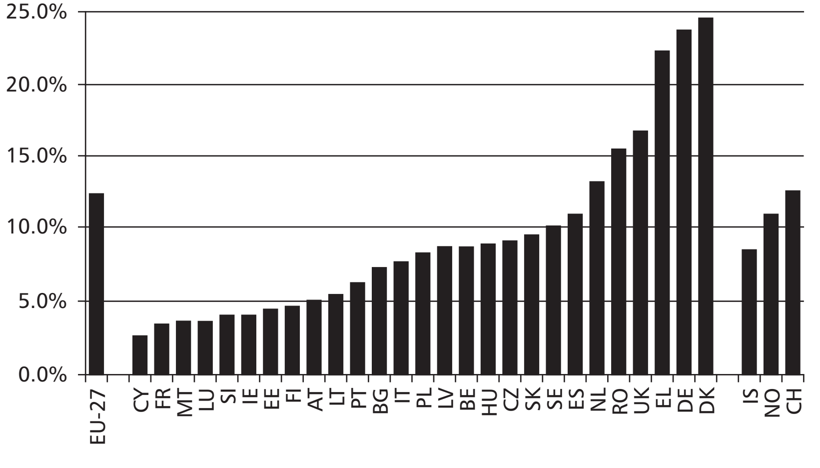
3. Statistical Portraits of the Social Situation 2010 (2011) European Commission Eurostat.

Figure 7.
Material deprivation rate by age group (per cent), 2009



Notes: s: Eurostat estimate, u: unreliable or uncertain data.
Source: EU-SILC.

Figure 8.
Housing cost overburden rate (per cent), 2009[4]



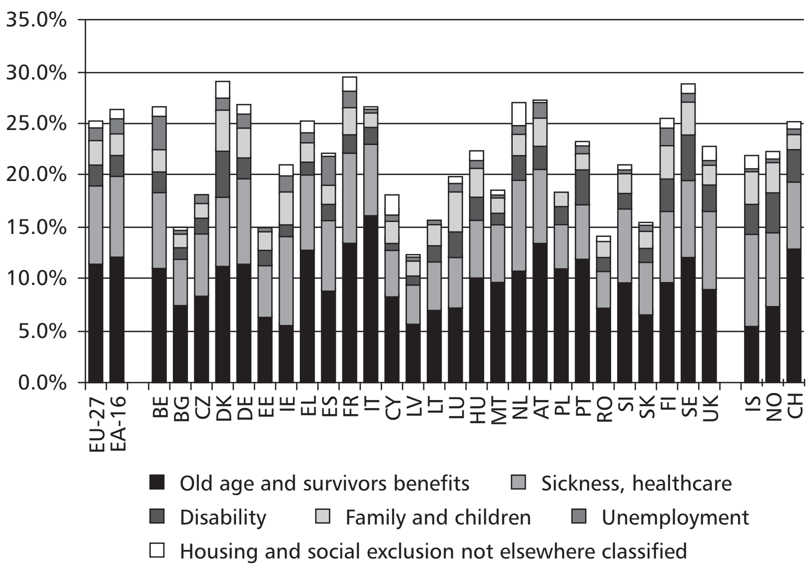
Source: EU-SILC.

4. Idem.

The National Context

Although official documents generally refer to the European social model, and the welfare state, actually there are differing social protection systems. The variations are manifested, among others, in the level of social security financed from public resources; in the variations of the sources of benefits, in the division of responsibilities between the different tiers of government, the market and the non-governmental sector; in the mandated and non-mandatory services and cash benefits. The impact of the economic downturn was presumably deeper in some of these types of the systems while others proved to be more resistant (Figure 9).

Figure 9.
Social benefits as per cent of GDP by grounds of functions, 2008



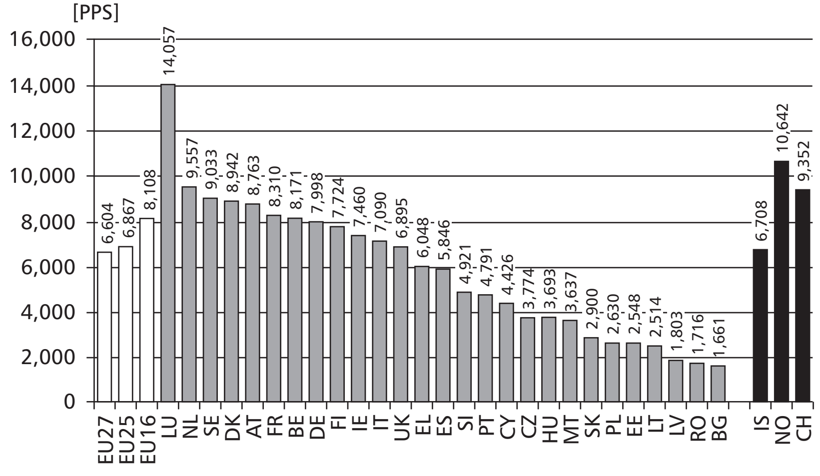
Source: Eurostat – European System of integrated Social Protection Statistics (ESSPROS).

In some countries welfare expenditure has been curtailed or heated dialogues started on the inevitability of its reduction. The Draft Recommendation of the Committee of Ministers on the proposed Charter of Shared Social Responsibilities calls attention to the need to "overcome a reductive view of economic efficiency that does not include collective well-being…"

Sharper differences are manifested if the expenditure on social protection in purchasing power standards (PPS) per head of population is also taken into consideration.

Compared to the EU-27 average (6,604), the value was in 2008 in Luxemburg 14,057 and in the Netherlands 9,557, while in Romania 1,716 and in Bulgaria 1,661 (Figure 10).

Figure 10.
Expenditure on social protection in PPS per head of population, 2008



Source: Eurostat – European System of integrated Social Protection Statistics (ESSPROS).

Social Responsibilities and Local Budgets

The basic institutions of the welfare system are the social insurance based services (health, accident, pension, unemployment), universal and means-tested cash benefits and social services. Responsibility for the operation of these institutions is divided between the central government, social security funds and local authorities in various ways. Depending on country systems, local government may bear some of the rising costs of:

- Housing and utility allowances (because of falling household incomes or slower reimbursement by central government);
- Safety net payments to the long-term unemployed and others eligible for minimum income guarantees;
- Emergency aid to families in advance of awards of state benefits;
- Care for a growing population of elderly and disabled people;
- Protection for an increasing number of children from distressed families.

In 2010 such costs to local budgets rose by 10 per cent in Denmark, 22 per cent in Hungary and 24.5 per cent in Slovakia.

These extra burdens are not necessarily permanent, although historically levels of employment recover more slowly than GDP. But the lasting and growing costs arise from demographic trends which will by 2050 increase the percentage of the population over 65 by half. In much of Europe the burden of care will fall on declining numbers in the normal working age group.

Local government's social responsibilities are under both short and long-term pressure. Care of the elderly is an area of expenditure which will simply keep on growing.

Local government capacity to meet these growing responsibilities is limited by the revenue shrinkages already discussed in Chapter II, and by reductions in staffing described in Chapter II. (Observers' reports refer to reductions in the numbers and remuneration of staff in 20 countries.) Strategies for bridging this gap between rising demands and shrinking resources include:

- Improved targeting of welfare benefits;
- Promoting community rather than residential care, particularly for the elderly;
- Increasing co-operation with other local governments, with private and social enterprises and with voluntary organisations.

These are discussed in turn.

Targeting Social Assistance

The crisis has begun to promote efforts to target benefits more precisely. Some Romanian cities including Bucharest have abolished subsidies to heating companies, replacing them with means-tested subsidies to individual consumers. Both Chisinau and Zagreb have started to means-test public transport subsidies. Access to free nursery and preschool education in Croatia is now subject to a means test. A draft law in Romania proposes to apply means tests to child allowances.

More effective targeting is a positive initiative if it aims to provide more financial resources to families living in poverty, but can be harmful if it is associated with forms of conditionality, which exclude some groups of the poor population from the welfare system.

Community Care

The demographic trends call for fundamental changes in the balance of provision of long-term care for the elderly, a field in which local government usually has a prime role in management and funding. Mention has already been made of the need to remove any institutional or financial bias towards residential care, which is generally more expensive and often less sympathetic than community care.

The historic balance between institutional and home care for the aged differs greatly across Europe, with post-Communist countries most associated with residential provision and traditions of family care most highly preserved in Mediterranean countries. But whilst reactions against state socialism have weakened the bias to institutional care in Eastern Europe, the potential of family care has also been eroded in most countries by the growing migration of younger generations to work in cities and foreign countries. Increasingly social policy now favours mixed provision and financial support for the elderly, which enables them to choose their location and type of care and to afford it.

Two financial mechanisms have been promoted for this purpose. The first is the introduction of compulsory long-term care insurance. Largely pioneered in Germany, this is widely recognised as a desirable solution, but fears of the addition to employment costs have so far prevented its compulsory adoption elsewhere.

As an alternative, several countries have now replaced in-kind services to the elderly with cash allowances towards the costs of daily living that are graduated by degrees of dependence, but can be flexibly used to buy support most needed from anyone able to provide it. Such allowances have been introduced in a range of countries such as France, Poland, Serbia, Slovakia, Spain and the UK. They provide beneficiaries choice and with choice comes competition, efficiency and dignity. Residential homes may operate outreach services selling services such as meals, "panic buttons", laundry, gardening or cleaning to non-resident elderly. In Italy a substantial number of migrants are employed in elderly households, at or below legal minimum wages and funded by the care allowance. In the UK volunteers may be paid petrol expenses to drive neighbours to the clinic, supermarket or bank.

In practice most family and voluntary carers are women. This needs to be recognised in arrangements that facilitate a combination of wage employment and home care together with re-entry into a full-time career at a later stage.

Helping old people to stay at home despite infirmity also involves support to family members and other informal carers on whom the major burden may fall. In several countries like Slovakia employees retiring early to care for a relative may be compensated for loss of pension earning. Residential care may be provided for a brief period to allow regular carers respite. In Bulgaria and Romania informal carers may be paid at the rate of the statutory minimum wage.

Infirmity and its associated dependence can also be arrested by the promotion of active lifestyles among the elderly, with leisure and day centres coming to the fore. Tai-chi is joining the menu of discretionary municipal competences.

Care for the elderly is increasingly a mixed economy. Eighty per cent of residential care in Spain is provided by the private sector, with religious bodies particularly specialising in mental healthcare. The Orthodox Church is expanding provision of residential care in Romania. Home carers in Bulgaria are funded by co-operation between municipalities, the Red Cross and UniCredit Bank.

Intermunicipal Co-operation

The growth in intermunicipal co-operation discussed generally in Chapter 3 is applying specifically to social service provision in efforts to reduce overhead costs, and increase economies of scale, leading to improved quality in terms of professional staffing and service variety. This development has been reported in Albania, Armenia, Austria, Croatia, Czech Republic, Denmark, Estonia, Finland, Georgia, Hungary, Iceland, Ireland, Latvia, Slovenia, the UK and Ukraine. Intermunicipal cooperation and amalgamation of service providers may have a particularly significant role in countries with relatively large agrarian populations.

Shared Social Responsibility

Care of the elderly is only one of a number of areas of social responsibility in which local governments increasingly co-operate with third-sector partners, from social enterprises to non-profit charities and individual volunteers. This reflects demand and supply, the latter enhanced by the increasing fitness and energy of newly retired people.

Involving community and civil society actors may enrich the service supply, foster innovation and contribute to the new interpretation of social cohesion, namely sharing the social responsibilities. However, in this sense the countries have followed different pathways as well: some of them have an age-long tradition of non-governmental involvement in service provision, others, primarily the post-socialist countries, have to revive or consolidate voluntary organisations.

There is anecdotal evidence, however, that cuts in local budget expenditures are falling disproportionately to support third-sector partners. There are at least two reasons. First, the services that such partnerships provide are often discretionary and less regulated by mandatory standards. Second, reducing such expenditure does not involve the redundancy costs of firing public employees.

This can be unfortunate if the principal beneficiaries of such services are the more vulnerable households. Early childhood development programmes prepare children from low-income or immigrant families for formal education. Kindergartens and after school clubs give space for low-income mothers to earn money. Third-sector partners provide much care for the disabled and for addicts. Giving priority to the support of public employees and mandatory services can have damaging repercussions for the needs of the most vulnerable and for social cohesion, dangers to which the Commissioner for Human Right drew graphic attention at the Strasbourg Conference in October 2010 and which he has recently reiterated. Some ministers responsible for local government have sought to counteract this trend and it is hoped that the Kyiv Conference may add its voice.

