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# Coping with the debt burden: local authorities in financial difficulty

Governance Committee

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## Summary

The right of local authorities to adequate financial resources of their own is a key principle of local autonomy, enshrined in Article 9 of the European Charter of Local Self-Government.

Following Congress Resolution 372(2014) and Recommendation 362(2014), this report discusses the scope of the financial autonomy of local authorities, and their ability to raise their own revenues and finance their mandatory tasks and functions. It explores to what extent the adequacy principle and the right of local authorities to be consulted, as enshrined in the European Charter of Local Self-Government, are implemented.

In its resolution, the Congress regrets the lack of progress in implementing its 2014 recommendations on this issue. It notes that several member States still have no constitutional or legal recognition or guarantee of sufficient municipal finance, and that, even where local authorities are free to provide services or to generate their own revenues, the latter are often insufficient to cover the cost of services. It commits to keeping under review those countries which are not meeting their commitments under Article 9 of the Charter and to undertaking, where possible, post-monitoring and co-operation activities to improve the situation.

In its recommendation, it asks the Committee of Ministers to call on governments to increase their efforts to ensure full implementation of Article 9, notably through dialogue and consultations with local authorities and their national associations.

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1 L: Chamber of Local Authorities / R: Chamber of Regions  
 EPP/CCE: European People's Party Group in the Congress  
 SOC: Socialist Group  
 ILDG: Independent and Liberal Democrat Group  
 ECR: European Conservatives and Reformists Group  
 NR: Members not belonging to a political group of the Congress

**RESOLUTION 438 (2018)<sup>2</sup>**

1. The right of local authorities to adequate financial resources of their own is a key principle of the European Charter of Local Self-Government. It also introduces the principle of proportionality, providing that any transfer or delegation of additional or non-statutory jurisdiction must be accompanied by resources corresponding to the new powers and services to be provided. However, these principles are rarely applied or implemented in Council of Europe member States.

2. In most member States, the explicit recognition of the principle of adequate financial resources is not included in the Constitution, but is guaranteed by law. However, even where the principle enjoys legal recognition, it is often not very directive. It is difficult to take cases to court, because financial autonomy appears to be more a political issue than a matter for the courts. Finally, some member States do not offer any recognition or guarantee, constitutional or legal, of the principle of sufficient funding.

3. If partial or indirect data, such as the share of GDP or public expenditure, can be used to determine to a certain extent the degree of financial autonomy of local authorities, a common definition of the concepts mentioned in Article 9 of the Charter would appear to be necessary.

4. Local taxation is a key element of the financial autonomy of local authorities, as genuinely local taxes allow municipalities to base their revenues on their own decisions. The capacity of local governments to generate revenue is thus an excellent indicator of their financial autonomy. There is a strong correlation between the degree of financial autonomy and the ratio of own resources to central government transfers. The greater the share of local revenues in the local authorities total budget, the greater their financial independence and the more they can finance their activities themselves. Similarly, the municipalities financial autonomy is all the greater as the ratio of overall/lump sum allocations to specific or reserved allocations is high.

5. The Charter enshrines the right of local authorities to be consulted on the way that resources are allocated or redistributed to them. While the existence of a formal consultation procedure, even with a legal basis, does not in itself guarantee that genuine consultation takes place, it is preferable that clear, predictable, effective, transparent, open and inclusive methods of consultation are put in place in all member States, in accordance with their legal and constitutional traditions.

6. The Charter expressly provides that local authorities should have the right of recourse to a judicial remedy if they consider that the central authority or another administration does not respect the principle of local self-government, and in particular their financial autonomy. In most Council of Europe member States, these cases fall within the competence of constitutional, administrative or ordinary courts. These remedies are, however, generally difficult to implement, as the Charter does not define in a precise and detailed manner the principle of sufficient funding and the corresponding national legislation and budgetary allocation procedures are often non-existent.

7. In view of the above, the Congress,

a. bearing in mind Resolution 372 (2014) and Recommendation 362 (2014) "Adequate financial resources for local authorities";

b. noting that the share of municipal own resources varies considerably from one member State to another, as does the development of the ratio between central government allocations and local revenues;

c. regretting that in several member States, notably Ireland, Liechtenstein and the United Kingdom, there is no constitutional or legal recognition or guarantee of sufficient municipal finance;

d. noting that in several member States, such as Albania, England (in the United Kingdom), Greece, Hungary, Montenegro, and Romania, even where local authorities are free to provide services or to dispose of revenues generated at the local level, the latter are no longer sufficient to cover the cost of services, thus going against the principle of proportionality;

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<sup>2</sup> Debated and adopted by the Congress on 8 November 2018, 3rd sitting (see Document [CG35\(2018\)21](#), explanatory memorandum), rapporteur: Heather McVEY, United Kingdom (L, SOC).

- e. concerned at the reduction, in some cases, of local revenues resulting from centralisation and/or deconcentration processes;
- f. regretting that in some member States, such as Cyprus, England (and to a lesser extent the rest of the United Kingdom) and Hungary, the consequences of the 2008 financial crisis have led to a massive reduction in municipal funding both in absolute and in relative terms;
- g. noting with concern that the fiscal capacity of local authorities is extremely limited in Greece, Latvia and Romania;
- h. noting that reserved allocations remain predominant in several countries, posing a threat to the financial and even the political autonomy of municipalities;
- i. noting that Ireland, Liechtenstein and the United Kingdom do not have legal rules and sometimes not even written rules on the subject of consultation of local authorities by higher levels of government;
- j. regretting that, while a number of member States have made significant progress, almost all the recommendations made by the Congress in 2014 could be repeated for those countries which follow the provisions of Article 9 only reluctantly, or simply ignore them;
- k. fearing that, in the absence of sanctions, even in the event of a clear violation of the provisions of the Charter, no positive change can be expected in the near future from member States recalcitrant to implementing the provisions of Article 9;
- l. regretting that neither the Council of Europe nor the European Union has reliable and comparable economic data on the financial resources of the municipalities of its member States, limiting the establishment of international comparisons, and impacting the quality of macroeconomic and economic decisions regarding international economic governance frameworks;
8. calls on its Monitoring Committee to continue to pay attention to countries that are not meeting their commitments under Article 9 of the Charter and to undertake, where possible, post-monitoring and co-operation activities to improve the situation;
9. calls on national associations of local and regional authorities to:
- a. promote a real culture of partnership, consultation and co-production of political and budgetary decisions between national and local authorities;
- b. engage or continue their discussions with their regional and national governments, so that predictable, effective, results-oriented, equitable, open and inclusive methods of consultation are put in place, while respecting the legal and constitutional traditions of each member State;
- c. promote the transparency of the criteria and methods used to calculate central government allocations and financial equalisation so that they and the local authorities can verify the calculation process and be consulted.

### **RECOMMENDATION 427 (2018)<sup>3</sup>**

1. Article 9 of the European Charter of Local Self-Government, regarding the entitlement of local authorities to adequate financial resources, constitutes a cornerstone of the Charter, safeguarding the right of local authorities to adequate and commensurate financial resources of their own, within national economic policy.

2. Unfortunately, the importance assigned to Article 9 is not suitably reflected within the legislation of many member States. The non-implementation of Article 9 is related to an over-centralisation of the financing of local authorities, a limited level of own income and a lack of financial resources that are freely available to local and regional authorities to exercise their powers.

3. Financial autonomy nevertheless remains an essential aspect of local autonomy and local democracy. It is crucial to allow for local authorities to perform their tasks and plan long-term successfully.

4. The discordance between the importance of Article 9 and its application has been addressed many times by the Congress, and remains one of the outstanding recurring issues identified by the Congress in its monitoring of the Charter.

5. In the light of the above, the Congress:

a. recalls its Recommendation 362 (2014), to which the Committee of Ministers replied on 17 June 2015;

b. recalls its Resolution 372 (2014), in which it asked its Governance Committee to “undertake, within the next four years, a review of those countries which are facing particular problems meeting their undertakings under Article 9”;

c. regrets that in 12 member States no change has been observed concerning the efficient implementation of Article 9;

d. regrets that the explanatory memorandum to this recommendation and its recent monitoring reports reveal flagrant violations of Article 9 by some member States;

e. takes up the Committee of Ministers’ offer for dialogue of the issue of the financial difficulties of local authorities in relation with the non-implementation of Article 9;

6. The Congress invites the Committee of Minister to call on member States to:

a. increase their efforts to ensure full implementation of Article 9 through dialogue and consultations with local authorities and their national associations;

b. adopt a common understanding of the financial autonomy of local authorities, notably ensuring that:

i. municipalities can fully comply with their mandatory tasks and functions with the resources at their disposal;

ii. municipalities can have a degree of discretion in expenditure and make choices over own and transferred resources that enable them to adapt them to local circumstances;

iii. the share of their revenues that is raised locally is commensurate with their competences and enables them to provide services that are suited to the needs of their communities;

c. guarantee the financial autonomy of their local authorities, with the aim of reinforcing local democracy within their countries.

