

Center of Expertise for Local Government Reform Local Finance Benchmarking Programme



Good local government depends on sufficient financial resources, which allow local authorities to offer services that are adjusted to their citizen's expectations, and on good financial management procedures, ensuring local budgetary flexibility and accountability of financial decisions. The Council of Europe's Committee of Ministers adopted two very important and complex recommendations. OECD, IMF, the World Bank and OSF were involved in the preparation of these recommendations. Together with Article 9 of the European Charter of Local Self-Government they constitute the Council of Europe's legal *acquis* in the field of local finance.

The two recommendations on local government finances are, as follows:

- (i) Financial Resources of Local and Regional Authorities Rec(2005)¹ and
- (ii) Financial and Budgetary Management at Local and Regional Levels Rec(2004)¹,

They focus on the central and local authorities, separating the recommendations by tiers of government.

Based on this *acquis*, the Centre of Expertise developed a Local Finance Benchmarking Tool, addressing both local and central authorities. The local component of this tool was first piloted in five municipalities of Bulgaria, in co-operation with the National Association of Municipalities (NAMRB), then in Ukraine (ten pilot cities) and later in seven cities of Greece, Portugal and Spain. Presently it is being implemented in the Bizkaia region of the Basque country.

The standard Local Finance Benchmarking tool and the first lessons of its implementation, was published in the Toolkit III. "Benchmarking for Public Ethics and Local Finance" by the Centre of Expertise. Later the local benchmarking toolkit component was supplemented with new items focusing on the aspects highlighted by the impact of the economic downturn¹.

Benchmarking as an analytical and planning tool

Benchmarking is primarily used for diagnostic purposes, when scoring and quantifiable results help to specify the areas of intervention and improvements by prioritising policy development actions. Focusing on local government resources, expenditures and financial management, this tool helps the national and the local governments to identify the factors of equitable system of intergovernmental fiscal relations, efficient local finances and effective local government financial management.

Both national and local level benchmarking support evidence based decision making. The assessment of local government finance systems (country level benchmarking) provides assistance to fiscal policy making and decentralisation. Local government level benchmarking helps elected officials and the city administration for designing local interventions, better targeting municipal actions in local finances and financial management.

Local Finance Benchmarking is based on external experts' diagnosis, so it is not a self-assessment tool. The benchmarks on financial resources and financial management use two types of assessment methods: surveys and finance indicators.

Local finance benchmarking survey

The benchmarks are grouped according to logical sub-groups of the recommendations on financial resources and financial management. Each benchmark is identified by activities,

¹ All the LFB documents are available on the project website:
http://www.coe.int/t/dgap/localdemocracy/Centre_Expertise/Local_Finance_Benchmarking/

which are the measurable elements of the recommendation. The actual benchmarks are formulated in two ways: (i) by specifying the assessment criteria of the recommendation or (ii) by providing indicators for evaluating their accomplishment. For helping the benchmarkers and to verify their statements, also the typical sources of information are identified. Each benchmark survey item is assessed on a ten-unit-scale. These scores are linked to individual recommendations or to the sub-group of recommendations.

Local finance dataset

The local finance dataset is an integral part of the LFB methodology. The datasets are needed for creating indicators, which help to assess the local tax policies, dependence on central budget transfers, and efficiency of expenditures and some financial aspects of capital investment financing. All these issues are subjects of the LFB survey, so the financial data make the actual scoring more objective. The fiscal data are supplemented by statistical information, which is used for calculating indicators, such as per capita revenues, unit costs, etc. This fiscal dataset is an important by-product of the LFB project measuring revenue autonomy and local government expenditures.

Targeted areas of local finance benchmarking

Financial resources

Both national and local benchmarks start by assessing some general principles of local government revenue assignment: how objectives of intergovernmental fiscal relations are met, which principles of own source revenue allocation and tax sharing are followed. Local taxes are critical conditions of local fiscal autonomy, so the scope of own source revenues, powers in local tax policy design and tax administration are the key areas of benchmarking. Fiscal equalization methods and grant allocation techniques are the two main areas of assessing fiscal decentralization (country level benchmarks). In the case of local finance benchmarks the local user charges and the methods of local asset management are also targeted. Regulations on local government borrowing, as critical sources of capital investment financing are also evaluated.

Financial management

Local public financial management aims to build a proper balance between municipal autonomous decisions and national control for sound, safe management of local services and budgets. Transparency in financial management is critical for local accountability. Fiscal planning and budgeting are the priority areas of local benchmarking. Budget implementation require assessment of fiscal risks, spending regulations over subsidiary entities, based on reliable fiscal information, accounting systems, audited reports of local service performance and local finances.

Implementation of LFB projects

Main outputs of local finance benchmarking are reports either on the local government finances in a country (the national level benchmarks) or on the assessment of finances at sub-national level (the local level benchmarks). These reports are primarily prepared for the relevant government officials, and, if participating authorities decide so, they can be made public. In the case of the local level benchmarks the impact of financial assessment will be greater if local councils, elected officials and the general public are all informed about the results. However, the two main outputs of the local finance benchmarking might be treated differently: the fiscal database with various indicators could be made fully public, while specific city reports might be kept confidential.

Institutionalisation of LFB is critical, because local level finance benchmarks are usually introduced over a longer piloting and dissemination period. Regular updating of fiscal data,

broadening of the comparative information and advocacy requires expertise and also a stable host organisation is needed.

Successful LFB programme in each country is ideally supported by a small Steering Group composed of the representatives of local government associations, the government and the Centre of Expertise. This Steering Group will define the main areas of benchmarking, invites the participating municipalities and local experts, overviews the programme and formulates general recommendations.

Implementation of a local finance benchmarking programme – either at national or at local level – consists of the following major steps:

1. *adaption* of the Council of Europe toolkit on local finance benchmarks to the specific country needs and legislation, in collaboration with the Council of Europe international expert,
2. *training* of minimum three local experts per country, selected by the partner organisations (ministry, local governments association) to develop the benchmarks and methodology for piloting,
3. *external evaluation* of fiscal regulations and financial management practices, identification of the areas for improvement by the local expert team.
4. *developing the local finance database*, including indicators characterizing local government revenue structure and expenditures,
5. *implementing the benchmarking survey*, preferably in two stages: as pilots and following the necessary corrections by using the tested, final methodology. The local assessments should be supplemented by information on municipal finances and service performance collected from other sources.
6. *writing brief assessment reports* and recommendations both for policy makers (local government associations, ministries, etc.) and in the case of local benchmarking for the participating local governments. The final report with findings of the benchmarking process (evaluation, comments, suggestions, recommendations for the follow-up, sustainability of the benchmarking survey and reporting back) will be presented to and adopted by the Steering Group.
7. *conferences and other visibility actions* are organized to present the main results, to raise awareness about the importance of the process and to exchange experiences among the participants and other interested parties.

Expertise needed for local finance benchmarking are, as follows:

- a) specialisation in local government finances, with knowledge of intergovernmental fiscal relations, local government revenue generation, financial management, including budgeting, accounting, cash management;
- b) expertise in local administration and procedures, with good understanding of legal, administrative and organisational, management issues within the domestic political-administrative system;
- c) capacity to cooperate with ministry and city administration;
- d) ability to support peer learning of the partners and the participating cities through discussion of the benchmarking results and by exchanging good practices.