CHAPTER IV

Sustainable Economic Development: Local Government's Role

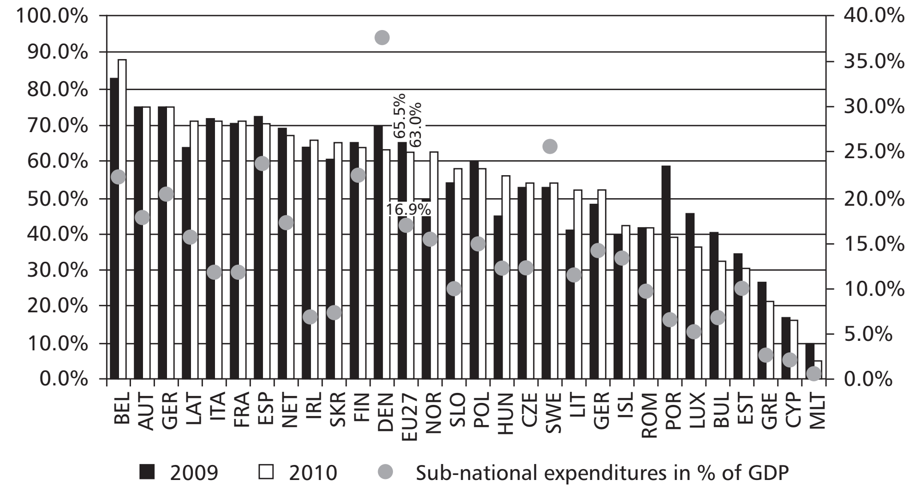
Financing Local Capital Investments

Local governments manage a significant portion of general government capital expenditures. In the average of the 27 European Union countries, subnational governments' share is almost two-thirds of the total government gross capital formation[5] (Figure 11: 63 per cent in 2010). So in the period of economic downturn the capacity of local governments to finance and to implement capital investments is critical. They can contribute to economic recovery by maintaining the level of public investments and launching new projects when private investments slow. However, the local governments' relatively high share and the dependency on external resources, such as national budget capital grants, makes capital investments an easy target of restrictions and consequently a rather vulnerable item of the public budget.

Local capital expenditures are closely related to the level of fiscal decentralisation. In the more decentralised countries local governments share in capital spending is well above the EU average; while in countries with a lower level of fiscal decentralisation – measured by the subnational expenditures in percentage of GDP – their contribution to capital expenditures is limited. There are exceptions in countries with high capital investments: in less decentralised countries such as Latvia, Ireland or Slovakia where local capital expenditures are primarily funded by the EU Structural Funds; in Italy and France administrative decentralisation partially explains the high level of subnational capital spending.

5. Gross capital formation is measured by the total value of the gross fixed capital formation, changes in inventories and acquisitions less disposals of valuables.

Figure 11.
Capital expenditures: Subnational in per cent of general government 2009–2010



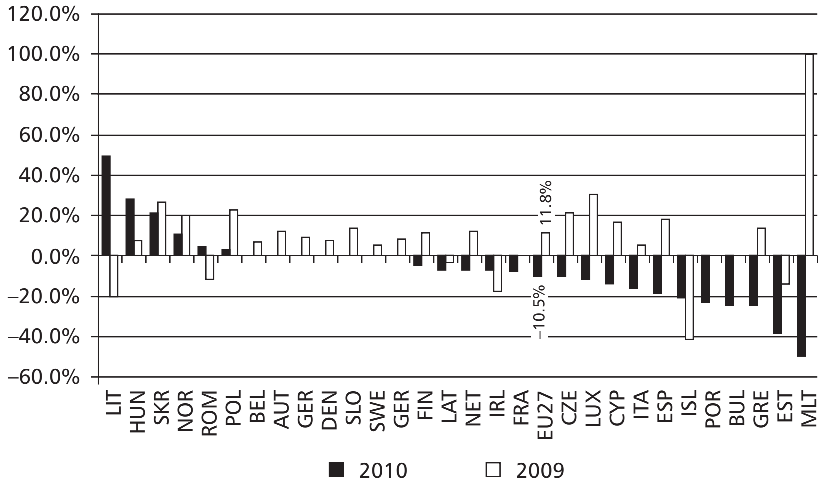
Source: Eurostat.

The economic downturn has reached local government capital budgets with some delay: the subnational governments' share in total general government capital expenditures was 65.5 per cent in 2009, but it started to decline last year (63 per cent). This time lag was caused partly by the economic stimulus programmes in the more developed countries of Europe and partly by the better local absorption capacity of EU funds. It seems that by 2010, the third year of the economic downturn, that these resources have diminished and also the overall centralisation trend made local governments less significant actors in public sector capital investments (e.g. Portugal, Bulgaria, Denmark, Greece, Estonia).

In the EU-27 countries the subnational government's capital expenditures decreased by 10.5 per cent in 2010 compared to the previous year (Figure 12). Only six countries were able to increase the local gross capital formation: among them five are new member states, which benefit mainly from the EU grants (Lithuania, Hungary, Slovakia, Romania, Poland). All the others either kept capital expenditures at the same level or decreased them. Beyond the least decentralised countries (Malta, Bulgaria, Cyprus), the countries mostly hit by the crisis belong to this group: Greece, Portugal, Spain and Italy.

So contrary to the favourable trends in 2009, when local capital investments increased by 11.8 per cent in the EU-27 countries, the following year brought drastic changes. The economic downturn in this respect has reached local governments with a one-year delay. Local governments had to cope with the cuts in all their revenues, so they were forced to balance their current budgets first.

Figure 12.
Changes in subnational gross capital formation (in per cent of the previous year)



Source: Eurostat.

Sources of Financing Local Capital Investments

Local governments in the future stage of economic recovery will be faced with new financial problems. The fiscal stimulus programmes in the developed part of Europe cannot be continued as budget deficit and high public debt will limit the national governments' capacity to launch major investment programs. The pressure on municipal current budget (debt repayment, tax reductions, operational costs of new investments, etc.) will limit the local funds available for capital investments.

In the new EU member countries where the main sources of financing capital investment projects were EU transfers, co-financing requirements and project implementation capacity might be the major limiting factors. The operating surplus previously used for capital investment financing has shrunk, so the absorption capacity of EU funds has also declined. In some countries it was coupled with the impact of the election cycle, because the changes in governments in 2010 slowed the commitments and disbursement of EU-funded programmes (e.g. this was the case in Hungary).

So in the period of overall restrictions local governments will not be able to continue capital spending at the earlier level and probably the funding schemes also should be changed. In the coming years the estimated level of general government debt will increase both in the Eurozone and in the OECD countries (Table 3). On the average gross financial liabilities are equal to the GDP and there are rather huge variations by countries.

Table 3.
General government gross financial liabilities as a percentage of GDP

	Financial liabilities in per cent of GDP	
	Euro area (14 countries)	**OECD-Total**
2007	71.7	73.1
2008	76.7	79.3
2009	87.0	90.9
2010	92.8	97.6
2011	95.7	102.4
2012	96.6	105.4

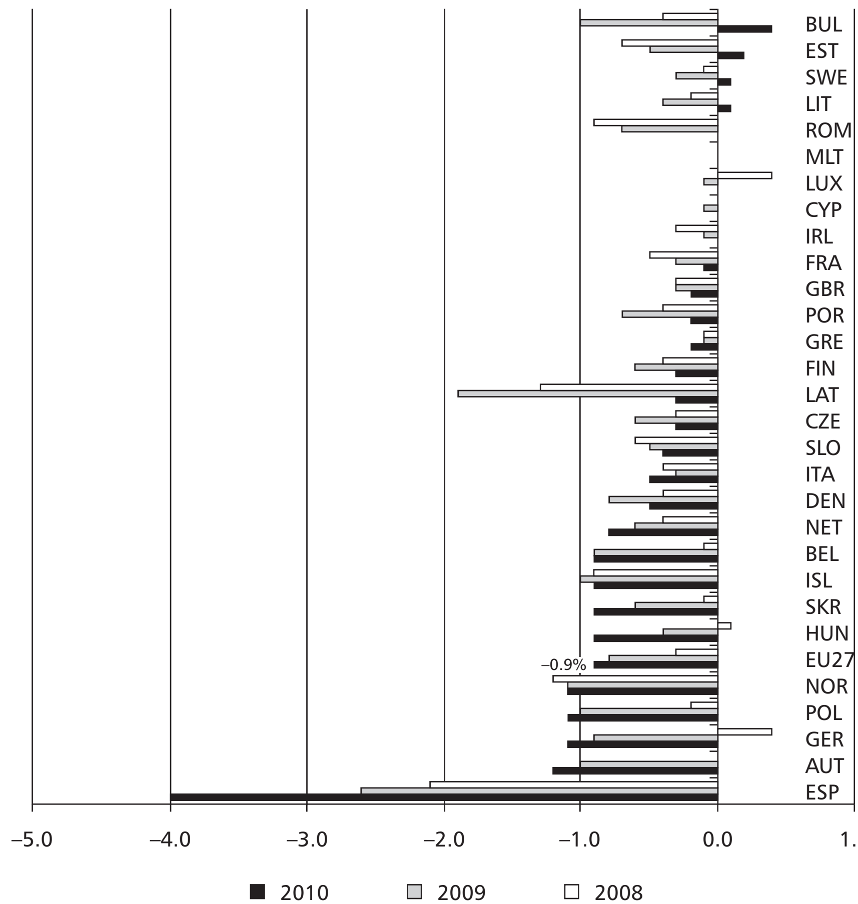
Source: OECD.

The already high and increasing level of public debt constrained the local scope of borrowing (Figure 13). Subnational borrowing declined in most of the countries in 2010 compared to the previous years. Again the Central European new EU member states (without the Baltic states), some of the more decentralised countries (e.g. Netherlands) and the federal states including Spain were able to issue more debt in 2010. The most indebted countries have already further limited local government loans either by discouraging municipal borrowing or temporarily lowering the limits on local debt (e.g. Spain).

The general government fiscal position very much determines the costs of local borrowing, regardless of the creditworthiness of a particular city. So the reports of leading credit rating agencies also will indirectly affect at the municipal level. The Parliamentary Assembly of the Council of Europe has already drafted a recommendation on over-indebtedness of states.[6] It draws the attention to the responsibility of the rating agencies in creating a vicious circle for the highly indebted countries: downgrading the sovereign debt rating will increase the borrowing costs and consequently will limit the options for financing the already high public debt.

6. Recommendation 1961 (2011): Over-indebtedness of states: a danger for democracy and human rights. Available online: http://www.assembly.coe.int/Mainf.asp?link=/Documents/AdoptedText/ta11/EREC1961.htm.

Figure 13.
Subnational borrowing (–)/lending (+) in per cent of GDP



Source: Eurostat.

Responses on the high public debt were formulated at all levels of government, including the European Commission. The European Stabilisation Mechanism provides financial assistance to countries with serious economic problems through a loan scheme. The European Commission borrows on the capital market and the debt is repaid by the beneficiary member state.[7] Alternative sources are provided by the European Financial

7. Available online: http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/173.

Stability Fund (EFSF) endowed with EUR 440 billion, of which EUR 250 billion is available in loans.[8] It is available for the Eurozone countries as loans to countries with financial difficulties. The 16 member countries guarantee the debt issued by the Fund.

At the very local level municipalities also make attempts to keep capital investments at the required level. In some countries alternative sources for financing capital investments are found at the local utility companies and other municipal subsidiaries, such as the asset management entities. However, this method of financing only transfers the burden to these extra-budgetary units. The service organisations also have to deal with the consequences of the economic downturn: arrears in payment of user charges have increased, the national regulations prohibit revenue rising, the private funding sources and the available loans are limited. The utility companies often borrow with municipal guarantee, so the local governments have the ultimate responsibility for these loans, as well.

If these financial obligations are taken into account then the level of local government debts, guarantees and other contingencies will be higher. As the national observer from Croatia reported the local payment arrears increased from 47 per cent to 69 per cent of local government direct debt. When the value of net financial assets is consolidated with local government utility companies, then the positive balance (in 2009 HRK 0.2 billion for the local governments) diminished (HRK –5.7 billion). There were already cases when municipal accounts were blocked by creditors because of the guarantees issued by the local governments.

Partnering with the Private Sector

Despite the present nationalisation and re-communalisation actions the public sector will operate in a market environment in the long run. Municipal service delivery, the revenue raising options through user charges and private investments, the urban and regional development programmes cannot be isolated from the private sector. The past two decades proved the difficulties, but also a number of advantages of this cooperation through better service performance, improved efficiency of utility services and mutual, public and private benefits of urban and local economic development actions.

However, the general public attitude towards private provision of public services has changed recently. The contracting-out and PPP schemes are rejected because the projects became more complex and sophisticated, so the municipal administration has not always been able to negotiate such deals with large multinational companies. The usual arguments against any form of private sector participation are the increased costs

8. Available online: http://www.efsf.europa.eu/about/index.htm.

of services due to profit gained by the private service organisations and the negative consequences of rigid contractual arrangements. PFI costs in the UK are also heavily increased by the higher interest rates paid by private investors. During the past decades the public actors (the clients, the regulators) are inclined to keep these services under direct control, as they have learnt a lot from the businesses in funding and managing municipal services. There is an increasing hostility towards foreign operators as the domestic utility companies became more experienced and prepared for taking back the service management.

In the future when beyond simple restrictive measures, economic recovery will require new types of public intervention, the cooperation between the public and the private actors has to be further developed. So new forms of partnership between local governments and market-based organisations might be a critical element of the responses to the economic downturn. Two aspects of partnership should be separated:

- private delivery of public services; and
- joint local actions of public entities and businesses.

Private Provision of Local Services

Countries are at a different stage of learning the costs and benefits of cooperation with the private sector in local public service provision. Local governments with a longer tradition of contracting out and established regulatory systems are in a better position compared to those that entered this market during the last two decades. The latter group is more dependent on the private capital, the transfer of technology and adaptation of management methods. This is the reason why more cases of re-municipalisation in the water sector are reported from France (e.g. Paris water services) and re-communalisation plans in the energy sector are discussed in Germany,[9] compared to Central and Eastern Europe where it is more exceptional.