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<sup>3</sup> See footnote 2

## EXPLANATORY MEMORANDUM

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## Introduction<sup>4</sup>

1. As a consequence of Congress Resolution 372 (2014), the Terms of Reference of the Governance Committee of the Congress of Local and Regional Authorities has scheduled the preparation of a report on the adequate financial resources for local authorities as a basic requirement of the European Charter of Local Self Government.<sup>5</sup> In fact, the examination of the implementation of Article 9 paras. 1-4 of the Charter is a recurrent topic in the work of both the Committee and the whole Congress. The Congress Resolution cited above and the connecting Congress recommendation<sup>6</sup> were adopted after a comprehensive survey conducted by the Group of Independent Experts (GIE) in 2013. The main goals of that survey were to review the different financial systems on which resources available to local authorities are based, to look at how the principle of “adequate resources” is defined within the national economic policy, and, last but not least, to assess whether the financial resources were sufficiently diversified and buoyant in the face of the world financial crisis after 2008.

2. Considering and evaluating the experiences of this survey, the Congress, in its Resolution 372 (2014) agreed to make a new report which can be used as the basis of discussions with the Committee of Ministers, in order to raise awareness of the need in Council of Europe member States to improve the consultation processes between the different levels of government to ensure a better match between competences and resources. The Congress noted that a number of country reports on monitoring the implementation of the Charter had identified the lack of adequate financial resources of local authorities, and received complaints from national associations that many local authorities are facing increasing difficulties to cover their mandatory tasks and functions. Thus, the Congress Resolution declared that the new report should also focus on countries facing particular problems of local government funding.

3. For this purpose, the Group of Independent Experts prepared a detailed questionnaire on the situation of local government funding in the Member States with special regard to the financial problems of local authorities, and sent it to the national experts. Having regard to the difficulties for determining in advance in which countries are local authorities in poor financial situation, the Group of Independent Experts decided in its meeting held in September 2016 that all member States should be involved in this research. On the basis of the empirical data and information provided in the replies, Prof. Zoltán Szente, the vice-president of GIE has prepared this report.

4. This report has the basic objectives as follows:

- to analyse and describe how Resolution 372(2014) and Recommendations 362(2014) on this topic have been implemented by the member countries;
- to reveal to what extent are local authorities to raise their revenues, and
- to offer and suggest techniques as ‘best practices’ applied successfully to the financial difficulties of local authorities in certain member States.

5. The underlying research of the report had to face the same methodological problems as the earlier ones,<sup>7</sup> due to the highly different local government financial systems of the various countries. The basic problem is that the general and abstract concepts of the Charter, like “adequate financial resources”, “commensurability” of finance and tasks or “local taxes”, are used in different ways in the member States. Moreover, the question whether the finance of local authorities is really adequate to their mandatory tasks and functions, largely depends on the national circumstances. However, we can use the relatively standard terminology that has been elaborated by the GIE in the previous years, and

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4 This report has been prepared by Zoltan Szente on the basis of contributions by: Edlir Vokopola (Albania), Anna Gamper (Austria), Aydin Aslanov (Azerbaijan), George Coucounis (Cyprus), Stanislav Kadecka (Czech Republic), Vibeke Vinten (Denmark), Vallo Olle (Estonia), Heikki Kulla (Finland), Michel Verpeaux (France), Veith Mehde (Germany), Nikos Chlepas (Greece), Mark Callahan (Ireland), Francesco Palermo (Italy), Iveta Reinholde (Latvia), Wilfried Marxer (Liechtenstein), Aiste Lazauskiene (Lithuania), Ronald Mayer (Luxembourg), Nathalie Aureglia-Carusso (Monaco), Slaven Lekic (Montenegro), Harald Baldersheim (Norway), Elena Tanasescu (Romania), Jelena Jerinic (Serbia), Tomas Cernenko (Slovakia), Iztok Rakar (Slovenia), Reto Steiner (Switzerland), Gordana Siljanovska Davkova (“the former Yugoslav Republic of Macedonia”) and Jon Bloomfield (United Kingdom).

5 CG/GOV01(2016)04.

6 Recommendation 362(2014).

7 The first relevant study was made by Professor Alain Delcamp in The financial resources of local authorities in relation to their responsibilities (Application of Articles 9 and 4, paragraphs 4 and 5, of the European Charter of Local Self-Government) - CPL (5) 4 Part II.

we can trust the experience and skills of the GIE members to make contributions to a comparative study of this issue, as well as to evaluate the national situation in the light of the Charter.

6. It is to be noted, that according to the decision of the GIE, this research has covered only the municipal level of self-governments. Although the finance of regional governments might have to cope with similar problems, the study of their financial situation would require a separate survey.

## 1. General part

### 1.1. *The incorporation of the principle of adequate finance of local authorities in the national (or federal state) legal system(s)*

7. Although the explicit constitutional recognition of the principle of adequate finance is not a requirement of the Charter, the Congress Resolution 372 (2014) (hereinafter Resolution) declares that the “constitutional incorporation of that principle is the most powerful legal instrument to protect municipal interests”. In most cases, if a national constitution recognises the principle, this requirement also appears in statutory law, which is reasonable, as the basic laws usually contain rather general references to adequate finance.

8. The principle is explicitly acknowledged only in a few member States. In Germany, the constitutions of the Länder incorporate the principle of adequate finances. The constitutional courts of the Länder accept such a right irrespective of the concrete wording or the Land’s constitution. The relevant constitutional provision does not remain a vague and meaningless declaration either, because its content and requirements are specified by law.

9. The commensurability principle is also recognised by the Greek Constitution of 1975 and it has been further strengthened through constitutional amendments later on. More precisely, the Constitution explicitly adopts this principle stating that “the State shall adopt the legislative, regulatory and fiscal measures required for ensuring the financial independence and the funds necessary to the fulfilment of the mission and exercise of the competences of local government agencies, ensuring at the same time the transparency in the management of such funds. (...) Every transfer of competences from central or regional administrations of the State to local government also entails the transfer of the corresponding funds. Matters pertaining to the determination and collection of local revenues directly from local government agencies shall be specified by law” (Art. 102, para 5). This safeguard appears in statutory law as well. When a law transferred new responsibilities to municipalities in 2010, it also prescribed supplementary funds from the central budget for local authorities if their revenues do not cover the costs of the new tasks.

10. The Italian Constitution in its Art. 119 para. 4 is also said to acknowledge this principle declaring that local revenues “shall enable the Municipalities, Provinces, the Metropolitan Cities and Regions to finance integrally the public functions attributed to them”.

11. The Constitution of Slovenia refers in a similarly indirect way to the principle of adequate finance stating that “Municipalities that are unable to completely provide for the performance of their duties due to insufficient economic development are ensured additional funding by the state in accordance with principles and criteria provided by law”.

12. In Austria the Financial Constitutional Act (which forms part of the Federal Constitution) contains the so-called “fiscal equalisation principle”: Accordingly, fiscal equalisation has to be consistent with the distribution of obligations arising from public administration and has to ensure that the capacity limits of any territorial tiers are not overstepped.

13. The Slovakian Constitution contains the principle, but also in case of the delegated tasks claiming that “the costs of the execution of state administration transferred [to local authorities] will be covered by the state” (Art. 71, para 1).

14. Where the constitution contains the principle of adequate finance, parliamentary legislation or other legal norms usually specify it, in particular in the general law on local authorities in which this is a well-known principle of local government finance.

15. The principle is also recognised in an indirect way in Finland, but differently: the Constitutional Law Committee of Parliament interpreted the Constitution in a way that when obligatory tasks are delegated to local authorities, sufficient funding must be in parallel provided for fulfilling them. There is a similar situation in Estonia, where, although the Constitution does not contain an explicit provision about the adequate finance, but the Supreme Court deduced that principle from some constitutional rules.

16. It is to be noted that some experts claim that the constitutional provisions on the financial autonomy of local authorities can be identified *per se* with the principle of adequate finance as it is understood by the Charter. Others argued that the constitutional recognition of the independent financial resources of local governments implicitly incorporates the requirement of sufficient finance. Although these views can be accepted if they reflect the real judicial practice in the respective countries, it must be emphasised that adequate finance and financial autonomy of local governments are two different principles of the Charter, even if there is obviously a strong connection between them.

17. In most cases, there is no proper provision in the national constitution, namely in Albania, Azerbaijan, Czech Republic, Cyprus, Denmark, Estonia, Ireland, Latvia, Liechtenstein, Lithuania, Luxembourg, Macedonia, Monaco, Montenegro, Norway, Romania, Switzerland and the United Kingdom. In Romania, there is a peculiar legal conception of the commensurability principle. The Romanian Constitution does not provide for a principle of adequate financial resources for local authorities. However, according to Art. 138 para 5 of the Constitution, no budget expenditure shall be approved unless its financing source has been established. In France, the notion of local financial autonomy appears in constitutional case law in the 1990s deducing this autonomy of a general reference to Art. 72.2 of the Constitution which guarantees that local governments may freely use their resources.

18. If we found a correlation between the constitutional recognition of the adequacy principle and its statutory regulation above, this connection sometimes is valid vice versa: where the Constitution is silent on this topic, the legal recognition of the principle is usually lacking also in statutory law as well. Nevertheless, even in the absence of a constitutional recognition, the sufficient finance of local authorities can be effectively protected by law. It is the case when under the constitutional level the statutory law contains legal guarantees. In Romania, for example, where no explicit constitutional rule lays down the adequacy principle, more statutory laws require it for both municipal and territorial levels. It is the case in Slovenia too, where only the Municipal Finance Act refers explicitly to the principle of commensurability. In Denmark, the principle of adequate finance of local authorities appears to be a practical guideline for governmental policy-making in the form of the so-called "extended total balance" principle regulated by a ministerial ordinance of 2007. As the Danish expert reports, this is a distributive guideline in public finance which takes account of the claim for the sufficient funding of local government.

19. In addition, the requirement that local government funding must be proportionate to the mandatory functions might be inferred from other constitutional provisions, or it might be respected or enforced by the judicial practice.

20. All in all, the complete lack of the requirement of local government finance proportionate to the mandatory functions in a national legal system is quite rare. However, it is not unprecedented, as there is no legal guarantee for sufficient finance in Ireland, Liechtenstein and the United Kingdom, although the resources allocated to local government have been severely and consistently reduced since 2010 in the UK. Thus, in some countries, not only the constitutional recognition, but also any legal guarantee of statutory law is missing. In this situation, there is no any legal basis for local authorities to claim for a sufficient finance or to seek redress in case of insufficient funding.

21. Even where the principle of adequate finance has legal recognition, its inadvertent formulation may also create practical problems, as it might be easily ignored, in particular, when more concrete precepts (like "autonomous local budget" or "own resources") can be referred to instead.

22. Another problem is that even though the principle of adequate finance is recognised by a number of national constitutions, it is formulated in very abstract ways, often without any reference to the available remedies (like judicial review). In that case, a general declaration that local revenues should cover the costs of public functions performed by local governments does not provide effective legal protection for the municipalities.



## 1.2. *The share of the local government sector in the GDP and/or the government expenditure*

23. While most relevant concepts used by the Charter are general and uncertain, the share of local authorities in GDP<sup>8</sup> and/or government expenditure<sup>9</sup> can assist to get an overview of local government finance in the Council of Europe member States. Gross Domestic Product is calculated in a similar way in all EU member States, and is generally used not only to characterise the economic performance of a country, but also to describe the way of redistribution and the role of the actors and stakeholders of the government machinery. Total government expenditure (spending) shows even more precisely the economic significance of local government sector within the national economy.

24. Because of the different methods used in the various countries, and the poor availability of the relevant data, no exact comparison can be made between the member States. Now, neither the European Union, nor the Council of Europe has credible and comparable data on the economic importance of local governments of their member countries. However, it is a valid correlation that the bigger share local governments have in the GDP or total government expenditure, the greater financial capacity they have to fulfil their mandatory functions. So, even if we only have incomplete data,<sup>10</sup> they provide meaningful information about the importance of local authorities in a particular country.

25. As to the share of local government sector in GDP, there are great differences between the member States. The highest level has been reported from Norway, where this rate is 17.8%. It follows from the other set of data (i.e. share in government spending) that this figure might be very high in Denmark and Finland as well. According to our research, the GDP share of local authorities is close to an average in Romania (9.4%), Latvia: (9.3%), Hungary (7.9%), Switzerland (7.1%), Czech Republic and Slovenia (6–6%) and Lithuania and Serbia, where this rate has varied between 6–7 percent in the last years. In a cross-European comparison, this level is relatively low in Slovakia (5.51%), Liechtenstein (5.3%), Montenegro (about 4%), Italy (3.5%), Greece (3.4), Albania (3.18%) while the lowest is in the UK (1.6%), Monaco (1.05%), and Azerbaijan (0.68%).<sup>11</sup>

26. It is worth noting that in some countries which have been deeply affected by the economic crisis, this share has not changed for the last few years. At first glance, it can be surprising that this figure is more or less the same as before the financial depression. In Greece, for example, it has varied between 3.3–3.5% in the last three years, which corresponds to the data taken from the pre-crisis years. However, it does not mean that the financial capacity of local governments has remained as it was beforehand, if the economic performance has equally decreased in all sectors.

27. Certainly, the percentage of local government expenditure in total government spending shows quite a similar situation. Local authorities consume a considerable part of public revenues in the Northern countries: this rate is 33% in Norway, and is about 20–25 percent in Denmark and Finland. Only Romania and the Czech Republic have a similarly high figure of 29.1% and 23.1% respectively (showing the local government incomes in total public revenues), while it is 20–21% in France, 18% in Germany, 17.3% in Lithuania, 15.75% in Macedonia, 12.96% in Slovenia and 10.8% in Albania. The proportion of local authorities is relatively low in Ireland (8.8%), Italy (7.4%), Greece (6.2%) and Monaco (5.17%), while completely insignificant in Azerbaijan (about 2%) and in Cyprus with less than 1% of total government spending.

28. In addition, some experts gave information about another indicator: the share of local government spending in all administrative expenditure. Although the calculation method of these figures is unclear, and presumably different, it can tellingly show the distribution of administrative tasks and functions in a particular country. This share in Luxembourg is about 9–10% (8.7% in 2015), while the same figure in Denmark is about 50%.

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8 Gross domestic product (GDP) is the standard measure of the value of the goods and services produced by a country during a period (usually in a year).

9 Total general government expenditure/spending consists of all consumptions, investments, and transfer payments of central, state and local governments, as well as social security funds.

10 Most data provided by national experts inform us about the local governments' share in GDP and/or total government expenditure from 2015. Some experts were able to give time series data from the last five or more years.

11 The data are taken from different years between 2013 and 2016.

29. It is sure that whatever indicator is used to study what economic and financial weight local governments have in a country, there are huge differences between the Council of Europe member States.

30. If we examine the very recent trends, we can find that in most cases, there have not been considerable changes in local governments' share in public expenditure or, in a more general context, in national economy. But just before we conclude that the overall financial situation has not worsened in the last few years, it must be stressed that in some cases, the share of local government sector has settled at a much lower level than before the restrictive budgetary policy of the near past. In the United Kingdom, for example, English councils collectively have seen an average real terms funding cut of more than 25 percent since 2009-10. In Hungary, the local governments' share in GDP was above 12 percent before the economic crisis, and since then this figure has sunk to less than 8 percent. In Cyprus, by reason of the economic crisis, the sum of the annual state grant had been gradually cut until recently when the cuts ceased and the level of state grant has been stabilised.

## **2. The ability of local governments to raise their revenues and finance their mandatory tasks and functions**

### *2.1 Central transfers versus local revenues*

31. While the share of local authorities in GDP and total government expenditure are good indicators to show what role local authorities play in a national economy, their real ability to raise their revenues give much more specific information about their financial autonomy, and, indirectly, about how the principles of the European Charter of Local Self-Government prevail in the member States. The Charter declares that local authorities must "be entitled to adequate financial resources of their own, of which they may dispose freely within the framework of their powers". In this way, the Charter requires that part of local revenues must be so-called "own resources" that are received on the basis of their own decisions rather than from central (or other external) transfer.

32. In order to examine the changes of the relevant situation in the member States since the previous survey in 2013, this report uses the same definitions suggested by the earlier studies. Thus, the major items of the so-called "own resources" are the local taxes, the fees and charges paid for local government public service delivery, and the revenues coming from the utilization of local government property. In fact, the national administrative systems frequently use different terminology, or use the same concepts in different meanings. However, the pillars of local revenues can be identified in all specific local government systems.