Service companies are often criticised once the first private investments improve the service performance and the tariffs are increased or user charges just kept at a higher level. In some cases populist actions led to re-municipalisation of services when in a

9. In the coming two to three years, municipalities should make a decision on 12,000 concession agreements in Germany, whether to extend the present concessions or to take over the network operation by a municipal company. The amendment of the energy regulations is already under discussion to limit the litigation, securing the information for the municipalities. (Information sheets provided by the CoE/LGI project national observer). These new trends are discussed by G. Wollman and H. Marcou (2010) *The Provision of Public Services in Europe*. Cheltenham: Edward Elgar Publishing Ltd.

decentralised environment local governments have limited regulatory capacities. In these cases, when re-communalisation happens before the service agreements actually expire, the private partners should be compensated for terminating long-term concessions or operating contracts, which will obviously cause one-time expenditures for the local governments.[10]

Buying back the assets and municipal shares in concession companies happens mostly in the energy and water management sectors. It could happen because the local administration and the municipal corporations improved their management capacities and new forms of cooperation have been experimented. Local governments themselves are more inclined to develop intermunicipal agreements on communal service provision, so the economies-of-scale can be realized not only by private companies but also by the municipalities as public service providers. They benefit also from merging the single-function service entities into holdings, which brings savings through synergies in revenue collection, efficient use of machinery and equipment or cross-subsidization of activities with different profitability. Local governments might gain indirect benefits through these arms-length companies by implementing energy saving programmes at local institutions or introducing renewable energy sources, which would not be a priority of private contractors.

However, partnership with the private sector is still regarded as an effective tool for municipal service provision. Countries legislated PPP laws recently (e.g. Croatia, Romania), although there might be mixed motivations behind these new regulations (as the Romanian national observer reported it is more an attempt to create avenues for bypassing the procurement legislation). In Albania there are simple cases of providing public land to investors in return for social housing. Property-related deals, such as sale-and-leaseback of municipal real estate, are not often used in this period of economic downturn (country report from Iceland).

The European market of Public Private Partnership agreement started a slow recovery in 2010.[11] The total value of PPP transactions reached by the financial close was EUR 18 billion of 112 projects, which is similar to the level of 2002–2004, but lower than during the pre-crisis boom period in 2005–2007. The most active countries are the UK (44 projects) Spain and Portugal and together these three countries represent 63 per cent of the total value of PPPs within the EU. In Eastern Europe only six deals were made.

The PPP projects are typically in the transportation sector and in the field of education or healthcare, so they are almost exclusively national government PPP programmes.

10. These cases are rather frequent in France, but a similar municipal buy-out of the concessionaire in the water sector also happened in a large city of Hungary. Available online: http://www.remunicipalisation.org/

11. Market Update. Review of the European PPP Market in 2010. Available online: http://www.eib.org/epec.

Promoting Local Economic Development

The other, broader aspect of partnership is related to local and regional development. Municipalities have learned various techniques of local economic development, which were successfully used in the period of more or less stable economic growth, the relative abundance of capital and funds for investment. The economic stimulus programmes also targeted small and medium-size enterprises and the EU programmes aimed to lower the administrative burden on these businesses.

In the coming years the countries of Eastern Europe probably will be faced with declining foreign direct investments and the more developed economies should find new, endogenous sources of economic growth. In this situation the local government strategies and development actions also should be transformed. National observers already reported few examples of direct local economic development actions. They range from simple cooperation between local governments and businesses for common goals (e.g. promoting tourism by sharing the burden of a local tourist information centre in Albania) to more strategic support of social entrepreneurship (e.g. setting up a special company for eco-agricultural production which provides jobs to the most vulnerable population of a municipality in Bosnia and Herzegovina).

The small and medium-size enterprises will not be able to create sufficient number of jobs and their overall impact on local tax base will be limited. However, the public and the private sector jointly search for employment opportunities. For example, in Denmark the unit of caseworkers and employment advisers are physically located in the company in order to increase the cooperation between the government and the businesses.

Specific forms of local economic development are used in these exceptional times. Cooperation and collaboration between local governments is critical for local economic development. Municipalities have to cooperate horizontally with their neighbours, the financial institutions or the public utility companies and vertically, with other tiers of elected governments (regions, urban areas) or the state administrative entities. Local governments should actively contribute to economic development by being more responsive in the local urban development strategies, planning regulations, investments in infrastructure, education and training programmes, creating favourable business environment for innovation, and so on.

The institutional forms of local economic development have been transformed, as well. For example in the UK the former regional development agencies were replaced by Local Enterprise Partnerships in England. These joint public authority and business partnerships are aimed to support economic growth by supporting small start-up businesses, tourism; cooperating with universities; tackling issues of planning and housing, local transport and infrastructure priorities, employment and the transition to the low carbon economy.

Box 4
Poles of competitiveness in France

Setting up 17 economic poles (clusters) for economic development: cooperation between state and local governments; industry/business and universities as NGO.

The poles of competitiveness (*pôles de compétitivité*) were conceived in 2004 as a tool for economic development policy by the national Agency for Regional Development (DATAR), a central government body. Though the idea is not totally new (Italy has "districts", Germany "nets of competences", California the Silicon Valley), it was a quite revolutionary shift in France. Regional development was traditionally considered as a policy of cohesion and equalization thanks to cooperation between state and local governments to create nearly the same investment and public services all over the country. Now a clear option is taken for "cluster" policies, polarized in certain territories, with very diverse projects; main actors are no longer public administrations, but enterprises, research centres, universities, hospitals, etc.

The objective is to stimulate cooperation between all these actors on specific long-term innovation programmes with a marginal support of public money.

Clusters and programmes are not regional in an administrative sense, for two reasons: (1) their leading centre is located in a given region, but members can be anywhere in France; (2) a pole must decide of the level of its ambition: to be a leader on a European or a global level, and not just a regional one. Successful activities cannot be locked up in administrative boundaries, but their development will of course benefit the region where they are.

The creation of a pole must come from an initiative of a group of entrepreneurs, mostly with support of LSG, who submits a project after the Agency has issued an invitation to tender. A limited number of poles are accepted. Originally it was meant to be quite low (10 to 15) and of world dimension (space, cars of future, chemistry, pharmacy, etc.) but 66 have been accepted in 2005 and five more were added in 2007, covering nearly all economic sectors. An international evaluation made in 2008 concluded that 13 were weak and finally accreditation of six poles with low output was withdrawn. But in 2010 six new ones were created, dedicated to eco-technologies (water, energy, waste, etc.). The total number is still 71. Their legal status is private law, mostly a non-profit association, which offers the greatest flexibility.

National competitive biddings are published for specific programmes with indication of the amount of money available, the general priorities and procedure information. From 2005 to mid-2011, 1,051 projects have been selected and received support. The 2011 September call for tenders was the 11th such call. The public money comes from central state ministries depending on the nature of the projects; from local governments, mostly regions but also other LSG bodies, and from the European Union (FEDER).

The principles of these poles are: cooperation between the economic actors, between public administrations (ministries, region, municipal, etc.) and between public and private; a common objective and strategic lines; to aim to be the best in a specific domain and on a certain range; therefore to boost innovation. There are no spectacular results and all poles do not work perfectly, but provisional evaluation is rather positive and solidarity in a period of crisis is an advantage. The next full evaluation is projected in 2012.[12]

This strategic approach to local development requires more comprehensive and coordinated actions from local governments. Both international development agencies and domestic organisations tend to promote recovery by integrating actions locally or regionally. The European Commission's planned new approach to regional development in the next budgeting period using the concept of "place based development",[13] the Barcelona Principles of economic recovery underlining the importance of active local leadership;[14] recognition of the need for multisectoral development programme design[15]all emphasize the same integrated approach to successful development actions. Domestic policy analyses also highlight the importance of local leadership and quality of place in economic recovery.[16]

12. More info available online: http://territoires.gouv.fr/poles-de-competitivite.

13. F. Barca (2009) *An Agenda for a Reformed Cohesion Policy*. A place-based approach to meeting European Union challenges and expectations. Independent Report prepared for Danuta Hübner, Commissioner for Regional Policy.

14. G. Clark (2009) *Recession, Recovery and Reinvestment: The Role of Local Economic Leadership in A Global Crisis.* OECD LEED.

15. C. Romanik (2011) *A New Definition of Local Development.* Available online: http://www.developmentandtransition.net/

16. The Work Foundation (2009) *Recession and Recovery: How UK Cities Can Respond and Drive the Recovery.* London.

Energy Efficiency

A specific cross-cutting issue of future local development is energy utilization. Beyond the global and national programmes, it is very much a local government issue. As large energy users, municipalities and their institutions have direct influence on energy consumption and also indirectly, through the building regulations, district heating or the public transportation systems they can determine the local segment of the energy market. Energy rationalisation programmes are local, because the solutions are specific and cannot be standardised even in a country across localities of different types.

There are huge differences within Europe as well: the Western, more developed countries launched energy saving and rationalisation programmes decades ago, while in Southern and Central Europe energy efficiency improvement is a recent issue. Fiscal decentralisation forced local governments to search for savings and also opened new options for economising on increasing energy expenses.

The European Commission's long-term strategy has also set important targets of sustainable growth. In the field of climate change and energy utilisation by 2020 it aims to decrease greenhouse gas emissions by 20 per cent lower than 1990; 20 per cent of energy use should be from renewable energy and it is planned to achieve 20 per cent increase in energy efficiency.

Energy rationalisation goes beyond the technical aspects of energy efficiency and the narrow environmental approach. The suppliers usually discuss these traditional engineering issues. Local leadership focuses on the economic and political aspects: what are the local institutional and regulatory conditions of having strong local fiscal interest in energy savings, how energy rationalisation, renewable energy can be made primary issues of local political debates. Climate change will also influence local policies, as there is already a visible greater demand for drainage system to manage rainfalls or protecting cities from floods.

The national observers reported various actions. In Spain the national action plan of 2008–2012 proposes changes in the street lighting regulation and improvements in the high-energy consumption of water supply and water purification facilities. Energy audits increase the efficiency of municipal facilities and public enterprises; savings can be achieved by providing energy-training courses for municipal technicians. A series of principles for energy efficiency have been set up between the central government, regions and local governments.

In Denmark within the framework of their climate action plans local governments develop agreements with private energy service companies to develop and fund projects in order to reduce operation and maintenance costs of their customers. National competitions and ministry awards raise local interest in mitigating climate change and promote clean technologies.

In Central and Eastern Europe some examples were reported on setting the foundations of energy rationalisation. In Georgia, Tbilisi adopted energy efficiency plan by setting the requirements for the developers and construction companies on energy efficient houses and office buildings. Modernisation of street lighting, installation of solar collectors on public buildings (Croatia), building insulation programmes, energy efficiency projects combined with renovation (Estonia) are the typical local actions. They are often funded by the EU Structural Funds (e.g. Bulgaria) or local governments benefit from the sale of national CO_2 quota (Estonia).

Recommendation Rec(2004)1 of the Committee of Ministers to Member States on Financial and Budgetary Management at Local and Regional Levels

Adopted on 8 January 2004

The Committee of Ministers, under the terms of Article 15.*b* of the Statute of the Council of Europe,

Considering that the aim of the Council of Europe is to achieve a greater unity between its members for the purpose of safeguarding and realising the ideals and principles that are their common heritage and facilitating their economic and social progress;

Considering that this aim may be pursued *inter alia* through the adoption of common action in economic, social, legal and administrative matters;

Having regard to the provisions of the European Charter of Local Self-Government, which it adopted in the form of an international treaty on 15 October 1985 and which to date has been ratified by a large majority of Council of Europe member states;

Having regard to the following reports of the Steering Committee on Local and Regional Democracy (CDLR):

- Effects on the financial autonomy of local and regional authorities resulting from the limits set at European level on national public debt (2000);
- Methods for estimating local authorities' spending needs and methods for estimating revenue (2001);
- Risks arising from local authorities' financial obligations (2002);
- Recovery of local and regional authorities in financial difficulty (2002);
- Budgetary procedures and budget management at local authority level (2002);

Taking into account CLRAE Opinion 20 (2003) on the Committee of Ministers' preliminary draft recommendation to member states on financial and budgetary management at local and regional level;

Aware that local and, where it exists, regional self-government implies a degree of autonomy in financial and budgetary management, without which local and regional authorities cannot be accountable for, and control and manage the share of public affairs falling within their remit;

Believing it important that public spending is managed openly and in accordance with the law and that financial and budgetary management procedures play a vital role in this respect;

Considering that financial and budgetary management procedures must be tailored to the needs of local and regional communities for greater effectiveness,

Recommends that the governments of member states:

1. take inspiration for their policy on financial and budgetary management at local and regional levels from the following principles of:
   a. securing consistency with the macro-economic targets of the national economic policy;
   b. establishing and ensuring financial stability of local and regional authorities;
   c. looking for cost-effectiveness of services provided to the community;
   d. ensuring openness and accountability of decisions;
2. ensure that these principles are respected through the appropriate means, including the use of domestic law by changing, where necessary, the regulatory framework of financial and budgetary management at local and regional levels, and by drawing on the guidelines appended to the present recommendation;
3. involve local and regional authorities or their representatives in debate and in any reforms that might prove necessary in the area of financial and budgetary management at local and regional levels, and in the area of financial relations between levels of government, particularly as a follow-up to the present recommendation;
4. translate the present recommendation into their official language(s) and circulate it to their local and regional authorities and associations thereof, inviting them to take note of the guidelines intended for them set out in Part II of the appendix.