33. One of the most relevant information about the domain of local financial autonomy is the ratio between the "own resources" and the central government transfers in the total local government finance, and the possible trends in the last few years. In this report, "central grants" are the transfers from state budget which are allocated to local authorities for carrying out their obligatory tasks. The connection is clear: the larger the share of local revenues in the total budget, the greater the financial autonomy of local governments, and the ability to finance their activities.

34. For the correct interpretation of these data, it is important to know that while the proportion of central grants can be given for the whole local government sector, since the amount of central subsidies depends on the financial situation and tax-raising capacity of the particular municipalities, the real share of central transfers in the individual local governments' budgets can be highly different. It is to be noted that for this comparison, the local governments' revenues coming from the so-called shared tax incomes (which have a different nature from those of central block or earmarked grants) were calculated as parts of central grants.

35. The last survey of local government finance revealed a negative tendency in some countries to recentralise competences and the related financial resources in the name of the financial and debt crisis, economic austerity and rationalisation programmes. This survey explores whether or not this trend has been stopped in the member countries.

36. It is important to note that even the decrease of the proportion of local revenues compared to the central grants in itself does not necessarily show a negative trend, although it is quite peculiar. In Luxembourg, over a longer period, the ratio has changed at the expense of the local resources, but the total amount of local governments revenues has increased from year to year. The shift towards a

greater part of central grants is the result of the faster growth of state subsidies (the total amount of the Municipal Fund together with the specific grants increased by 52% from 2009 to 2015) than that of the own revenues.

37. In addition, the invariance in this ratio means stability and predictability for local authorities only if they get sufficient money for their work. Otherwise, where municipalities are heavily underfinanced, like in Cyprus, the permanence itself is equivalent with the conservation of the poor finance of local governments.

38. In most member States, there is a well-balanced ratio between the central grants and local revenues. The proportion of these resources is about 50–50% (+/-5%) in Denmark, France, Macedonia, Norway and Romania, while the portion of state transfers is slightly higher in Greece (54%) and Lithuania (55%). We can evaluate the local government finance as a centralised system where the central grants exceed the 60%, like in Albania and United Kingdom (64%), Cyprus (68%), Italy (~ 69% to 31% in 2016), and Monaco (75%). There is an extremely centralised local government financial system in Azerbaijan, where more than 92% of all local revenues come from central grants. In contrast, among the countries from which we have data, in Finland and Latvia the share of local revenues significantly exceeds that of the central transfers, as the latter amounts to 20% and 32% respectively. In Czech Republic, the share of own resources amounts to no less than 76.9% (in 2015), including the local government revenues from the shared taxes. However, it should not be forgotten that these are average rates. In the cases of some municipalities in Northern Finland, for example, the percentage of the central grants can reach the 70%.

39. If we turn to the very recent changes in this ratio, we also get a very mixed picture. In certain countries, like Albania and Greece, the proportion of central grants has slowly increased in the last years, while in Macedonia, an opposite trend has prevailed since 2013. In Denmark, the legislation on local taxes and fees has been subject to more and more sophisticated and detailed regulation by the central government in the last years. The tendency is to diminish the amount of local revenues as well as to limit the freedom of municipalities to spend their own revenues. Both trends are the consequences of the economic crises which brought about frequent cuts in public expenditure including local government budgets. Remarkably, in Denmark there is an ongoing debate on centralisation and decentralisation. In the last few years there has been a tendency of centralisation simultaneously with deconcentration, moving government agencies away from the capital. One of the most interesting new trends is the development of electronic services run by central government agencies, instead of local government functions. A small increase in central transfers is noticeable also in Monaco, although its share was already quite high (~74%) in the preceding years as well. In Romania, the percentage of the own resources dropped from 48.7% in 2013 to 43.5% in 2015, which is one of the biggest decreases among the countries examined here.

40. A new scheme for state subsidies was introduced in 2015 in Finland, but the ratio has not changed until now. There were some changes also in Greece decreasing the local revenues in parallel with the wane of central grants, so the ratio between them has not changed significantly. In 2015 Albania implemented an administrative and territorial reform with the purpose of improving the efficiency of local governmental units and strengthening their capacity to fulfil legal functions; along with the implementation of the reform, important functions were decentralised from the central to the local government with a new law on local self-governance, accompanied by specific financial transfers.

41. We can observe some positive trends in local government finance in a few countries. In Germany, for example, the increase of the tax revenues of the Länder in the last few years has led to the rise of state grants allocated to local authorities, and the local tax revenues themselves have also increased every year since 2010. Since 2013 the ratio has also changed in Italy, compared to the preceding years showing an increasing trend of own resources and an overall decrease of central transfers. Similarly, the share of local revenues increased against the central transfers in the last years in Lithuania too. Apart from the changes in the ratio between the central transfers and own revenues, there is a moderate increase of both resources of the municipalities in the last few years in the Czech Republic.

42. Finally, it is important to note that in some countries (in Slovakia, for instance, where this rate is 74.3% and shows a growing tendency) the most part of the municipal revenues comes from shared taxes (most frequently from personal income tax). Since the share of local authorities is determined by the central government (usually through law of Parliament), which may freely change it, this kind of

finance can enhance the financial vulnerability of local authorities. On the other hand, these revenues come frequently as lump sums, which gives some room to manoeuvre for the local councils.

## 2.2 *The nature of central transfers: block versus earmarked grants*

43. We can move from the percentages of local revenues and central grants towards the ratio between the block and earmarked grants. Here is also a general presumption: the higher the ratio of the block grants compared to the specific grants, the greater the financial autonomy that municipalities have. In terms of this report, “block” or “general” grant means a state subsidy transferred by the national government to local authorities with only general provisions as to the way it is to be spent (lump sum). Specific grants or subsidies are understood here as another type of central transfers which are allocated to local authorities for specified targets, and can only be spent (and exclusively) on the determined targets.

44. The Congress resolution drew attention to the fact that in some member States the balance of central transfers had shifted from the general grants to earmarked or specific transfers. As such a tendency apparently decreases the discretion of the local authority to decide how and on what the money should be spent, it is important to survey whether this trend has changed or continued. However, our research did not confirm this presumption or perception.

45. In fact, only a few national experts have reported about a discernible shift from the general or block grants to earmarked or specific grants. In Albania, the ratio of specific grants has jumped from 33% to 38% since 2016, but the reason for this increase was the wide-ranging delegation of state competences from central to local government, so it does not show a considerable restructuring of the central transfers.

46. Where there is a high proportion of earmarked grants, or all capital expenditure is covered by special grants of the central government, leaving no room for local decisions in local development and investment projects, these are older problems like consequences of structural defects of local finance, rather than repercussions of the economic policy of central governments in the last three or four years. Still, the very high proportion of earmarked grants is a problem as it excludes the local discretion of spending this money. Such a high rate is in Estonia, for example, where specific grants amount to no less than 81% of all central transfers. In contrast, in the Nordic countries, the share of earmarked grants has always been low (or, in Finland, earmarked or specific subsidies were generally abolished in the 1990's), and in some other countries these grants are traditionally allocated for capital expenditure (i.e. for local development projects).

47. As a matter of fact, there are some examples for the opposite trend, such as in Lithuania and Italy, where the percentage of general grants vis-à-vis specific grants has increased.

48. Nevertheless, the financial autonomy of municipalities is negatively affected when special grants are the only resources of local investments. In these countries, the central government, dictating the precondition of the state subsidies (and, thereby, the resources coming from EU funds) may get through its own priorities and may control all capital expenditure of local authorities. In these systems, local authorities have to apply for these grants and, in case of success, these subsidies are allocated through individual agreements between the central government and the respective municipalities.

49. It is to be noted that in this area, the most radical changes are expected in the UK, where all block grants will be removed from local government finance making local councils more dependent on the money they can raise from council tax and business rates. Withdrawing government funding shifts the ground on which councils operate, encouraging business-friendly initiatives and the construction of high-value properties as the only way of increasing income. However, it does not mean an unlimited freedom and greater financial autonomy for a number of local authorities which are in detrimental situation, and do not have real capacity to get money from local business activity or other sources.