Appendix to Recommendation Rec(2004)1

Part I – Guidelines for central authorities

These guidelines are addressed to central authorities insofar as they are responsible for defining the legal framework and supervising the activity of local or regional authorities.

In certain federal states, these competences belong to the federated entities. In such cases, these guidelines are addressed to them. Central authorities are invited to bring these guidelines to their attention.

General principles

1. The local or regional authority should be entitled, within the framework of national economic policy, to foreseeable resources commensurate with its competences and responsibilities that would allow it to implement these competences effectively and of which it may dispose freely.
2. The overall system of local and regional finance should aim at striking a suitable balance between financial transfers, including grants and shares of nationally determined taxes on the one hand, and locally determined taxes and charges on the other. Such balance should provide discretion to adjust revenue and expenditure levels to local priorities, and also ensure that local services nevertheless reach minimum standards, whatever the local or regional fiscal capacities may be.
3. Higher-level authorities whose decisions impose additional costs on local and regional authorities should ensure that these costs are covered by new financial resources such as additional fiscal resources, evolving financial transfers or other financial means.
4. Legislation should establish rules for drawing up, approving and implementing local and regional budgets and for the supervision of their implementation, as well as for their healthy, balanced management in the long term.
5. It should not be possible to delegate the adoption of the budget and the approval of the accounts to a committee or a body other than the elected deliberative body of the local or regional authority.
6. Within the limits of the legislation, the local or regional authority should be able to independently adopt its budget and to adapt the operational rules applicable to its budget and to apply them to its specific situation.
7. The local or regional authority should be able to allocate credit balances carried over from a budget year to non-recurrent expenditure (for example, self-financing from investments, the reduction of public borrowing, setting up provisions or reserves, etc.) and carry over debit balances in order to rectify the situation by allocating funds from subsequent budgets to write them off.

Limitations on the financial autonomy of local and regional authorities

8. The state or legally established supervisory authority may take measures to restrict the financial autonomy of a local or regional authority or to limit or reduce the amount of funding transferred to it. Such measures should be taken within the framework defined by statute and should not be excessive or threaten the principle of local autonomy.

9. Such restrictive measures may be general (applied to all authorities) or specific (applied to a limited number of authorities, having regard to their particular situation). Their aim should be to:

   - ensure a healthy macro-economic policy at state level, on the one hand, and
   - ensure sound and safe management, while observing the rules laid down by statute and administrative law, and overcome financial difficulties or deal with exceptional situations encountered within those local and regional authorities subject to the restrictions, on the other hand.

10. The limitations which may be imposed by the state on the financial autonomy of local and regional authorities should be established by law. Limitations should be based on objective, transparent and verifiable criteria, applied fairly and in such a way as to avoid accounting devices that obscure the truth.

11. The local or regional authority should be consulted, following appropriate procedures, prior to any measure to restrict its financial and budgetary autonomy, and it should be notified of the application and consequences of any such measure. Institutional mechanisms of regular dialogue, consultation and co-operation between the different levels of government could be created.

12. Regular checks should be made by the central authority to gauge whether the limitations are necessary and effective.

13. Specific measures restricting the financial and budgetary freedom of certain local or regional authorities should be short-term and lifted once they have achieved their aim.

14. The limitations imposed on each authority should be clear, objective and quantifiable.

15. The limitations should be proportionate to the desired aim and be free of any punitive nature.

16. Measures having a substantial impact on the financial autonomy of a local or regional authority, such as the general and rigid capping of spending and taxation rates, should be avoided if other, softer, measures such as incentives and flexible limitations (which vary in time and take account of the situation and of the average spending and taxation rates for a certain type of community) could be used.

Methods of financial estimation

17. Evaluations of the evolution, at the national level, of local and regional authority spending needs and provisional receipts, of financial transfers and of criteria for sharing these transfers should be prepared and published. These are to be considered as provisional evaluations; they should be subject to adjustment at regular intervals. They should be based on calculation formulae that are transparent, stable, fair and objective.

18. The purpose of these evaluations should be to provide information on changes in the macro-economic situation and the foreseeable amount of transfer funding that could be granted by the central authority to local and regional authorities, and they should allow, where applicable, for transfers to be shared fairly between authorities.

19. Where appropriate, the state should promote the setting up of standards for essential local and regional services and should develop outline procedures for financial estimations relating to spending needs at local and regional levels.

Assessment and management of financial risk

20. The assessment of financial risk should comprise prior monitoring and warning mechanisms (such as tables presenting the evolution of revenue and expenditure, of indebtedness and interest rates, of the main tax bases, etc.) as well as intervention and supervisory procedures. An approach of overall regulation should be preferred to that of control of individual activities.

21. Speculative investment by local and regional authorities should be prohibited. If the local or regional authority wishes to invest on the equity market, such investment should be managed professionally.

22. Any financing techniques which have the object or the effect of concealing the level of debt of the local or regional authority should be prohibited. All financing techniques should be subject to conditions that ensure or restore the transparency of the financial situation or limit the risks involved.

23. Legislation should exclude or limit the possibility of using buildings and assets indispensable to the fulfillment of the local or regional authority's mandatory or related tasks as collateral for guaranteeing borrowing.

24. In general, local and regional authorities should have the right to incur debts only for the funding of investment expenditure and not for current expenditure. The level of debt could be established in relation to the volume of the authority's own resources, their extent, stability and foreseeable development.

Local elected representatives and employees

25. The quality and accuracy of the financial and budgetary information issued by the local or regional authority should be guaranteed by the mayor, the chief executive or any other elected representative or executive body designated by law, who assumes responsibility.
26. Officials responsible for collecting local or regional tax revenue and/or committing local or regional expenditure and enjoying a degree of independence in the exercise of their duties should be personally accountable for their acts of management, in accordance with the law.
27. The central authority should ensure that local or regional officers and elected representatives receive appropriate professional training. If such training is not provided by the local or regional authority itself or its association, the central authority could, for example, set up standards in this respect, organise such training and help the local or regional authority and its association to organise training for their elected representatives and officers.

Control

28. The external supervisory procedure should be laid down by law and should be balanced and fair. The procedure should be limited to an examination of the legality of decisions. In the case of a disagreement, the procedure should provide the supervising authority with the possibility of recourse to the competent jurisdiction.
29. In general, control after the event should be preferred to prior approval or authorisation.
30. Failing this, where prior approval is required, particularly for the exercise of delegated powers, a reasonable time limit should be set by law for the supervisory authority to give its approval, which shall be deemed granted if no reply is forthcoming within the time limit set.
31. There should be a legal deadline for the adoption of local and regional budgets and mechanisms to ensure the continuity of public services if the budget is not adopted in due time, or if the local or regional authority fails to fulfill its obligations (such as omission from the budget of expenses that are legally or contractually binding, inaccuracy of budgetary entries, gross violation of budgetary procedures, etc). Such mechanisms may provide for the intervention of the central authority, of the controlling body or of an independent administrative body in order to redress the situation, while at the same time guaranteeing that the intervention is proportional

to the cause, is neither political nor excessive, does not endanger local or regional self-government and is not prolonged beyond what is needed to redress the situation or to tackle the deficiencies observed.

32. There should be statistical and comparative analysis of budget implementation, spending and the rate of spending in order to detect any anomalies and trigger the relevant warning procedures, rather than a series of successive authorisations that provide no dynamic overview.

33. The central authority should ensure that arrangements are made for drawing up comparisons of budgets and performance for local or regional authorities of comparable size and socio-economic characteristics that are widely accessible (through publications or Internet site postings) and accompanied by explanatory texts (such as the meaning of indicators used, etc.).

Recovery of local and regional authorities in financial difficulty

34. As a general principle, the central authority should not guarantee the borrowings of a local or regional authority.

35. Current expenditure of the local and regional authority should be financed out of current revenue and non-earmarked reserves, except in exceptional cases of cash advances and short-term loans.

36. The state or supervisory authority should establish procedures for monitoring the financial situation of local and regional authorities by gathering financial information and making it public. This information should enable citizens, the local and regional authority and the government to be aware of the financial situation of a given authority, to compare it with that of other authorities with similar characteristics and to take appropriate measures, where necessary and according to law, to avoid any financial difficulties arising.

37. Procedures should exist enabling the local or regional authority to handle a localised and short-term financial crisis without requesting assistance from the next highest level of authority or the state. Such procedures could be established, for example, under a bankruptcy and insolvency code for local and regional authorities.

38. The state or supervisory authority should establish and observe clear rules for intervention to assist a local or regional authority in financial difficulty.

39. These rules of intervention should pursue the aim of financial recovery of the local or regional authority concerned while making elected representatives and officers responsible for their acts. There should be provisions aimed at discouraging and

avoiding perverse effects such as local or regional authorities becoming accustomed to assistance or becoming careless in their financial management or competing for state aid.

40. In cases where the financial difficulty arises from a structural income deficit, the central authority should not only provide financial assistance but should also intervene to eliminate the causes of that structural deficit.

41. The central authority should make provision for special financial resources in order to help local and regional authorities that are in an emergency situation, or victims of natural disasters or affected by sharp economic decline.

42. Financial assistance should be granted following dialogue with the given local or regional authority and on the basis of an economic recovery plan that includes financial contributions and undertakings from the authority itself.

43. Financial assistance should be adjusted according to the local or regional authority's wealth and medium-term economic and fiscal potential.

Part II – Guidelines for local and regional authorities

Local and regional authorities are invited to take into account the following measures when designing their policies in the field of financial and budgetary management, insofar as they fall within their competence.

General principles

44. It would be desirable for newly elected local or regional executives to present a programme at the beginning of their term in office setting out aims, priorities and measures with an indication of the time-table of implementation and of the relevant budget resources.

45. The local or regional authority should draw up pluri-annual budget plans (covering the two to four years following the current year) setting out the overall budget objectives, an indication of the cost of pursuing the policies and undertakings subscribed to, and future budgetary consequences of decisions taken or to be taken.

46. Budget projections and proposals should be prepared with the involvement of in-house experts (for example, receiver, treasurer, internal auditor) and outside opinions (such as economists, independent auditors, etc.), particularly in the event of public debate (hearings before the relevant committees, the local or regional council, etc.).

47. Whenever a decision is taken by the executive or the local or regional council, the budgetary expenditure for the current year and the following financial years should be clearly explained.

48. As a general rule, the proceedings of committees dealing with budget matters should be open to the public and their documents should be published and accessible to the public.

49. The elected representatives and officers of local and regional authorities should be offered and benefit from appropriate training in budgeting, both basic and advanced, that enables them to understand the documents submitted to them and to take appropriate, informed decisions. Incentives for training such as a closer link with promotion criteria should be implemented for officers.

50. Any activity of a local or regional authority that may result in public debts or entail significant financial risk should be primarily agreed upon and authorised by the elected deliberative body concerned.

Information and openness

51. Budget and accounting documents should be easily readable, providing both a clear and comprehensible overview of the budget (including main balances, issues and priorities, key data, etc.) and sufficient detail to analyse the content of the budget and make relevant comparisons (with other financial years, other authorities, etc.).

52. Published documents, for example via the Internet, should be accompanied by a suitable explanation making them more easily comprehensible to a lay public.

53. Expenditure and receipts should be presented by type and by function in budget documents, identifying as far as possible the different sectors of local and regional government involved so that the sharing of resources between fields of activity may be gauged.

54. Information on the performance of the local or regional service management (financial indicators, output and impact indicators, comparisons with the performances of other local or regional authorities and the interpretation of such information) should, where appropriate, be appended to budgetary documents.

55. The local or regional authority should stimulate participation by citizens and social partners in public affairs by regularly consulting them and should ensure that objective information is provided on the financial aspects of the issues under consultation.

56. The local or regional authority should make it possible for citizens to be informed of draft budgets as soon as these are forwarded to local or regional councillors for

final approval. When a budget has been adopted, its outlines and consequences for the community should be made public; for example by explaining changes in taxation or priority allocation of the authority's funding, and mentioning services ready to provide the public with further details.

Preparation of the budget

57. Preparation of the budget should be the responsibility of a specialised unit of the local or regional authority with a good knowledge of the authority's operational departmental costs and budget consumption so that it can propose different options to the executive and prepare internal arbitration before arbitration at a later stage.

58. Budget proposals should be discussed by the authorities and persons responsible for the domain concerned and then by those responsible for finance, who should consider overall balances, overall income, borrowings and any problems raised.

59. Choices between different investment projects should be made more objective, for example by using a "scoring" system based on several criteria. When the size of the proposed investment justifies it, a participatory process involving the local community should be envisaged; if this occurs, procedures should be set up in order to guarantee that the exercise is properly run.

60. The budgetary consequences of a local or regional authority's links with the commercial sector (for example, income and expenditure linked to shareholding, execution of guarantees given, etc.) should be carefully assessed in accordance with the rules and procedures for assessment used in the private sector.

Assessment and management of financial risk

61. The presentation of the budget and accounts must give as complete and objective a picture as possible of the local or regional authority's financial situation. The local or regional authority should work towards drawing up consolidated accounts, integrating the results and showing the risks and obligations of the different satellite agencies.

62. Where the consolidation of the accounts is not possible, the local or regional authority should present an overview of its participation or involvement in any external organisation and possible risks to which the organisation may be exposed in which the local or regional authority is a financial stakeholder.

63. The presentation of the budget should be accompanied by an analysis of the financial risks to which the local or regional authority is exposed: the quantifiable risks should

give rise to setting up reserves, while the degree of exposure to non-quantifiable risks should be estimated.

64. In those countries where the local or regional authorities are at liberty to deposit their funds at the banks that they deem appropriate, a system of insurance or re-insurance is needed to protect the local or regional authorities against the loss of some of their assets in the event of bankruptcy of their bank.

65. Guarantee or guarantee deposit obligations should be published, with a distinction being made between the obligations during the financial year, the loans outstanding and the costs arising from these guarantees; the use of risk-assessment ratios to limit these risks is to be recommended.

66. Establishing or managing commercial enterprises and participation in such enterprises should be limited, in principle, to public service activities or to activities in which there is no competitive market or activities that are aimed at economic promotion (such as housing developments, creation of business parks and start-up activities, promotion of employment, etc.).

67. If the local or regional authority has the right to invest on the financial market, it should, in principle, limit such investment to the bond market. Any other financial product should be the subject of specific ratios for assessing their volatility and risk and in every case be subject to professional management.

68. Follow-up systems and ratios should be set up, the most important of which must be made public so as to enable the financial situations to be compared and the divergences to be analysed and to prevent risks.

69. Local and regional authorities should acquire, individually or collectively, the expertise necessary to manage risks arising from their financial obligations; that expertise may imply training financial executives of local administrative bodies or involving the state services or independent public consultancy bodies, the associations of local authorities and the private sector on a commercial basis. Consultancy and supervisory functions should not be exercised by the same body.

70. Horizontal and vertical co-operation between authorities should be encouraged to facilitate the completion of major projects, in such a way as to share the expenses and the risks.

71. Estimates of investment-project costs should not overlook recurrent subsequent costs (such as staffing, operation, maintenance, etc.), which should logically be incorporated into pluri-annual budget programming.

72. In public-private partnerships, the risks should be shared out realistically and the local or regional authority should avoid, by its intervention, taking on the role of

guarantor of risky private investment. In particular, an explicit public guarantee is preferable when the nature of the structure or service is such that the authority may find it difficult, to put its future in the hands of the user.

Approval of the budget

73. A budget strategy debate should be organised at the beginning of the budgetary procedure, permitting initial discussion of the overall objectives to be adopted for the year and possibly the years to come.
74. The local or regional authority should set sufficient time limits in which councillors may read and analyse the budget documents issued.
75. If the elected representatives consider the information received to be inadequate or unclear, they – individually or collectively (for example in the competent committees) – should be able to request further information, question the relevant officers and, where necessary, hear the experts of their choice.

Implementation of the budget

76. Where appropriate, a debate on the implementation of the budget should be held mid-year, in order to put budget changes into perspective and to review the changes in the economic, budgetary and social context, and after the end of the financial year.
77. The council should receive regular updates (for example, every three or four months) on the monitoring of the budget. If budget adjustments prove necessary, it would be advisable to group them in one or two "sets" per annum, accompanied by an overview or even a debate on the state of budget spending.
78. Budget adjustments should be limited in number and in scope in order to avoid diverting the aims of initial budgetary objective. Adjustments should be organised in such a way as to give a clear view of the changes suggested and on their importance, and they should be given the same level of transparency, publicity and conditions of democratic control as the initial budgets.

Budget accounts

79. The accounts (for financial year n) should be submitted to the council within a reasonable time, and certainly before the holding of the debate on budget implementation for the following year (n + 1) and before the budget for the year after that (n + 2) is drawn up.

80. Approval of the accounts should be properly debated, in committee and then in the council, in the light of an outside opinion (for example an external audit).

81. The executive of the local or regional authority should ensure that the reports of committees and the council concerning the budget are published (allowing public access or on-line consultation).

Control

82. The local or regional authority should establish and put into general practice a framework for internal auditing (for example a code of ethics, independence measures, a right of initiative, conditions of intervention, notification of the council, follow-up, publishing of reports, etc.) and organise support for such internal auditing (recommended methodology, outside technical back-up).

83. Without prejudice to any existing legal obligations, the local or regional authority should make systematic use of annual external auditing (in whatever form) to certify accounts and check their compliance with the law (including measures combating fraud and corruption).

84. The local or regional authority should assess the efficiency of its management at regular intervals, for example by making use of external audit.

Financial difficulty

85. The local or regional authority should not request financial aid from the state or supervisory authority if it is able to redress its financial situation through other means.

86. As soon as it finds itself in financial difficulty, the local or regional authority should devise and set up a financial recovery plan, if necessary with assistance from the state or supervisory authority, independent administrative authorities or private auditing firms.

87. The recovery plans should be debated and adopted by the council or assembly in public sittings. The plan should set out the necessary data and the undertakings on which the following budgets are to be based. The plan may be contractual, depending on legislation, vis-à-vis the body providing financial support to the local or regional authority concerned.

Recommendation Rec(2005)1 of the Committee of Ministers to Member States on the Financial Resources of Local and Regional Authorities

Adopted on 19 January 2005

The Committee of Ministers, under Article 15.*b* of the Statute of the Council of Europe,

Considering that the aim of the Council of Europe is to achieve a greater unity between its members for the purpose of safeguarding and realising the ideals and principles which are their common heritage and facilitating their economic and social progress, and that this aim may be pursued, *inter alia*, by common action in economic, social, legal and administrative matters;

Considering that local self-government implies a degree of financial autonomy;

Considering the provisions of Article 9 of the European Charter of Local Self-Government, which it adopted as an international treaty on 15 October 1985 and which has now been ratified by a large majority of member states of the Council of Europe;

Having regard to the Resolution on local government finance adopted at the Conference of European Ministers responsible for Local Government in Lisbon in 1996;

Having regard to Recommendation Rec(2004)1 of the Committee of Ministers on financial and budgetary management at local and regional levels;

Having regard to the following reports of the Steering Committee on Local and Regional Democracy (CDLR):

- Local finance in Europe (1997);
- Limitations of local taxation, financial equalisation and methods for calculating general grants (1998);
- Effects on the financial autonomy of local and regional authorities resulting from the limits on national public debt set at European level (2000);
- Methods for estimating local authorities' spending needs and methods for estimating revenue (2001);
- Risks arising from local authorities' financial obligations (2002);
- Recovery of local and regional authorities in financial difficulty (2002);
- Budgetary procedures and budget management at local authority level (2002);

Having regard to Recommendation 79 (2000) of the Congress of Local and Regional Authorities of the Council of Europe, adopted in connection with the monitoring of the implementation of the European Charter of Local Self-Government and concerning the financial resources of local authorities in relation to their responsibilities;

Considering that local taxation, state grants and financial equalisation mechanisms should be adapted to the needs of local communities so that their authorities can operate as effectively as possible, with due regard for the rules and codes of conduct applicable at national level;

Considering that the solutions to local authorities' financial problems should be adapted to the specific features of each state, as resulting, *inter alia*, from its structure, territorial organisation, distribution of powers between the different tiers of government and traditions;

Considering that this Recommendation, which was specifically developed for local authorities, may also apply, *mutatis mutandis*, to self-governing regional authorities and recalling in this respect the Helsinki Final Declaration on regional self-government adopted by the Conference of European Ministers responsible for Local and Regional Government in 2002;

Considering that the changes that have taken place since its adoption justify replacing Recommendation Rec(2000)14 of the Committee of Ministers to member states on local taxation, financial equalisation and grants to local authorities by this Recommendation,

Recommends that the governments of member states:

1. ensure a fair distribution of public financial resources between the different tiers of government, taking account of the responsibilities assigned to each of these tiers and changes in those responsibilities, as well as economic circumstances;
2. guarantee local authorities a system of financing their expenditure that is based on the following principles:
   - local authorities' resources and their allocation must be consistent with the requirement that they discharge their responsibilities effectively;
   - local authorities are entitled, within the framework of national economic policy, to raise adequate resources of their own;
   - a substantial proportion of transfers, and, generally, of their own resources, must not be earmarked for specific purposes;
   - the amount of state grants must be fair, transparent and foreseeable; fairness demands that allocation rules be universal, non-discriminatory, stable, and neither arbitrary nor negotiable on an ad hoc basis;
   - the financial equalisation system should allow local authorities to provide their citizens, if they so wish, with broadly comparable levels of services in return

for comparable levels of taxation and charges; this system should take account both of disparities in the financial capacity of local authorities and disparities in their spending needs;

- where the demands of national economic policy so require, measures should be taken to ensure that the system of financing local authorities is consistent, overall, with those demands; such measures should:

  a. not be disproportionate to the demands in question;

  b. should be negotiated with these authorities or their representatives; and

  c. should be introduced by law;

- specific limitations which apply to a limited number of local authorities should be lifted as soon as the situation permits.

3. review – if necessary – the legal and administrative framework for local taxation and grants to local authorities so as to encourage the improvement of services and their efficient provision, and the legal and administrative framework for financial equalisation, so as to ensure fairness and solidarity between authorities, with due regard in particular for the guidelines appended to this Recommendation;
4. involve local councillors in the debate on reforms needed in this area, particularly those undertaken pursuant to this Recommendation, and on arrangements for implementing such reforms;
5. translate this Recommendation into their official language(s) and circulate it to local authorities and associations of such authorities, inviting them to take note of the guidelines addressed to them, as set out in Part II of the Appendix.

Appendix to Recommendation Rec(2005)1

Part I – Guidelines for Central Authorities

These guidelines are addressed to central authorities, in so far as they are responsible for defining the legal framework and supervising the activities of local authorities. In certain federal states, these responsibilities rest with the federated entities. In such cases, these guidelines are addressed to them. Central authorities are invited to bring the guidelines to their attention.

1. Definitions

Within the meaning of this Recommendation:

a. From the point of view of the authority's capacity to alter their level, resources may be classified as either own or transferred resources.

An authority's "own resources" are resources of which it can vary the level, possibly within a predetermined range. These resources may, for example, be fiscal or non-fiscal, exclusive or shared, etc.

An authority's "transferred resources" are resources whose level the authority may not vary. They may be, for example, fiscal or non-fiscal, exclusive or additional, proportional or non-proportional (grants), etc.

b. From the point of view of the authority's capacity to use their proceeds freely, resources may be classified as either earmarked or non-earmarked.

A local authority's "earmarked resources" are resources which must be used for a purpose (goods, property, a service, a programme) decided on by an authority other than the authority in question.

"Non-earmarked resources" are resources which may be used freely, with due regard for the legislation concerning the use of public funds, by the local authority.

c. From the point of view of the relation between the sum that constitutes revenue of the local authority and the total sum levied locally, resources may be proportional or non-proportional.

An authority's "proportional resources" are resources that depend directly on the amount raised locally. They may be, for example, fiscal or non-fiscal, exclusive or non-exclusive (shared), etc. Own resources are normally proportional.

"Grants" are non proportional financial transfers.

d. From the point of view of the number of authorities which share their proceeds, resources may be exclusive or shared.

An authority's "exclusive resources" are the resources whose proceeds, as a whole, constitute the revenue of the authority in question. They may, for example, be financial or non-financial, own resources or financial transfers, etc.

An authority's "shared resources" are resources that are raised by the authority in addition to resources raised by another authority on the same basis.

e. Other definitions

"Additional resources" are shared own resources.

"Surcharges" are fiscal additional resources.

"General grants" are non-earmarked, non-proportional financial transfers.

"Specific grants" are earmarked non-proportional financial transfers.

The "financial capacity" is the maximum revenue an authority can raise in standard conditions which are set at the national level. As a rule, financial capacity largely depends on the tax (fiscal) capacity. There are, however, authorities that can raise very substantial non-fiscal resources (revenue from property, in particular land and buildings, economic activities or financial investments); their financial capacity takes account of this.

An authority's "tax (fiscal) capacity" is its ability to raise taxes in standard conditions which are set at the national level. Tax capacity is therefore proportional to the tax base, and differences in tax base lead to differences in tax capacity.

An authority's "spending need" is the amount theoretically necessary for the authority to produce or provide goods or services or a predetermined set of goods and services at standard level. The differences between authorities' spending needs stem either from differences in the unit costs of the goods and services produced or provided by the authorities in order to meet the quantity and quality minima imposed on them, or from the number of services needed (economies of scale) to attain these minima, or from differences in the number of residents entitled to the services.

"Delegated tasks" are competencies for which the ultimate responsibility falls on a higher level authority but the implementation of which has been transferred to a local authority.

"Exceptional revenue" is revenue which does not occur on a regular basis.

"Fiscal pressure" is the ratio between the total compulsory contributions and the added value (for companies) or income (for families) on the considered territory.

2. General principles

1. States are invited to take note of and put into practice the fundamental principles to be observed in respect of local and (*mutatis mutandis*) regional authorities' financial resources, as set out in Article 9 of the European Charter of Local Self-Government.
2. The main objectives in developing intergovernmental financial relations should be to the following:

- to secure revenue for each tier of government according to the assignment of their responsibilities and standard financial needs (vertical fiscal balance);
- to achieve an equitable distribution among local authorities (horizontal fiscal balance);
- to enhance the efficiency of the public sector.