## 2.3 *The significance of local taxes and other “own” revenues*

50. According to the Charter, at least a part of the financial resources of local authorities must derive from local taxes and charges. In this report, local taxes are taxes that are levied by the local government itself. In a narrow sense, a tax is seen as a genuine local tax only if the local government (in fact, its deliberative body) is also entitled to determine the tax rate (see Art. 9 (3) of the Charter). In

practice, however, there is a great variety of the power of municipalities in relation to the rate of local taxes. While in some countries it is set by law, in others there is a rate-capping legislation, or the tax rate is not limited at all. Local taxation has a key role in the financial autonomy of local authorities, as real local taxes provide opportunity for municipalities to raise their revenues based on their own decision (apart from the so-called shared taxes, where both the imposition and the rate of the tax are determined by central government). Besides local taxes, local authorities usually have some other types of own revenues. Thus, they can be entitled to get fees and charges for public services they deliver for their inhabitants. Fees and charges are revenues that are paid directly by users for public services provided by the local government. In addition, in many countries, local authorities may sell their property, and are entitled to do certain business-like activities. The financial position and room for manoeuvre, as well as the liquidity of local authorities can temporarily be improved by other revenues as well. These might be credits and loans from the financial market, shared taxes (central taxes from which local authorities have a share) or other transfers (from social security, for instance).

51. The share of local taxes in all local government revenues is traditionally high in some Northern European countries, where this rate varies between 51% (in Finland) and 68% (in Denmark). There is a very high percentage of local taxes in Italy, where 71.4% of local revenues comes from local taxes.

52. There is a relatively high percentage of local taxes in “own” revenues of local authorities in Azerbaijan, where about 41% of the local revenues is received from two local taxes (land tax and property tax), but having regard to the extremely low level of the total local government revenues, this rate has not any significance.

53. The percentage of local taxes in the total local revenues is less than 50% in half of the member States from where we have comparable data. In Luxembourg, this rate was in 2013, 2014 and 2015 26.3%, 26.1%, and 24.7% respectively (the local authorities' share in central taxes is more or less the same: 2013: 22.32% / 2014: 22% 2015: 23.34%). The respective figure in Norway is 34%, Cyprus 13.5%, Macedonia 25%, Lithuania 12–13%, Slovenia 8.9%. There has been a massive drop in Albania, where the part of local tax revenues was approximately 50 % in 2012, while this figure is about 31% in this year. We have only aggregated data from Ireland and Romania; in the former, the share of local taxes and charges was very high (75%) in 2016, which is even more remarkable if we compare it with the respective rate of 57% in 2011. In the latter country, the percentage of all local revenues (including local taxes, fees and other resources) was 15.6% in 2015 showing a decreasing trend in the last years.

54. It is to be noted that in some countries, like Slovenia and Romania, the relatively low level of local tax revenues is associated with a disadvantageous trend as municipalities have a decreasing proportion in shared personal income tax in both countries.

55. It is worth noting that in some Member States, the taxation power of local authorities is severely limited to a degree which raises the issue whether these situations are compatible with the requirements of the European Charter. One of these countries is Greece, where local authorities have only a strictly limited taxation power, and the municipalities have only insignificant revenues from local taxes (1,6% of all local revenues). According to the report of Latvia, there are no local taxes in this country. If this is the case, it is a clear breach of the Charter. A special limitation is imposed upon local authorities in Romania, where local tax revenues may be spent only for the expenses for which the particular local taxes have been imposed. Thus, these resources behave as specific (or earmarked) grants, instead of supplying freely usable financial resources. Monaco is in a special situation from this aspect, because, although the share of local taxes is less than 1% in the municipal budget, the city council has much more revenues from charges and fees than it is usual in other countries.

56. As to whether the legal conditions and environment of local revenues has changed in the past few years or not, the major finding of our research is that the national regulation of local taxes, fees and charges has changed only in some Member States in the near past. This signifies also the preservation of the post-crisis financial situation which was discernible in the area of central transfers too. However, in Italy, since 2012, the taxation power of local authorities has been revised several times by central legislation, producing, as the Italian expert says, “a rather chaotic legal framework”. Since 2012, some new local taxes have been introduced, like property tax or waste tax. The major changes on local taxing power have been provided, however, by Stability Law of 2013 establishing new municipal taxes and transforming some others. Although local authorities may increase their revenues from this source in Denmark, some recent legislation has limited their taxation power in a way that if the local tax revenues exceed a centrally set limit, the surplus is transferred to other

municipalities which are in financial need. In Cyprus, the annual raise of waste collection fees cannot exceed 14%. Since the percentage of charges and fees in this country is unusually high (around 42% of the total local government revenue), it can make sense. At first glance, there is a great prospect for local councils in the United Kingdom, where they will be expectedly free to raise council tax by an additional two per cent, as well as to retain 100 per cent of the revenue from business rates. However, the municipalities will pay a huge price for these new opportunities as all general grants coming from central government will be simultaneously abolished. There is a similar tendency in Ireland where a considerable reduction of central transfers has taken place in recent years, and where the lost incomes have been replaced by the revenues from the local property tax introduced in 2015.

57. From the point of view of financial autonomy of local governments, there is a further unbeneficial phenomenon, although on the basis of our research it cannot be decided whether it is a new trend, or is permanent practice. Nevertheless, it is striking how high the rate of municipal revenues is which come from shared taxes. In Luxembourg, for example, about half of the local government incomes are received from such taxes: 18% of the total revenues from personal income tax, 20% from the tax on motor vehicles, and 10% from VAT. As a matter of fact, shared taxes do not leave room for local taxes, so all municipal tax revenues come from state taxes. At the same time, it is an advantage of the centrally imposed shared taxes that these contributions are safe, as the central government levies, collects and redistributes them.

#### 2.4 *The scope of financial autonomy of local authorities in the age of indebtedness*

58. As to the freedom of local authorities to spend their revenues, according to the Charter, local authorities should be able to dispose freely of their revenues, which must “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” (Art 9 (3) and (4) of the Charter). To assess this freedom, you should evaluate the discretionary power of local authorities to determine their expenditure priorities, and to decide how to finance their particular tasks.

59. It must be said that the level or scope of financial autonomy and freedom of local authorities depends basically on the balance between their total revenues and their mandatory tasks and functions, and, secondly, on the structure of their revenues. The higher the part of central block grants and the revenues from shared taxes in local budget, the greater the financial independence that local authorities have (one of the exceptions to this general rule is Romania where the VAT revenues of municipalities are apportioned by law for specific targets (setting quotas for the various mandatory functions)).

60. Exploring the recent changes of local government finance in the Member States, it is clear that the world financial crisis has had long-term effects in some countries. In terms of local financial autonomy, these changes show a mixed picture. In order to prevent the (further) indebtedness of local authorities some countries have introduced various restrictions on financial management of municipalities or regional governments. At the same time, some other measures have aimed at helping local authorities to cope with their debt burdens or easing their difficult financial situation.

61. Certainly, there are general limitations. For example, the financial management must be in compliance with legal frameworks concerning budgeting and accounting. For the purpose of transparency of public finance, local authorities are obliged to follow a number of rules and guidelines of budgetary planning and accounting which are sometimes sanctioned by serious central measures. In Serbia, for example, if a local authority may not implement these rules, the central government may temporarily suspend the transfers from the central budget, including the revenues from shared taxes. In addition, in a lot of countries local authorities have to prepare mid-term financial or budgetary planning in which they outline their plans of maintaining the financial liquidity, or their local development policy.

62. Other overall principles like economy, expediency or efficiency may also be legitimately controlled by other bodies (e.g. audit commissions). However, in order to overcome the negative the consequences of the world financial crisis, a number of countries have introduced special measures imposing various limitations on local governments. Almost all national experts have reported about debt-brake measures and stability pacts, the introduction of financial limitations imposing balanced budgets, and so on.

63. Undoubtedly, the freedom of local authorities in financial issues depends on the amount of local debts. There are great differences between local authorities even within the same countries. Municipalities with low debts and high revenues from local taxes might have a great capacity not only to provide mandatory local services of high quality, but might also be able to deliver optional (non-obligatory) functions as well, while many other municipalities with low-level money-raising capacity must struggle for their survival (i.e. keeping their liquidity).

64. The most usual debt-brake rule is to allow local authorities to take up loans and credits only for capital expenditure. This limitation can be found in almost all countries reviewed in this report (only the Macedonian expert has reported about liberalisation in this area, while in Albania the municipalities may take up loans for both ensuring liquidity and capital spending). In Luxembourg, for example, municipalities may resort to borrowing exclusively for capital spending based on sound justification. The whole subject to approval by the Minister of the Interior for any loan exceeding 50.000 €. In Greece, there is a relatively new limitation imposed by legislation on local governments' financial management, namely that municipalities are not allowed to establish or participate in commercial companies anymore. Moreover, although municipalities may take loans, it is permitted only if their debt ratio does not exceed 60% and debt service does not exceed 20% of their annual revenue. It is to be added that these revenues may be used only for investments (in other words, these make capital expenditure), with an exception, introduced by a law of 2015, which allows to get loans in order to repay previous debt payments, if municipalities are not in the position to balance their budgets. Major changes in the conditions of loans and credits in Italy where the new legal framework, having entered into force in 2015, imposes limits on deficits trying to prevent municipalities from overspending. Here the level of indebtedness of local authorities decreased substantially between 2010 and 2015 from 2.7% to 2.0% of overall public administration debt as a result of stringent limitations on borrowing. In Romania, local councils may take out loans only from the state at a fix annual rate (of 6.25%) for a period of five years with interest payments not beginning until the second year. In order to benefit from these loans, local authorities must be given permission by the Public Finance Ministry's Commission for the Authorisation of Local Authority Loans. There is a similar situation in Slovenia, where municipalities are allowed to borrow money for investments within the national credit market. The Irish local authorities may not run a deficit in current spending. They may take out loans for capital spending, but only in restricted circumstances, and with the prior approval of the central ministry responsible for local government.

65. In Hungary, most municipalities and counties were relieved from almost all of their aggregated debts in 2012, when the state budget assumed them. However, local authorities paid a huge price for it: the central government took over some basic public services, like public education or most welfare, social and health services. In fact, the county governments lost all their institutions and have become co-ordination centres for regional development and planning. In sum, the share of local government has reduced, as the most costly public services were centralised.

66. Nevertheless, the most serious restriction on local government budgetary autonomy is imposed in Cyprus, where there is only a minimal freedom of local government, since all local budgets must be submitted to the central government for approval.

67. The guiding motivation of these changes has been the principle of balanced budget in all these countries preceding any other consideration.

## 2.5 *Financial equalisation as corrective mechanism*

68. In most countries, the financial equalisation system has a special function of equalising the economic and financial differences of local authorities. It is applied to enable local authorities in detrimental situation to work. Our research did not aim to survey the existing methods or systems, but it focused on the possible changes of this kind of redistribution mechanisms in the last few years.

69. Basically, equalisation is managed in two ways. First, redistribution through general grants serves this purpose, while in many countries, special financial equalisation systems are working. Frequently, both mechanisms are dynamic and ever-changing. In Austria, for example, the Fiscal Equalisation Act is revised every fourth years (although the effect of the last one in 2008 has been prolonged). The general equalisation system has been under debate several times also in Denmark, at the last time in 2012, but basically it has not been changed. There is a new equalisation system in Finland where it was reformed in 2015, making the whole mechanism more open and transparent by simplifying, for example, the calculation method. In Greece, the allocation system (through general grants) was changed in 2013, when the central government accepted the proposals of the association of

municipalities. A new scheme was introduced in 2015 in Albania, as part of the administrative and territorial reform.

70. We received worrisome information from Azerbaijan, Hungary and Macedonia. In Azerbaijan, the calculation method of the so-called central “donations” (lump sum payments) is unclear, while in Hungary, although the equalisation is arranged through several different mechanisms, the whole system is also intransparent and unpredictable. While municipalities may freely apply for supplementary subsidy to the central government every year, the criteria of the allocation of these subsidies are not known. In addition, much more money is allocated (usually when the state budget has a surplus at the end of the year) to municipalities without any application mechanism or publicly known criteria. These grants are distributed by a government decision, based on unknown considerations. In Macedonia, according to the national report, the major purpose of the financial equalisation is to keep local authorities alive artificially because of purely political interests.

71. However, in most countries no change has taken place at all.

### **3. The adequacy principle**

#### *3.1 The principle of sufficient finance in case of mandatory as well as delegated tasks and functions*

72. Article 9 para (1) and (2) contain the general requirement of commensurability between the financial resources and the tasks and functions of local authorities. In this way, the Charter clearly requires a balance between the total revenue of local authorities and the mandatory responsibilities, determined by law. This requirement means that the local authorities' financial resources must be sufficient for fulfilling their responsibilities assigned by law to them. In other words, the commensurability principle explicitly applies to new additional tasks transferred to local government in a manner that every transfer of competences must entail the transfer of the corresponding funds.

73. This principle must also prevail in case of delegated tasks. In this case, state competences are conferred, sometimes only temporarily, on local authorities for a more effective or efficient fulfilment of these tasks. In some member States (in Norway, for instance) this method is not in use. However, in most countries, where this kind of transfer of responsibilities is allowed, the principle of adequate finance is mentioned separately in the national constitution and/or by the relevant legislation. It means that if the central government delegated a state competence to municipalities, it must transfer in parallel the necessary funding. There are only a few countries (like Luxembourg or Lithuania) where the commensurability principle is not explicitly recognised by law.

74. Ascertaining whether there exists such a balance is extremely difficult. Nevertheless, this requirement sets some conditions for transferring tasks to local authorities. Thus, any assessment requires a clear definition of competences of local governments, which contributes to the transparency and predictability of the local government system. Moreover, it encourages the application of a careful calculation of the real costs of service delivery and the operation of local authorities.

75. In this report, the term of “commensurability” or “adequacy” refers to the requirement of the European Charter for sufficient financial resources of local authorities to be able to carry out their tasks and functions. Presumably, the costs of the individual public services are estimated using more or less objective criteria, but the calculation of the total budget of local authorities is an extremely complex issue.

76. The most frequent method is to assess the standard costs of the mandatory tasks of local authorities, taken several indicators (like the number of inhabitants, population density, the size of municipality and the special indicators of the various public services) into consideration. Sometimes the calculation of central transfers is based on requests and needs of local authorities which provide their own estimations directly for the central government. When the amount of central transfers is calculated, the tax revenues of local authorities are also taken into account. A variant of this standard method is used in most member States.

77. In some countries, like Finland or Norway, an average tax revenue is also counted for the whole country, which is determined as a threshold figure: the municipalities which have less tax revenues than this threshold, are entitled to get central subsidy, while in Norway, local authorities which have tax incomes above the determined level, pay the surplus into an equalisation fund.



78. In fragmented local government systems, that is where a lot of small communes exist, there is no individualised estimation of expenditure, but standard and uniform costs are calculated. Since the various municipalities are frequently in extremely different situations, the method of calculating nationwide average costs or quotas can be disadvantageous for many small and economically weak municipalities.

79. In many countries, a “basis approach” is used, where the total expenditure of the previous year is taken as a basis, and is modified by certain criteria (e.g. by inflation rate) for calculating the general costs of the mandatory tasks of local authorities. But some other methods are used as well, from task-based to project-based finance. This is the case in Cyprus or Lithuania, for example, where budgetary planning depends heavily on the local authorities’ budgets of the preceding year.

80. While in some countries the whole methodology appears to be transparent, in others, local authorities (or their national associations) cannot check the calculation process. In Italy, for instance, a four-step-method is used, based on a new system introduced in 2015, whereas there is no clear and accessible method of the allocation of central grants in Hungary and Montenegro.

81. Another option is to use a procedural mechanism to determine the apportionment of tax revenues between the central, regional and local governments (federal, state and local levels in federal countries), and the amount of central transfers (e.g. with a consultation mechanism between the representatives of central government and local government associations).

82. Normally, the central government (or the affected line ministries) proceeds consultations with local authorities before any delegation of state competence to them, about the conditions (including the necessary financial means) of the delegation. Since particular functions are delegated, the necessary funds are usually transferred to the local authorities in the form of special grants or target subsidies which can only be used to perform these tasks. In fact, in most countries, both the substantial (i.e. using a standard methodology to calculate the necessary funding) and procedural (i.e. consultation with the respective municipalities) ways are used during the budgetary planning process.

### *3.2 The available legal instruments to enforce sufficient resources for performing local government tasks and functions*

83. According to Article 11 of the Charter, local authorities must have the right of recourse to a judicial remedy seeking respect for principles of local self-government that are enshrined in the constitution or domestic legislation, like sufficient finance.

84. In one part of the Member States, this judicial protection is realised by the constitutional court to which local authorities may turn for redressing any infringement of their rights. In Austria, the Constitutional Court is ultimately responsible for deciding on financial controversies between tiers of government. This way is available also in Germany, Hungary, Serbia and Slovenia where local authorities may seek judicial protection against any law which infringes their right of local self-government. As sufficient resources are part of their rights, local authorities may turn to the constitutional court of the respective federated state challenging the constitutionality of the objected law.