3. Local authorities should, within the framework of the national economic policy, be entitled to their own resources, which should be adequate, and of which they may freely dispose, in the exercise of their powers and responsibilities, within the limits of the law (financial autonomy).
4. Taxes (right to levy, proceeds and capacity to set the rate, if necessary inside a pre-established bracket) should be assigned to local authorities unless these taxes would exhibit significant horizontal spillovers, entail an inequitable pattern of revenue among local authorities, or discrimination or distorsions among authorities, which warrants these taxes being administered at higher levels of government (subsidiarity principle). Where taxes are assigned to local authorities, they should also be given some power to intervene in their administration in order to improve their efficiency and to appropriate their proceeds (fiscal autonomy). Fiscal autonomy includes some tax policy discretion on behalf of local authorities, especially in the setting of tax rates.
5. To the greatest extent possible, each local authority should finance, from its own resources, the expenditure it decides on (fiscal equivalence at the local authority level).
6. Fiscal equivalence at individual level requires local authorities to charge, within a common regulatory framework, for local public services, and to tax citizens and local businesses in accordance with their use of local infrastructure (tax-benefit principle).
7. Local authorities should balance the financing of public services through taxation and charges, according to the public-private benefit they provide. When an authority deems it necessary to help a category of citizens to have access to a public service, it should not subsidise the service, but grant financial help to the users in question, in a targeted and, as far as possible, personalised way.
8. For regulatory purposes of local interest, local authorities should be able to levy fees, fines and emoluments and to grant permits and user rights to local businesses.
9. Where taxes are shared with local tiers of government, the local share should be commensurate with the local tax effort in order to encourage local officials to strengthen and develop the local tax base (derivation or origin principle).

10. Where there are large inter-jurisdictional disparities between local financial capacity and spending needs, central authorities should ensure the compensation of the financially weaker local authorities. These transfers should be unconditional and secure financing of a reasonable standard level of public service provision for all local authorities.

11. For local services of national interest (vertical spillovers) or for which some degree of national harmonisation is desirable, central authorities should guide local authorities through standard setting, and support these programmes through specific grants or service-related elements calculated for the general grants.

12. Where local authorities act as agents of a higher administrative level, the principal government must share the costs of these programmes (connectivity principle). Full funding is appropriate where the mandating government can control the administration of the programme; where this is not true, local authorities could be required to share some costs in order to contain their volume and to support the targeting and the effective administration of the programme.

3. Local taxation guidelines

a. Fiscal decentralisation

13. Financial autonomy of local authorities implies that local authorities have sufficient own resources to fund a significant proportion of the costs incurred in the discharge of their responsibilities, as defined in the Constitution or by law. This proportion should be sufficiently large to allow for and encourage substantial room for manoeuvre and accountability on the part of local authorities when they determine the expenditure to be incurred in the discharge of these responsibilities.

14. Shared resources of local authorities should primarily consist of non-earmarked additional resources and/or non-earmarked shared proportional resources decided by a permanent law.

15. A degree of tax decentralisation is therefore required. The following parameters may be used to determine this degree:

    – the ratio of local authorities' tax revenues to total state tax revenues;

    – the ratio of local tax revenues to total local resources;

    – the ratio of tax revenues to the grants from the state and other public authorities;

    – the ratio of local authorities' own tax revenues to the country's gross domestic product;

– the ratio of the maximum resources to the minimum resources that the authorities can raise by varying local taxation rates within the statutorily permitted range.

16. When the degree of fiscal decentralisation is considered low on the basis of the above parameters, the central authorities should consider, in conjunction with the local authorities, means of increasing the proportion of local authorities' own tax revenues and tax revenues transferred under a permanent law, without necessarily increasing overall tax pressure.

17. Local authorities should be able to establish the level of their (exclusive or additional) taxation, if appropriate within predetermined limits, so that they can vary the quantity and quality of their services according to local needs and preferences and so that elected representatives are more accountable.

18. When they can decide on the level of their revenues derived from taxes established at national level, local authorities should, in general, be able to vary the rate rather than the tax base. The rates fixed should reflect a local political choice, whereas the tax base should be assessed objectively and uniformly based on the law.

19. Local authorities' freedom in tax matters should be restricted only for reasons relating to fairness or national economic policy constraints.

20. Limitations on the financial autonomy of local authorities should not be disproportionate to the objectives pursued, and should be discussed with local authorities or associations of such authorities, provided for by law and lifted as soon as possible.

21. In general, when higher authorities take decisions that reduce the local authorities' tax base, compensation should be provided.

22. In order to send out a clear message to the public and ensure that local authorities are accountable, local taxation rates should vary essentially in accordance with their respective communities' choices as regards level of services. For this reason, differences in financial capacity, and in particular in the local tax base and spending needs, should be subject to an equalisation system.

23. Minimum conditions regarding the openness of decisions concerning local taxation should be laid down by law, both for central authorities (publication of information on which decisions are based, national debates, consultation of local authorities or their associations) and for local authorities (public meetings, public votes or votes by roll call, publication of key documents before meetings at which decisions are taken, etc.).

b. *Structure of local taxation*

24. The tax revenues of a local authority should come from resident individuals or property or businesses on the territory of the local authority in question.[1]

25. The structure of local taxation should be such as to ensure a fair, open breakdown of the burden of local taxation according to the taxpayers' ability to pay.

26. The structure of local taxation should be such as to ensure that the overall tax burden and its relation to the level of services provided for the individuals and businesses that bear it is clearly visible (as this is a prerequisite for the efficient allocation of resources according to local preferences).

27. Local authorities should be able to vary the rates of taxes that account for a substantial proportion of their revenues, so as to prevent slightly different levels of services from being matched by large differences in local taxation rates.

28. Local taxes should have a sufficiently high yield and low administrative and inspection costs.

29. Local taxation should be reasonably stable so as to make for continuity and foreseeability in public services, and have a certain degree of flexibility, so that tax revenue can be adjusted to changing budget costs.

30. Local taxes should be neutral and create little negative economic distortion (minimum impact on growth and the economic structure of the municipality), demographic distortion (so as not to prompt people to migrate) and social distortion (so as not to cause further problems for social groups in difficulty).

31. The central authorities should be able to help local authorities draw up local tax regulations. The establishment of a single database (or a single access point) for all local taxation can make for greater openness.

32. Care should be taken to avoid: unduly large or unduly rapid changes in the tax base or taxation rate introduced by the higher authority; the risk of incentives that are contrary to local interests; measures that undermine the incentive to collect the tax intended for local authorities and carry out the inspections necessary to this end; unduly long delays in paying the sums collected; and a lack of information about the amount collected.

1. The CDLR studies show that local and regional authorities have greater financial autonomy in countries where they receive a share of revenues from income tax and all revenues raised in tax on land and buildings.

c. *Tax collection and litigation*

33. Consideration should be given to the possibility of the central authority's registering and collecting the taxes. The main advantage of such a system is that the regulations are drawn up by the central authority, registration costs are reduced and collection and litigation costs are lower, because there are economies of scale, and are borne by the higher authority.

34. If the taxes are collected by the local authorities, the central authority should provide them with logistic support (training, access to information, integrated, interoperable software, etc.) and set up special databases at national level.

35. When the tax is collected by a higher authority before being transferred to the local authorities, it is important that the sums concerned should be transferred within a reasonable time set by the law. A system permitting regular payments is of key importance to the municipality's cash management. The local authorities should be provided with transparent information about the calendar of transfers and the amounts paid.

36. It is desirable to have a single litigation procedure for local taxes, established at national level (or regional level in federal states). Failing that, it is recommended that the various procedures have as much in common as possible.

4. Financial equalisation guidelines

a. *Equalisation systems*

37. The purpose of financial equalisation should be to allow local authorities to provide their citizens, if they so wish, with services of generally similar levels for similar taxation levels.

38. When designing their equalisation systems, central authorities should take account of the fact that the differences in the tax burden that authorities have to impose on their residents to achieve the same level of services are generally the result of differences in their financial capacity, their spending needs or their managerial efficiency.

39. The equalisation system should compensate, at least in part, for differences in authorities' financial capacity (so as to provide more resources to financial weaker authorities) and spending needs (so as to provide more resources for authorities that either have additional responsibilities or, by virtue of their geographical location, demographic situation or other factors, are obliged to spend more in order to discharge their responsibilities). It should not compensate for differences in managerial efficiency or differences in cost stemming from the adaptation of service levels to local preferences.

40. A substantial degree of financial equalisation is a prerequisite for the success of fiscal decentralisation and sound local self-government. At the same time, financial equalisation is a prerequisite for the success of policies geared to economic stability and balanced, sustainable regional development. The decision concerning the desirable degree of equalisation is an eminently political one. There is no optimum level of equalisation at European level. It is important, however, that, once the decision has been taken, an efficient equalisation system is set up to implement it.

41. Local authorities should be provided with appropriate information about the way in which equalisation systems work, for they cannot accept a system with which they are unfamiliar or which they do not understand.

42. Equalisation may be achieved by means of grants from a higher authority (vertical equalisation) or the redistribution of local tax revenues, particularly if they are collected by central government departments (horizontal equalisation) or a combination of both. Vertical equalisation generally lessens the risk of resentment among local authorities. Horizontal equalisation (provided for by law, in accordance with the principle of solidarity between authorities of the same level) has the advantage of strengthening inter-municipal solidarity and giving local authorities greater independence from the central authority; it should be envisaged, in particular, in cases where local taxation capacity varies too much for it to be possible to achieve the desired level of equalisation solely by means of financial transfers from the state. The extent to which local authorities with above average per capita revenues are expected to contribute to horizontal redistribution should not be so great, however, as to discourage them from the exploitation and development of their revenue base. The volume of resources contributed by the national budget to vertical equalisation should reflect the priority of the services for which local authorities are responsible within the overall framework of public expenditure; their stability should be guaranteed by a permanent law and some form of indexation to the growth of aggregate national budget revenues is highly desirable.

43. The desired degree of equalisation of disparities in spending needs and in financial capacity should be clearly and foreseeably specified.

44. Equalisation systems should specify openly and foreseeably which local parties are eligible for financial transfers to equalise financial capacity and spending needs. Eligibility criteria should be laid down by law.

45. Although equalisation systems normally operate at national level, it may be worth encouraging systems for pooling certain local taxes or redistributing certain local taxes among local authorities that make up an urban area and, in particular, between municipalities that constitute the industrial and commercial heart of the urban area and those which are residential areas. A local equalisation system of this kind makes

it possible to compensate, at least in part, for externalities and may be set up by means of an agreement among the municipalities concerned. In some cases, if it is impossible to reach such an agreement, it may be necessary to legislate.

46. In all cases, the mechanisms adopted to equalise among jurisdictions should be based on standardised (not actual) levels of revenues and expenditures. The standardisation of costs and revenues acts as a safeguard against implicit financial bail-outs that would otherwise eliminate the local authorities' (and their officials') accountability and result in wasted public resources. It also avoids moral hazard by local authorities because it precludes the manipulation of distribution criteria by recipient governments.

47. Central authorities should regularly check how their equalisation systems are working and consider, with local authorities, improvements that can be made in order to ensure that the adverse effects of an unequal distribution of resources and spending needs are effectively remedied.

b. Equalisation of spending needs

48. The equalisation of (standardised) specific spending needs should be effected through grants based on appropriate and objective criteria. Even when these grants are programme-specific, they should allow some limited discretion as to their use within programmes, and should avoid onerous monitoring and reporting.

49. Spending needs should be estimated primarily on the basis of criteria which:
    - are objective and which local authorities do not directly control;
    - are unlikely to affect local authorities' freedom of choice, within the limits of the budgets available;
    - do not penalise local authorities that endeavour to streamline the management of their services to make them more efficient, either by lowering unit costs or by trying, by means of co-operation arrangements or mergers, to increase the number of users and units produced in order to obtain economies of scale, and which do not involuntarily provide incentives to indulge in behaviour that is contrary to the objectives of local accountability and efficiency in the provision of public services;
    - take account, as far as possible, of demographic, geographical, social and economic features leading to disparities in costs.

50. The calculation formulae used to estimate spending needs should fulfil the following conditions:

- the weight afforded to the various individual indicators should be determined on the basis of objective information about the impact of variations in those indicators on the actual cost of local services;
- insofar as the assessment of needs nevertheless entails value judgments as to the weight to be afforded to the various indicators, it is necessary to identify and assess the results of these judgments in conjunction with representatives of the local authorities concerned or their associations;
- formulae for evaluating needs (models) should be as simple as possible, so that they are easy to understand and make for openness and accountability, but comprehensive and detailed enough to be reliable;
- formulae for evaluating needs should remain as stable as possible, to allow local authorities to make long-term forecasts and so that changes in estimated needs reflect genuine changes in the situation of local authorities over which they have no control.

51. The equalisation of spending needs should take account of as many local authority activities as possible, and in particular those that are very important or compulsory. A different formula should be drawn up for each spending need in respect of which equalisation is to apply.

c. Equalisation of financial capacity

52. The equalisation of (standardised) financial capacity should aim at reinforcing a deficient revenue base of a local government measured against a national yardstick (benchmark); such transfers should be unconditional general grants at the discretion of local authorities.

53. The estimate of the financial capacity of local authorities should preferably include all sources of revenue. The aim should be to gauge overall financial capacity.