85. In some countries, local authorities may challenge the relevant decisions of the central government before the administrative or the ordinary court, like in Finland, Liechtenstein or Luxembourg. However, as the Finnish expert points out in his country report, there is no existing practice concerning this matter. There is the same situation in Hungary, where, although local authorities may turn to the (ordinary) court for protecting their rights, no relevant judicial case has been known in the last decades. Judicial protection is provided by the ordinary courts in some other countries, like Greece or Lithuania. Both constitutional review and administrative litigation are an open way for local authorities in Estonia, if their financial support falls below the minimum necessary level. In such a case, the Supreme Court may declare the relevant financial law unconstitutional, or may also submit an application to the state to allocate additional financial resources and, if the application is dismissed, to submit an action in administrative court.

86. There is a special solution in Monaco, where a financial committee, which consists of the representatives of the National Council (Parliament), the central government and the municipalities, may examine the objections concerning the adequate finance.

87. The consultation process, that is the legally guaranteed involvement of local authorities in the legislative or decision-making process concerning the local government funding is also a frequently applied legal way of protecting the adequacy principle. In Austria, for example, the consultation mechanism has a special constitutional status enabling municipalities to receive information on any planned regulation of either the federation or the Länder which would have financial impact on them, and to request a consultation procedure. In Denmark and Norway the political negotiation with the central government is the major instrument provided for local governments to influence the budgetary decisions and to ensure sufficient resources.

88. As for the judicial protection or any other institutional device of local authorities against insufficient or disproportionate finance, there are several problems. First of all, the judicial remedy in this area seems to be only a symbolic or ostensible way of protection of local government rights and interests. Even where the constitutional or administrative court has an explicit power to enforce the adequate finance, this problem can hardly be transformed into legal standards. In other words, these courts are certainly reluctant to take the responsibility for determining the “sufficient” level of finance, and they show deference to the central government decisions as policy measures falling without the competence of the courts. The role of judicial protection in this field obviously could be strengthened only if the standards of the principle of adequate finance, or the whole process of financial planning were much better regulated or much more precisely developed than now. The courts cannot be expected to undertake the function of government in determining the real financial needs of local authorities or defining which level of funding is proportionate to the mandatory tasks and functions thereof. However, if the planning process would be elaborated in a controllable way, the justifiability of these issues could be enhanced. Finally, it is certainly a problem when no legal instruments are available for local authorities at all to enforce the sufficient finance, like in Albania where municipalities may not launch any procedure in case of inadequacy of local financial resources.

89. In some countries, however, there are examples for judicial intervention in this field. In Greece, there have been some litigations in the near past which led to court decisions cancelling concrete transfers of additional responsibilities by the implementation of the relevant provision of the Constitution and declaring that transfer of additional tasks without the corresponding funds had violated the constitutional principle of “commensurability”.

90. Finally, it must be stressed that in some countries there are not any legal instruments for this purpose at all. It is the case – among others – in Slovakia, or Norway. Where local authorities are in a well-balanced financial situation, and the national traditions have improved well-established and effective forms of co-operation between central and local governments, the lack of legal recourse against the insufficient finance does not create any problems. However, where this is not the case, the lack of legal devices makes municipalities more vulnerable.

#### **4. The consultation process**

91. Article 9 (6) of the Charter states that “[l]ocal authorities shall be consulted, in an appropriate manner, on the way in which redistributed resources are to be allocated to them”. On this ground, the relevant Resolution and Recommendation<sup>12</sup> of the Congress set certain requirements for the consultation process. Thus, national authorities should establish structures and procedures to ensure effective representation of local and regional authorities in consultation procedures with other levels of government in, among others, the issues of the allocation of the appropriate resources. The consultation mechanism must be “clearly defined and transparent, preferably enshrined in law, otherwise in written agreements, in line with the criteria laid down in the relevant provisions of the European Charter of Local Self-Government, specifying the format of such consultations, the level of participation of representatives of local and regional authorities, the time frame for consultations and covering all matters of interest for local and regional authorities.” Furthermore, these consultations must be regular and systematic. The central authorities have to provide clear and detailed information about their proposed policies, “well before the consultations are due to take place”. In the provision of adequate finance for local authorities, their involvement in the decision-making process of the central funding has a crucial role.

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<sup>12</sup> See Resolution 347 (2012) and Recommendation 328 (2012) on the right of local authorities to be consulted by other levels of government.

92. As an earlier Congress report also showed, the central–local government consultations have a legal basis in most member States. It is important, however, what special practices and traditions can make these frameworks effective and useful.

93. In Austria, where the annual Fiscal Equalisation Act allocates the state grants among local authorities, it is an established tradition that the representatives of the Federation, the Länder and the municipalities yearly negotiate the bills of this law. Since the consultation has a constitutional status, municipalities are in a beneficial position to get information or to influence the final decisions of the relevant fiscal policy. In Finland, according to the law, the central government has to prepare a program for local government finance, as a part of its fiscal plan and budget proposal, and the Association of Finnish Local and Regional Authorities participate in the preparation of the this program providing a voice of the national association in the decision-making process. Furthermore, an Advisory Committee monitors and assesses the trends in local government finances ensuring that the program for local government finances is taken into account in the drafting of legislation and decisions concerning local government.

94. The most usual frame for consultation exists in Greece where the opinion of the national union of local authorities concerning the amounts and the allocation criteria for state grants is submitted to the government every year, prior to the finalisation of the state budget. In addition, representatives of local government associations are always invited to the law-making process affecting the financial situation of local governments. In Italy, a special kind of consultation is run by central government: it is the so-called conference-based method where there is a common co-ordination body composed of representatives of the different levels of government including local authorities having the tasks to determine the public finance objectives, the distribution of equalisation funds, and so on.

95. There are no written rules in some countries, like in Ireland, Liechtenstein, Norway or the United Kingdom. However, the lack of legal frameworks of central-local government consultations in itself is not worrisome, if well-established practice or customs provide opportunities for municipalities to get involved in the preparation of the decisions which affect their financial position. In Ireland, for example, numerous specific provisions of Irish law do provide for consultation of local authorities in specific instances. While in Norway the framework for consultations has no legal status either, and its outcomes are not binding on the parties, the co-ordination between the central and local governments is an established practice, in Albania, Hungary or Montenegro, in contrast with the legal entrenchment of the consultation process, the central government decision-making is usually intransparent for the associations of local authorities without any chance to make an influence on this process. In Hungary, for example, local government associations receive only aggregate data about the central grants, and they have no idea how the standards of local government financial needs were calculated.

96. The effectiveness of the central–local government relations including the consultations between them on financial issues depends on the willingness and openness of the negotiating parties, rather than on whether the consultation process is regulated by or not.

97. It is much more problematic if the existence or the effectiveness of the whole consultation process depends practically on the willingness of the central government. Another issue is that in some countries, Hungary, for example, the individual lobbying of the municipalities has greater importance than the formal ways of co-ordination. Sometimes, political motifs are the driving forces of the allocation of supplementary funds to local authorities. These mechanisms are not transparent and effective, but underfinanced local authorities must participate in them for survival.

98. Even when the system of central–local consultation is entrenched by law, these rules are usually not guaranteed by legal sanctions, which means that if the central government fails to proceed, or simply ignores them, there is no legal way to enforce these consultations.

99. It is another well-known problem of consultation that sometimes it happens through fragmented mechanisms. In Greece, for example, different ministries have different approaches concerning local government. Thus, the decision-making procedure tends to be too cumbersome and slow, and there is a general lack of transparency with regard to the agenda and the related decisions.

## **5. New mechanisms and good practices in local government finance**

100. It was one of the objectives of our research to get information whether the national governments have introduced and used new methods and mechanisms of local government finance.

101. While most experts did not report about new methods or significant changes in local financial management, some drew the attention to very recent or ongoing administrative reforms affecting local finance. In some countries, new financial mechanisms have appeared in order to handle the negative effects of the world economic crisis as well as to facilitate the local government funding, or to make it more effective. It is not the objective of this report to describe all these new technics, but some innovations can be mentioned showing the major directions of reforming local government finance.

102. Remarkably, the economic effects of the world financial crisis inspired more comprehensive administrative reforms in certain countries. Some of these reforms have used well-established methods for coping the financial difficulties and enhancing the efficiency of the financial management of the municipalities. Thus, some reforms have brought about changes of municipal boundaries, usually merging the small communes into larger units (e.g. in Albania). In other countries the reforms have aimed at restructuring the division of tasks and functions between the different tiers of government. While the major trend of the reforms in certain member States is further decentralisation of tasks (like in Albania and Italy) from central government, in other countries, mainly in Hungary, strong centralisation can be observed when the central government referring to the incapacity of local authorities has taken over most costly functions from municipalities.