54. Care should be taken to ensure that the equalisation of financial capacity does not undermine local self-government by, in practice, inducing authorities to provide the same level of services or apply the same taxation rates.

55. Equalisation of financial capacity should not deter local authorities from improving the tax base and ensuring efficient tax collection. The measurement of financial capacity for equalisation purposes should be based on the assumption that all local authorities levy taxes at the same rates and are equally efficient in assessing and collecting taxes, so that authorities are not penalised for the efforts they make or rewarded for laxity. This assumption should be used solely to calculate equalisation funds and should not undermine the authorities' right to vary the actual rates of

the taxes levied. Local authority decisions should not directly affect the amount of equalisation funds received or paid.

56. In contrast to the equalisation of spending needs, where there is more than one local tax, equalisation should not take place for each tax: a representative fiscal system should be devised that reflects the total local tax-raising potential. A resource equalisation fund should be set up and the money allocated according to discrepancies between the various authorities' tax capacity and the average tax capacity.

57. Actual fiscal pressure should not be used as indicator of the financial capacity.

5. Grants to local authorities

58. Grants are provided by the central authorities for various reasons and may take various forms. In general, they should be provided for by law or decided on in the light of clear criteria laid down by law. The government's discretion in calculating and effecting transfers should be reduced in order to avoid objectivity and credibility problems.

a. General grants

59. The higher authorities' contribution to local budgets should mainly take the form of general grants.

60. The sum total of such grants should:

    – cover the standardised cost of discharging delegated tasks and the structural shortfall in local authorities' resources in relation to their statutory responsibilities;

    – take account of such factors as demographic changes and economic circumstances such as economic growth and rising costs, particularly when the level of local authorities' own resources and their ability to influence these resources do not make it possible to adjust them to meet expenditure increases caused by economic factors;

    – take account of variations in costs generated by decisions taken at national level, in particular variations in such general factors as salaries and social security costs, minimum standards for local services and environmental protection standards applicable to local authorities.

61. States should assure local authorities of a degree of stability in this sum total, possibly by law or by virtue of arrangements designed to ensure economic stability, with the cooperation of all tiers of government. The sum total of transfers should

not be subject to frequent, arbitrary fluctuations when the state's annual budgets are drawn up.

62. Criteria for the allocation of general grants should be clearly defined by law, or at least in accordance with the legal framework, on a non-discretionary basis. This should enable local authorities to calculate in advance the amount of the grants they will receive and adopt their budgets accordingly.

63. Any major redistribution of resources between local authorities resulting from a substantial change in the criteria for calculating grants, sharing out taxes or equalisation formulae should take place gradually, over a sufficient number of years to allow local authorities to adapt their budgets to the new funding levels without any excessive transfer of services.

64. Local authorities should not be in a position to influence the amount of the general grants they receive, unless this is one of the explicit objectives of a particular grant.

b. Specific grants

65. Specific grants restrict local authorities' freedom of choice as regards policy, are less effective than general grants in making good shortfalls in resources in relation to responsibilities and are not very useful as equalisation tools. Recourse to specific grants should therefore generally be restricted to what is necessary to achieve the following objectives:

   – (co-)financing capital expenditure as part of balanced, sustainable regional development policies;

   – ensuring that certain local public services, for which minimum standards are laid down at national level, are provided at a standardised level throughout the country;

   – offsetting any centrality costs affecting the provision of certain local public services, insofar as they are not compensated for by horizontal transfer mechanisms, following voluntary agreements or statutory obligations;

   – financing certain public services that local authorities provide on behalf of the state or offsetting costs which local authorities incur when discharging responsibilities delegated by other authorities; while specific grants may be used for these purposes, particularly because they can serve as an incentive, general grants are often more effective; the central authorities should consider which solution is to be preferred, with due regard for local autonomy, in the particular situation in question.

66. Specific grants should generally be awarded on the basis of objective, transparent criteria related to spending needs. All the authorities eligible for such grants should be informed about the availability of funds and the relevant criteria and should be able to submit applications for such grants, which should be compared by means of transparent procedures.

67. Where specific grants are conditional upon financial contributions on the part of the authorities receiving them, the level of such contributions should be flexible so as to take account of the authorities' financial capacity. The central authorities should examine the possibilities of modulating the specific grants according to that capacity so that the financial effort, and not the financial input, of the authorities is comparable and the most disadvantaged authorities are not denied such grants.

6. Other financial resources

a. Fees and charges

68. Recourse to fees and charges can make a considerable contribution to local authority revenues. Their impact on the demand and on the access to services should, however, be examined.

69. Local authorities should be entitled to decide what to charge for the services they provide according to the situation and local preferences.

70. In the case of essential services, the central authorities may lay down minimum (quantitative and qualitative) standards and conditions of access for disadvantaged sections of the population (exemptions and subsidies).

71. If necessary, the central authorities may, in order to ensure equal access throughout the country, lay down maximum charges for essential services and minimum charges for convenience services.

b. Sundry resources

72. With regard to the sundry resources of local authorities (revenues from economic activities, property, investments, donations and legacies), and also to loans, states are invited to take note of the guidelines addressed to them in Recommendation Rec(2004)1 on financial and budgetary management at local and regional levels.

7. Borrowing

73. Local authorities should be able to borrow in order to finance their capital expenditure projects. Such projects are intended to benefit future generations, and recourse to borrowing may therefore make it possible to spread the burden fairly among generations. As future generations do not have a say in the choice of projects to be financed, however, financing through borrowing is mainly suitable for services for which the loan will be repaid by means of charges to users.

74. Except in the case of cash advances and in exceptional circumstances, local authorities should not be allowed to take out loans to finance current expenditure. Current expenditure benefits the current generations and financing it through loans would mean that the costs would be borne by future generations. In addition, financing current expenditure through borrowing would make elected representatives less accountable for the financial implications of their decisions.

75. Local authority access to borrowing may be restricted on account of national economic policy constraints, in order to limit the risk of non-repayment and to avoid decisions that would transfer an excessive financial burden to future generations. Any such restrictions should be fair, commensurate with the constraints in question, discussed in advance with the local authorities or their representatives and lifted as soon as the macro-economic situation permits.

76. In order to make decision-makers more accountable, local authorities should be held fully answerable for their decisions to resort to borrowing. The central authority should not offer guarantees for loans raised by local authorities, save in exceptional circumstances.

Part II – Guidelines for local authorities

1. General principles

1. Major decisions such as the establishment of taxation rates, charges payable by users for services provided and recourse to loans should be taken by the elected deliberative body (council or assembly) at a plenary meeting, and not delegated to the executive or a committee or other body subordinate to the elected deliberative body.

2. Financial and budgetary discussions should take place and the relevant decisions should be taken at meetings of the elected deliberative body that are open to the public.

3. The consequences of local authority decisions concerning sources of revenue should be made public. Budgetary documents should include overviews that are easy to understand on this topic.

4. In areas in which local authorities enjoy discretionary powers, major financial decisions should be grouped together and taken at specific intervals. In general, decisions concerning revenues and those concerning expenditure should be taken together when the budget is adopted and revised.

5. Associations of local authorities can play an important role in finding solutions that strike a balance between the various tiers of authority when national economic policy is framed; the same is true with regard to helping local authorities to draw up local tax regulations, for example.

6. Local authorities should use information technologies to improve managerial efficiency (collection and processing of information, preparation of decisions, follow-up to decisions). Priority should be given to "real-time", open, evolutive systems that are, where possible, interoperable with the authority's other systems and with systems established centrally or as a result of horizontal co-operation. Opportunities for payment by electronic means at a distance should be increased.

7. Local authorities should make sure to provide their staff with the various forms of training they are likely to need (legal, financial, fiscal, organisational, etc.) and regularly update key technical skills.

8. Local authorities should set up systems to enhance the professionalism and ethics of staff dealing with financial and, in particular, fiscal matters. They are invited to take note of the best practices pinpointed by the CDLR in the Public Ethics at Local Level Handbook, adopted at the Conference on Ethical Standards in the Public Sector, Noordwijkerhout (31 March-1 April 2004).

2. Local taxation

9. The basic principles for determining local taxation should be fairness (taxation should be commensurate with each taxpayer's ability to pay) and efficiency (a high yield and a low collection cost).

10. When they establish the level of local taxes, local authorities should do so as openly as possible, so that their decisions are clear to the public. Measures ensuring the transparency of fiscal decisions should include publishing (in paper and electronic version), posting up and possibly disseminating all draft fiscal decisions, the documents needed to understand them and the decisions actually taken.

11. Local authorities should vary the level of taxation only in order to adapt the level of services to local needs and preferences.

12. Local authorities should avoid introducing too many taxes, as this inevitably increases administration and is liable to increase the cost of collection, grounds for litigation, etc.

13. Although the incentive purpose of local taxation should not be overlooked, it should not render impossible activities that are otherwise lawful. Any incentive should respect the principle of the equality of citizens before the law. In such cases, the determination of the tax base, taxation rate and exemptions should be consistent with the objective pursued.

14. Untimely changes in the local tax framework that could cause excessive disruption to economic operators or households should be avoided.

15. The local authority should provide the public with information and explanations concerning any taxes in addition to tax levied by a higher authority. If they are exclusive taxes, it is up to the municipality to draw up its fiscal regulations and bring them to the attention of the public.

16. Local authorities should provide the public with comprehensive, readable information about the use made of tax revenues by the authority.

17. The means used to inform the public about local taxation should take account of specific local features: electronic publication, posters, direct mailing, telephone service, etc. Certain methods of prior consultation may also be useful, as may public meetings after the council has adopted regulations.

18. In the case of exclusive local taxes, the authorities should pay particular attention:

    – to ensuring that tax bands are both simple and fair;

    – to the quality of the drafting of tax regulations, particularly in small municipalities;

    – to tax avoidance and evasion mechanisms that may be prompted by local regulations.

19. Information on the tax base should be regularly updated and founded on factors that do not lend themselves to contestation. Cooperation between local authority departments should be arranged in order to obtain the necessary information (police, registry of births, marriages and deaths, etc). Cooperation with the higher authorities may enable local authorities to obtain the information needed to establish the tax base.

20. The bulk of local taxation should rest on a relatively stable tax base.

21. Registration and collection of local taxes right at the start of the financial year enable the municipality to have financial resources at its disposal earlier in the year and therefore to improve its cash flow. Steps should be taken to avoid delays that could lead to subsequent adjustments obliging taxpayers to pay, in the course of the same year, tax due in respect of several years. A system for following up unpaid taxes should be set up, both to protect the interests of the community and to take account of social situations.

22. Local taxes should require the least possible effort and the fewest possible formalities on the part of taxpayers, so that they do not inadvertently evade tax. Local taxation should not be based on taxpayers' prior tax returns.

23. Payment demands should allow taxpayers to check the accuracy of the information on which the amount of tax payable is based: tax base, rate, any exemptions, etc. The procedure to be followed for lodging a complaint should also be clearly mentioned, as should the procedure for requesting easy payment terms in the case of a sizeable tax.

24. Given the delays involved in court proceedings and the uncertainty surrounding such proceedings, it is desirable that litigation be reduced to a minimum. It is therefore recommended that every effort be made to limit it: laws and regulations should be clear, with few exemptions and special cases; it should be easy to obtain information; social situations in which easy payment terms are desirable should be identified, etc. Tax documents should mention the deadline for lodging a complaint, the method of doing so and the time-limit within which a decision should be taken and the possibility of appeal. Budgetary reserves should, where appropriate, be set aside to take account of trends in litigation.

25. Local authorities should carry out audits at regular intervals for each tax directly levied by the authority. Such audits should:

   – compare collection costs (and changes in such costs) with the proceeds from the tax;
   – indicate whether, for example, all taxpayers have been identified and whether they all pay the tax;
   – assess the incentive and discouraging role of any taxes that have such an objective.

3. Fees and charges

26. As a rule, charges should not exceed the cost of services and the local authority should not seek to make a paper profit from the provision of public services.

27. The charges applied should not reduce demand excessively, particularly in the case of important public services.

28. The choice between financing through charges (in which case users pay) and financing through taxes (in which case taxpayers pay) should be explicit and taken by the authorities with due regard for the specific features and preferences of each authority. It should be taken, for each service, in the light of considerations of fairness and equality.

29. Local authorities should make sure that access to essential services is preserved for the most disadvantaged sections of the population.

4. Other resources

30. Local authorities are invited to take account of the guidelines concerning other resources (borrowing, income from economic activities, property, investments, donations and legacies) addressed to them in Recommendation Rec(2004)1 of the Committee of Ministers on financial and budgetary management at local and regional levels.

31. Exceptional revenue should only be used to finance capital expenditure and the reimbursement of debt.

European Charter of Local Self-Government

Strasbourg, 15 October 1985

Preamble

The member States of the Council of Europe, signatory hereto,

Considering that the aim of the Council of Europe is to achieve a greater unity between its members for the purpose of safeguarding and realising the ideals and principles which are their common heritage;

Considering that one of the methods by which this aim is to be achieved is through agreements in the administrative field;

Considering that the local authorities are one of the main foundations of any democratic regime;

Considering that the right of citizens to participate in the conduct of public affairs is one of the democratic principles that are shared by all member States of the Council of Europe;

Considering that it is at local level that this right can be most directly exercised;

Convinced that the existence of local authorities with real responsibilities can provide an administration which is both effective and close to the citizen;

Aware that the safeguarding and reinforcement of local self-government in the different European countries is an important contribution to the construction of a Europe based on the principles of democracy and the decentralisation of power;

Asserting that this entails the existence of local authorities endowed with democratically constituted decision-making bodies and possessing a wide degree of autonomy with regard to their responsibilities, the ways and means by which those responsibilities are exercised and the resources required for their fulfilment,

Have agreed as follows:

Article 1

The Parties undertake to consider themselves bound by the following articles in the manner and to the extent prescribed in Article 12 of this Charter.

Part I

Article 2 – Constitutional and legal foundation for local self-government

The principle of local self-government shall be recognised in domestic legislation, and where practicable in the constitution.

Article 3 – Concept of local self-government

1. Local self-government denotes the right and the ability of local authorities, within the limits of the law, to regulate and manage a substantial share of public affairs under their own responsibility and in the interests of the local population.
2. This right shall be exercised by councils or assemblies composed of members freely elected by secret ballot on the basis of direct, equal, universal suffrage, and which may possess executive organs responsible to them. This provision shall in no way affect recourse to assemblies of citizens, referendums or any other form of direct citizen participation where it is permitted by statute.

Article 4 – Scope of local self-government

1. The basic powers and responsibilities of local authorities shall be prescribed by the constitution or by statute. However, this provision shall not prevent the attribution to local authorities of powers and responsibilities for specific purposes in accordance with the law.
2. Local authorities shall, within the limits of the law, have full discretion to exercise their initiative with regard to any matter which is not excluded from their competence nor assigned to any other authority.
3. Public responsibilities shall generally be exercised, in preference, by those authorities which are closest to the citizen. Allocation of responsibility to another authority should weigh up the extent and nature of the task and requirements of efficiency and economy.
4. Powers given to local authorities shall normally be full and exclusive. They may not be undermined or limited by another, central or regional, authority except as provided for by the law.
5. Where powers are delegated to them by a central or regional authority, local authorities shall, insofar as possible, be allowed discretion in adapting their exercise to local conditions.

6. Local authorities shall be consulted, insofar as possible, in due time and in an appropriate way in the planning and decision-making processes for all matters which concern them directly.

Article 5 – Protection of local authority boundaries

Changes in local authority boundaries shall not be made without prior consultation of the local communities concerned, possibly by means of a referendum where this is permitted by statute.

Article 6 – Appropriate administrative structures and resources for the tasks of local authorities

1. Without prejudice to more general statutory provisions, local authorities shall be able to determine their own internal administrative structures in order to adapt them to local needs and ensure effective management.
2. The conditions of service of local government employees shall be such as to permit the recruitment of high-quality staff on the basis of merit and competence; to this end adequate training opportunities, remuneration and career prospects shall be provided.

Article 7 – Conditions under which responsibilities at local level are exercised

1. The conditions of office of local elected representatives shall provide for free exercise of their functions.
2. They shall allow for appropriate financial compensation for expenses incurred in the exercise of the office in question as well as, where appropriate, compensation for loss of earnings or remuneration for work done and corresponding social welfare protection.
3. Any functions and activities which are deemed incompatible with the holding of local elective office shall be determined by statute or fundamental legal principles.

Article 8 – Administrative supervision of local authorities' activities

1. Any administrative supervision of local authorities may only be exercised according to such procedures and in such cases as are provided for by the constitution or by statute.

2. Any administrative supervision of the activities of the local authorities shall normally aim only at ensuring compliance with the law and with constitutional principles. Administrative supervision may however be exercised with regard to expediency by higher-level authorities in respect of tasks the execution of which is delegated to local authorities.
3. Administrative supervision of local authorities shall be exercised in such a way as to ensure that the intervention of the controlling authority is kept in proportion to the importance of the interests which it is intended to protect.

Article 9 – Financial resources of local authorities

1. Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers.
2. Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the law.
3. Part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate.
4. The financial systems on which resources available to local authorities are based shall be of a sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks.
5. The protection of financially weaker local authorities calls for the institution of financial equalisation procedures or equivalent measures which are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden they must support. Such procedures or measures shall not diminish the discretion local authorities may exercise within their own sphere of responsibility.
6. Local authorities shall be consulted, in an appropriate manner, on the way in which redistributed resources are to be allocated to them.
7. As far as possible, grants to local authorities shall not be earmarked for the financing of specific projects. The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction.
8. For the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law.

Article 10 – Local authorities' right to associate

1. Local authorities shall be entitled, in exercising their powers, to co-operate and, within the framework of the law, to form consortia with other local authorities in order to carry out tasks of common interest.
2. The entitlement of local authorities to belong to an association for the protection and promotion of their common interests and to belong to an international association of local authorities shall be recognised in each State.
3. Local authorities shall be entitled, under such conditions as may be provided for by the law, to co-operate with their counterparts in other States.

Article 11 – Legal protection of local self-government

Local authorities shall have the right of recourse to a judicial remedy in order to secure free exercise of their powers and respect for such principles of local self-government as are enshrined in the constitution or domestic legislation.

Part II – Miscellaneous Provisions

Article 12 – Undertakings

1. Each Party undertakes to consider itself bound by at least twenty paragraphs of Part I of the Charter, at least ten of which shall be selected from among the following paragraphs:
   - Article 2,
   - Article 3, paragraphs 1 and 2,
   - Article 4, paragraphs 1, 2 and 4,
   - Article 5,
   - Article 7, paragraph 1,
   - Article 8, paragraph 2,
   - Article 9, paragraphs 1, 2 and 3,
   - Article 10, paragraph 1,
   - Article 11.
2. Each Contracting State, when depositing its instrument of ratification, acceptance or approval, shall notify to the Secretary General of the Council of Europe

of the paragraphs selected in accordance with the provisions of paragraph 1 of this article.

3. Any Party may, at any later time, notify the Secretary General that it considers itself bound by any paragraphs of this Charter which it has not already accepted under the terms of paragraph 1 of this article. Such undertakings subsequently given shall be deemed to be an integral part of the ratification, acceptance or approval of the Party so notifying, and shall have the same effect as from the first day of the month following the expiration of a period of three months after the date of the receipt of the notification by the Secretary General.

Article 13 – Authorities to which the Charter applies

The principles of local self-government contained in the present Charter apply to all the categories of local authorities existing within the territory of the Party. However, each Party may, when depositing its instrument of ratification, acceptance or approval, specify the categories of local or regional authorities to which it intends to confine the scope of the Charter or which it intends to exclude from its scope. It may also include further categories of local or regional authorities within the scope of the Charter by subsequent notification to the Secretary General of the Council of Europe.

Article 14 – Provision of information

Each Party shall forward to the Secretary General of the Council of Europe all relevant information concerning legislative provisions and other measures taken by it for the purposes of complying with the terms of this Charter.

Part III

Article 15 – Signature, ratification and entry into force

1. This Charter shall be open for signature by the member States of the Council of Europe. It is subject to ratification, acceptance or approval. Instruments of ratification, acceptance or approval shall be deposited with the Secretary General of the Council of Europe.

2. This Charter shall enter into force on the first day of the month following the expiration of a period of three months after the date on which four member States of the Council of Europe have expressed their consent to be bound by the Charter in accordance with the provisions of the preceding paragraph.

3. In respect of any member State which subsequently expresses its consent to be bound by it, the Charter shall enter into force on the first day of the month following the expiration of a period of three months after the date of the deposit of the instrument of ratification, acceptance or approval.

Article 16 – Territorial clause

1. Any State may, at the time of signature or when depositing its instrument of ratification, acceptance, approval or accession, specify the territory or territories to which this Charter shall apply.
2. Any State may at any later date, by a declaration addressed to the Secretary General of the Council of Europe, extend the application of this Charter to any other territory specified in the declaration. In respect of such territory the Charter shall enter into force on the first day of the month following the expiration of a period of three months after the date of receipt of such declaration by the Secretary General.
3. Any declaration made under the two preceding paragraphs may, in respect of any territory specified in such declaration, be withdrawn by a notification addressed to the Secretary General. The withdrawal shall become effective on the first day of the month following the expiration of a period of six months after the date of receipt of such notification by the Secretary General.

Article 17 – Denunciation

1. Any Party may denounce this Charter at any time after the expiration of a period of five years from the date on which the Charter entered into force for it. Six months' notice shall be given to the Secretary General of the Council of Europe. Such denunciation shall not affect the validity of the Charter in respect of the other Parties provided that at all times there are not less than four such Parties.
2. Any Party may, in accordance with the provisions set out in the preceding paragraph, denounce any paragraph of Part I of the Charter accepted by it provided that the Party remains bound by the number and type of paragraphs stipulated in Article 12, paragraph 1. Any Party which, upon denouncing a paragraph, no longer meets the requirements of Article 12, paragraph 1, shall be considered as also having denounced the Charter itself.

Article 18 – Notifications

The Secretary General of the Council of Europe shall notify the member States of the Council of Europe of:

- any signature;
- the deposit of any instrument of ratification, acceptance or approval;
- any date of entry into force of this Charter in accordance with Article 15;
- any notification received in application of the provisions of Article 12, paragraphs 2 and 3;
- any notification received in application of the provisions of Article 13;
- any other act, notification or communication relating to this Charter.

In witness whereof the undersigned, being duly authorised thereto, have signed this Charter.

Done at Strasbourg, this 15th day of October 1985, in English and French, both texts being equally authentic, in a single copy which shall be deposited in the archives of the Council of Europe. The Secretary General of the Council of Europe shall transmit certified copies to each member State of the Council of Europe.

Acknowledgements

This report has been prepared by an editorial group composed of OSF and former LGI experts Ken Davey, Sorin Ionita, Gabor Peteri, Katalin Tausz, CDLR representatives Joe Allen (Ireland) and Markku Mollari (Finland), and independent experts Paul Bernd Spahn and Jorgen Lotz.

The group is grateful to members of the OECD Network on Fiscal Relations across Levels of Government and CEMR members for responses to the 2011 survey, to Dexia for providing insight to their report *Subnational Public Finance in the European Union* analysing EUROSTAT data.

The data for this research was supplied by the governments of the respective countries and with the assistance of the following team of country observers:

Country	*Observer*
Albania	Fran Brahimi
Armenia	David Tumanyan
Bosnia and Herzegovina	Dario Vins and Zdravko Miovcic
Bulgaria	Yana Kirilova
Croatia	Anto Bajo
Czech Republic	Vera Kamenickova
Estonia	Katarina Rebane, Risto Kaarna
Georgia	David Melua
Hungary	Gabor Peteri
Latvia	Sanita Skiltere
Moldova	Sorin Ionita
Poland	Julita Łukomska
Romania	Sorin Ionita

Country	*Observer*
Russian Federation	Irina Turgel and Elena Tselishcheva
Serbia	Dusan Vasilievic
Slovakia	Ján Marušinec
Ukraine	Katerina Maynziuk and Yuriy Dzhgyr

We would like to thank to the governments and CDLR members from Albania, Armenia, Austria, Belgium, Bulgaria, Croatia, Czech republic, Denmark, Estonia, Finland, France, Germany, Hungary, Ireland, Latvia, Luxembourg, Moldova, Monaco, Norway, Portugal, Russia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey, Ukraine, and the United Kingdom for providing the data used as reference for this report, and to all CDLR members for the valuable comments on the relevance of the policy options discussed.

How have local budgets fared in the recession? And, more importantly, how are local governments across Europe coping with the prevailing fiscal crisis? What, if anything, can be done to minimise harm to the public services they perform?

In 2009, ministers of local and regional government decided in Utrecht to make the financial crisis the priority issue for their conference. The response was a fully fledged set of guidelines to be used as a source of inspiration for domestic policies aimed at tackling the crisis.

The ministers returned to the issue two years later in Kyiv. The crisis has since deepened and encompassed sovereign debt and the very future of the Euro; the epicenter is no longer the Baltic but the Mediterranean, having skirted the Atlantic on the way. Meanwhile, the numbers involved have grown exponentially.

The ministers adopted an updated set of rules, believing in coordinated action and supporting local governments to fight recession and sustain the most vulnerable. Although extreme uncertainty surrounds the future, we do know the challenges that will persist: youth unemployment is 20 per cent and rising, the proportion of the population over 65 will grow by half over the next four decades, and targets to cut CO_2 emissions are not being met.

So how can local government live with these challenges and threats?

Three strategic responses have emerged over the last three years. The first goal should be to build greater stability into local budget revenue bases. Second, local governments have to make the most of limited resources and they are already doing this in several ways. The third strategic response is increased partnership in meeting economic, social and environmental challenges – partnership with other public authorities, with business, social enterprise, universities and research institutions, voluntary bodies and whoever has resources, knowledge and energy to contribute. Keeping local economies ahead of the game is a major challenge.

So is there light at the end of the tunnel?

These issues are addressed in the report presented to ministers responsible for local and regional government at their 17th Council of Europe conference in Kyiv in November 2011. The analysis was prepared by a team convened by the Open Society Foundations and the Council of Europe's Committee on Local and Regional Democracy (CDLR), as part of their established collaboration. It was based on end-of-year data for 2010 and a survey of policy responses conducted by observers in Council of Europe member countries.

With funding from

OPEN SOCIETY FOUNDATIONS

COUNCIL OF EUROPE CONSEIL DE L'EUROPE