103. In most countries more specific reform programs have been accomplished with the explicit objective to relieve the financial burdens of local governments or to maintain their liquidity. In Finland, for example, the new local government act of 2015 contains new rules concerning assessment procedure for municipalities in a very difficult financial position. According to these provisions, the respective municipalities and the central government must examine together the opportunities of local authorities for delivering local public services in an efficient way, and must take measures to ensure the preconditions of the local service delivery. In Greece, a new legislation introduced the double entry accounting system for all local governments in 2010, provided that municipalities would join a "Special Economic Recovery Program". Entering such a financial recovery program provides access to special funding with special conditions imposed on local financial management. Similarly, in Germany, the Länder governments opened special funds for local authorities to help them to repay their debts in exchange for their efforts to improve the budgetary situation (e.g. cutting costs, increasing taxes or charges).

104. Other countries attempt to introduce new financial and budgeting systems, like "task-", "program-" or "project-based" finance applying central transfers only for particular mandatory functions, for a program implemented under a specified period, or for individual development projects respectively.

105. In addition, in the world of local government finance, new legal and policy principles have emerged such as "balanced budget", "financial consolidation" and new institutions have been applied for realising these principles, like "stability pacts", special funds and debt-brake rules. Besides, some traditional procedures have been sharpened or become more stringent, especially the financial monitoring or the conditions of taking up loans and credits. In general, local budgets have been closely integrated into the national budgetary system with all consequences thereof. In some countries, local authorities are obliged to submit their operational or financial plans for the following years and provide accurate data about the implementation or progress of their budgetary plans.

## **6. Conclusions**

106. In conclusion, it can be said that national constitutions recognise the principle of adequate finance directly or indirectly in more than the half of the member States (among the responding countries). In most cases, where the requirement of sufficient finance is laid down by the national constitution, it is also specified by statutory law. However, it is a frequent problem that the principle is not standardised, which means that its components or procedures are not clearly defined, so even if it is legally recognised, its realisation takes place in an intransparent way. In certain countries, there are no legal rules requiring the balance between the mandatory tasks of local authorities and the corresponding financial tools or resources.

107. Although the various member States have developed several different legal instruments available for local authorities to prevent their rights, including the right to get sufficient finance, the general experience is that the judicial protection is not an effective way to enforce the adequate finance, or, at least, there is no relevant case-law in most countries. Instead of this, the consultation

and other political or informal mechanisms seem to be more useful for the municipalities which seek additional resources.

108. There are huge differences between the Council of Europe member States in the share of local government sector in total public expenditure or, in a wider context, in the national economy. It is certain, however, that these figures have not been rewritten after the world financial crisis; the percentage of local authorities is by and large as was beforehand, so, there have not been considerable changes in local governments' share in public spending. It is to be added that when local government revenues were dramatically reduced, the losses have been more or less made up in recent years.

109. As to the ratio between central transfers and local or "own" revenues in local budgets, it can be concluded that there are no clear and general trends; in most countries, no significant changes have happened, and, in other member States, there are examples for changes in both directions. In relation to the internal structure of central transfers, we also get a very mixed picture. The various countries have chosen different directions for their local government reforms; some of them prefer further decentralisation, while some central governments refer to the indebtedness and irresponsibility of local authorities when they justify the massive centralisation of tasks and functions.

110. It is worth noting that where new budgetary methods were introduced to help local authorities to cope with the problems of financial restrictions and decreasing revenues, most new devices have been applied for the financial recovery of local authorities, rather than for improving their funding in general. Occasionally, these new instruments and procedures increased the dependence of local governments, and strengthened central supervision over them.

111. From the national reports received, it can be concluded that financial restrictions have not been removed in some member States even though the national economy recovered from the financial depression. In these cases, the restrictive policies introduced as only provisional measures necessary for overcoming the negative effects of the financial and debt crisis, have become constant limitations imposed on local government finance.

112. The Congress stated in its Resolution 372 (2014) that "serious problems" have been highlighted in some member States concerning the financial resources of local authorities, which were not limited to the effects of the world financial crisis. After exploring the general trend in local government finance and the various national instruments and ways of adequate finance, our research has extended to an overall estimation of how the commensurability principle is implemented in the member States. This part of the report comprises the personal views and assessments of the national experts – the members of GIE – concerning the balance between the mandatory functions and the financial resources of local authorities. In doing so, they had to take into account the last monitoring reports on their countries, the views or possible complaints of national associations, and other information sources.

113. In fact, even a general assessment of the implementation of the adequacy principle is very difficult, as the principle itself is quite abstract without specified and controllable measures and indicators. Thus, it is not surprising that some experts gave a careful response or evaluation emphasizing that the requirements of sufficient finance are only partly implemented. As the expert of Monaco put it, the balance between the tasks and mandatory functions of the Commune is "precarious", while local authorities in the United Kingdom are unable to perform many previous activities anymore. Some experts highlighted the fact that the calculation of central transfers (or of municipalities' share in tax revenues) is prepared in an unsatisfactory way. In particular, the centrally calculated transfers do not cover the real costs of the various tasks. Furthermore, in some cases, the results of the ongoing administrative reforms cannot be assessed yet, as the new systems have not been fully implemented, like in Italy.

114. However, all signs show that in some countries the principle of adequate finance of local authorities is ignored to an extent that realises the violation of Article 9.

- According to the Albanian report, the specific transfers do not cover the costs of delegated tasks.
- In Hungary, the new system of the task-based finance is intransparent and unsatisfactory, in which earmarked grants never provide sufficient funding for local authorities. This country produced the greatest cut in local governments' share in public expenditure, and the municipalities have proved

to be the absolute losers of the restrictive economic policy of the central government, without any prospect for improvement or restoration of their earlier financial position.

- In Greece, which is perhaps the most deeply affected country by the world economic and financial crisis, the balance between tasks and financial resources has obviously become much worse since the outbreak of the crisis, because, as the Greek expert said, municipalities are now asked “to do much more with much less”.
- As the national report categorically expresses, Montenegro is “absolutely unable to manage, implement (...) this principle”.
- In Romania, most of the administrative-territorial units (except big cities) cannot fully cover their expenses with their own revenues.

115. The other side of the coin is that in a number of member States the financial situation of local authorities has stabilised, or even improved in the recent years. Not surprisingly, this took place in richer countries where municipalities had been in a better financial position before the crisis. Certainly, it does not mean at all that no counterexamples are in these member States. There are poorer regions or municipalities in worse financial situation in every country. However, the general trends are beneficial, and, by and large, there is a balance between the mandatory tasks and financial resources in most local authorities. As an overall assessment, it is the situation in Austria, Germany, Ireland, Liechtenstein, Luxembourg, Slovakia, Switzerland and the responding Nordic countries, Denmark, Finland and Norway.

116. The scope of financial freedom of local authorities has not significantly changed since the previous report prepared in 2013. The only significant change is the spread of the principle of balanced budgets of local governments, or, more exactly, the fact that the compliance with this principle is taken more seriously than beforehand. Although there is a great variety in the various member States as far as local governments’ financial autonomy is concerned, and these differences seem to be independent of the restrictive measures inspired by the world financial crisis. Where there was a highly centralised system before the economic austerity programs, this centralisation has remained as a major feature of local finance (like in Montenegro or Cyprus), and where local authorities had traditionally greater freedom, municipalities have been able to preserve their autonomy or economic capacity.

117. It is obvious that some Council of Europe member States ignore the relevant provisions of Article 9 of the Charter. In particular, Hungary and Montenegro openly violate the European Charter in several ways. Some other countries breach only one or two paragraphs of this Article, like Albania where there is no effective consultation process between the central and local governments. It is an even more serious problem, if possible, that in some countries, first of all in Cyprus (and, presumably, in Armenia and Azerbaijan from which no national reports are available), local authorities have such little power and influence in local affairs that the formal compliance with the requirements of Article 9 does not have any practical effect.

118. While a number of member States have made remarkable progress, almost all recommendations taken by the Congress in 2014 could be invariably repeated for the countries which follow the provisions of Article 9 only reluctantly, or simply ignore them. Since there are no sanctions even in case of rude violations of the Charter, no positive changes can be expected in the near future in these recalcitrant member States.